

立法會
Legislative Council

LC Paper No. CB(1)953/05-06
(These minutes have been
seen by the Administration)

Ref: CB1/PL/ES/1

Panel on Economic Services

**Minutes of meeting held on
Monday, 23 January 2006, at 10:45 am
in the Chamber of the Legislative Council Building**

Members present : Hon James TIEN Pei-chun, GBS, JP (Chairman)
Hon Jeffrey LAM Kin-fung, SBS, JP (Deputy Chairman)
Ir Dr Hon Raymond HO Chung-tai, S.B.St.J., JP
Hon Fred LI Wah-ming, JP
Hon CHAN Kam-lam, SBS, JP
Hon SIN Chung-kai, JP
Hon Howard YOUNG, SBS, JP
Hon LAU Chin-shek, JP
Hon Abraham SHEK Lai-him, JP
Hon Vincent FANG Kang, JP
Hon Andrew LEUNG Kwan-yuen, SBS, JP
Hon WONG Ting-kwong, BBS
Hon Ronny TONG Ka-wah, SC
Hon CHIM Pui-chung
Hon Albert Jinghan CHENG
Hon KWONG Chi-kin
Hon TAM Heung-man

Members attending: Hon Audrey EU Yuet-mee, SC, JP
Hon WONG Kwok-hing, MH
Hon LEE Wing-tat
Hon LEUNG Kwok-hung

Members absent : Dr Hon David LI Kwok-po, GBS, JP
Dr Hon LUI Ming-wah, SBS, JP
Hon Miriam LAU Kin-yee, GBS, JP

**Public Officers
attending**

: Agenda item IV

Mr Stephen IP
Secretary for Economic Development and Labour

Miss Janice TSE
Deputy Secretary for Economic Development and Labour
(Economic Development) 3

Miss Winky SO
Principal Assistant Secretary for Economic Development
and Labour (Port, Maritime and Logistics)

Mr Martin GLASS
Deputy Secretary for Financial Services and the Treasury
(Treasury)

Agenda item V

Mr Stephen IP
Secretary for Economic Development and Labour

Mr Howard LEE
Deputy Secretary for Economic Development and Labour
(Economic Development) 2

Ms Brenda CHENG
Principal Assistant Secretary for Economic Development
and Labour (Economic Development) Financial Monitoring

Mr Harry LAI
Chief Electrical and Mechanical Engineer
(Electricity Team)
Economic Development Branch
Economic Development and Labour Bureau

Clerk in attendance : Mr Andy LAU
Chief Council Secretary (1)2

Staff in attendance : Ms Debbie YAU
Senior Council Secretary (1)1

Miss Winnie CHENG
Legislative Assistant (1)5

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I Confirmation of minutes and matters arising

(LC Paper No. CB(1)609/05-06 - Minutes of meeting held on 28 November 2005)

The minutes of the meeting held on 28 November 2005 were confirmed.

II Information papers issued since last meeting

(LC Paper No. CB(1)646/05-06(01) - Tables and graphs showing the import and retail prices of major oil products from December 2003 to November 2005 furnished by the Census and Statistics Department)

2. Members noted the information paper issued since last meeting.

III Items for discussion at the next meeting scheduled for 27 February 2006

(LC Paper No. CB(1)706/05-06(01) - List of outstanding items for discussion

LC Paper No. CB(1)706/05-06(02) - List of follow-up actions)

3. Members agreed that the following items proposed by the Administration would be discussed at the next meeting scheduled for 27 February 2006 –

(a) Freight Container (Safety) (Amendment) Bill

(b) Subsidiary legislation to implement International Maritime Convention

4. In reply to the Chairman's question on the nature of the above two legislative proposals, the Deputy Secretary for Economic Development and Labour (Economic Development)³ (DS/ED3) advised that they involved technical amendments which aimed to bring local marine-related legislation in line with international standards, and relevant industry bodies had expressed support upon consultation.

5. Noting from press reports that the consultancy study on the competition situation in the auto-fuel market in Hong Kong had been completed, Mr Fred LI suggested that the Administration should be invited to brief the Panel on the findings and recommendations of the consultancy report at the next meeting. Members agreed. The Secretary for Economic Development and Labour (SEDL) noted the Panel's request and undertook to confirm before the Chinese New Year whether the Administration was ready to discuss the item at the next meeting.

(Post-meeting note: The Administration has subsequently advised that it was not ready to discuss the consultancy report at the next meeting. The item has been listed in the Panel's "List of outstanding items for discussion".)

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IV Purchase of equity in Digital Trade and Transportation Network Limited

(LC Paper No. CB(1)657/05-06(01) - Information paper provided by the Administration

LC Paper No. CB(1)705/05-06 - Background brief on Purchase of equity in Digital Trade and Transportation Network Limited prepared by the Secretariat)

6. The Chairman explained that the Panel had considered the item at its meeting on 24 October 2005 in which the majority of members present were not in support of the Administration's proposal. Members noted that subsequent to the meeting, the Panel had received written views from 12 industry players/organizations which urged the Panel to lend support to the Government's proposal. On the other hand, an e-trading company had written to the Panel, attaching a complaint letter to the Competition Policy Advisory Group (COMPAG) about the anti-competitive practices of Tradelink Electronic Commerce Limited (Tradelink) and the potential conflict of interest arising from the Government's purchase of equity in Digital Trade and Transportation Network Limited (DTTNCo).

Introduction by the Administration

7. At the invitation of the Chairman, DS/ED3 briefed members on the Administration's plan to obtain funding approval from the Finance Committee (FC) for the Financial Secretary Incorporated (FSI) to purchase equity in DTTNCo, which was initially incorporated under Tradelink. She highlighted that the DTTN system was an information infrastructure sought to provide a neutral, open and secure e-platform to connect players in the supply chain. It filled a gap in the information flow by enabling connection amongst vertical and stand-alone information systems without replacing or changing them. As the exchange of electronic business messages involved commercially sensitive data, the industry called for the participation of the Government in the management of the DTTN services to ensure the neutrality, security and non-exclusivity of the System. On the recommendation of the Hong Kong Logistics Development Council (LOGSCOUNCIL), the Government decided to purchase equity in DTTNCo in order to secure industry support and participation. However, the Administration would keep shares held by the FSI to a minimum level (eventually be at least 21%) sufficient for the Government to exercise veto over major decisions, which would be subject to the approval of 80% of its shareholders before they could be put to vote by ordinary or special resolution (the "80% rule"). For example, under the Operating Agreement (OA) signed between the Government and the DTTNCo, the latter could not increase the service charge beyond the cap for the first five years of service launch and any proposed price increase thereafter needed to be approved by the DTTNCo Board, and in consultation with the Government. Moreover, the DTTN Shareholders Agreement (SA) provided that six of the 11 DTTNCo Board of Directors would be appointed by FSI.

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8. DS/ED3 further advised that since the last meeting in October 2005, 12 industry player/organizations, including trade associations such as the Hong Kong Shippers Council and the Hong Kong Association of Freight Forwarding and Logistics Limited as well as professional bodies like the Hong Kong Logistics Association and the Institute of Purchasing & Supply of Hong Kong had reaffirmed the Panel their support to the DTTN initiative. As deferral in the purchase of DTTNCo shares by FSI would undermine confidence in and support for the DTTN System, DS/ED3 sought members' support for the Government's proposal.

Discussion

Justifications for the Government's proposal

9. Given that the development of the DTTN System had started since 2003, Mr Andrew LEUNG questioned why there was a need for the Government to purchase equity in the DTTNCo at this juncture. He understood that the logistics industry players, particularly the Small and Medium Enterprises (SMEs), were eager to see the early launch of the DTTN System in order to lower their operating costs and enhance their competitiveness. Mr LEUNG was concerned whether the present proposal, if approved by the FC, would help expedite the development process and enquired about the earliest timing when the DTTN System would be launched in the market.

10. Miss TAM Heung-man enquired whether the Government would consider acquiring all the shares of DTTNCo and turning the company into a statutory body for provision of services to industry players. She also enquired about the measures to be taken by the Administration to promote the use of the DTTN System among industry players.

11. DS/ED3 explained that at the outset, the Government had no intention to become a shareholder of the DTTNCo. The industry regarded the DTTN an industry-wide information infrastructure that could not be left entirely to the private sector as a commercial endeavour at its inception. They considered that the direct Government involvement in the DTTNCo as a shareholder could help steer the operation of the company in compliance with the principles of neutrality and non-exclusivity, which were of paramount importance in securing industry acceptance of and confidence in the DTTN System. On the implementation timetable, DS/ED3 advised that whilst the DTTNCo had launched the DTTN services by the end of 2005 as scheduled, deferral in the purchase of DTTNCo shares by FSI would undermine confidence in and support for the DTTN System. The Administration therefore proposed to seek FC's funding approval as soon as possible so as to settle the outstanding payment for the shares acquisition.

12. SEDL further highlighted that the Administration was mindful of the Government's long-standing policy to keep its involvement in commercial endeavour to the minimum. He stressed that the current proposal was made in response to industry expectation. In line with the practice to invest in and undertake infrastructure projects which could not be taken forward entirely by the private sector

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at the inception stage, the Government decided to purchase equity in DTTNCo. SEDL assured members that after the Government's policy objectives for the investment had been realized, it would consider selling down its shares to allow more private sector participation as the Government had done in the case of Tradelink.

13. Whilst indicating support for the Government's proposal, Mr KWONG Chi-kin relayed the concerns of labour unions and SMEs about the potential problem of data leakage when using the DTTN services. Mr KWONG sought information on measures to be taken by the Administration to ensure the security of the DTTN System.

14. DS/ED3 assured members that the DTTNCo Board would bear in mind the industry's views and ensure that the Company would put in place adequate measures against information leakage when using the DTTN services.

15. Appreciating the dilemma between upholding the principle of "Big Market, Small Government" and the need for the Government to involve in the DTTNCo so as to boost the confidence of the logistics industry in using the DTTN services, Mr Howard YOUNG indicated his support for the development of the DTTN System. He reminded the Administration to exercise due care in proceeding with the proposal. On the issue of data security, Mr YOUNG remarked that the e-platform developed by the airline industry for data transmission also contained sensitive commercial information but there was no need for Government to participate in the development process so as to ensure its security. Mr YOUNG enquired whether the DTTN System was mainly intended for use by the marine sector.

16. As there were unscrupulous practices in the market, involving the trading of business information, Mr FANG Kang said that measures must be in place to ensure the confidentiality of the DTTN System. Citing the successful case of Singapore, Mr FANG urged the Administration to waste no time in rolling out the DTTN services so as to enhance the competitiveness of the logistics industry in Hong Kong.

17. DS/ED3 explained that the DTTN System was a platform that provided interconnection among the industry stakeholders and their information systems to facilitate information flow and enhance efficiency. The scope of the DTTN would include major industry stakeholders along the supply chain, including buyers, sellers, carriers (sea, road or air), banks and financial institutions, insurance companies etc. The DTTN System would co-exist with, or complement existing information systems used by industry stakeholders. Any industry stakeholder with appropriate means (i.e. web browser, system gateways and an e-mail application) could interface with the DTTN System which supported both inter- and intra-company data inheritance. Participants could choose to reuse relevant business data wherever appropriate along the end-to-end trade and logistics business processes. The DTTN System also supported the transformation of commonly adopted message formats and character encoding from one standard to another such that the implementation and maintenance costs for individual companies were minimized. Moreover, significant savings in terms of the reduction of paperwork, process time and time spent in data re-keying

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would be realized. On the question of security, DS/ED3 advised that the DTTN System *per se* provided a secure communications environment such that participants would have mutual confidence. However, the industry considered that Government's involvement in DTTNCo as a shareholder was the only effective way to ensure the neutrality, non-exclusivity and security of the DTTN System. DS/ED3 advised that Hong Kong had lagged behind Singapore in the implementation of similar e-logistics services despite it had initiated the discussion on the subject earlier. She therefore stressed that in the face of keen competition in the port and logistics sectors, Hong Kong should strive to maintain its competitive edge over neighboring ports by taking forward the DTTN initiative without further delay.

18. Mr Jeffrey LAM was concerned about the compliance issues relating to the guiding principles of neutrality and non-exclusivity, and the penalty for violating the principles, as enshrined in the OA.

19. DS/ED3 recapped that whilst the OA defined the parameters for the development and operation of the DTTN services by the DTTNCo, it did not grant the company any exclusive franchise. The company was required to grant a non-exclusive, royalty free, non-revocable and worldwide licence to anyone who applied to it to use and exercise the company's intellectual property rights. Besides, the DTTN System should provide fair access to all relevant stakeholders without discrimination. It should also offer a level-playing field and being free from conflict of interests or sector influence. DS/ED3 stressed that by subjecting the DTTN services to market forces, the DTTNCo would be compelled to provide services in accordance with the OA and respond to users' needs in order to gain industry support and entice subscription.

Unfair competition

20. The Chairman noted that an IT service company, Global e-Trading Services Limited had written to the Secretary of the Competition Policy Advisory Group (COMPAG), complaining about unfair competition posed by Tradelink and sought the Administration's explanation.

21. DS/ED3 acknowledged that the Administration had received the complaint letter from Global e-Trading Services Limited. However, she pointed out that the company was in fact complaining about unfair competition posed by Tradelink in operating the Government Electronic Trading Service (GETS). She stressed that unlike GETS the use of which was mandatory for the submission of certain trade-related documents to the Government, the use of DTTN services was strictly voluntary and industry players could use fax, instead of the DTTN System, to exchange data with other logistics players in the supply chain. DS/ED3 highlighted that in complying with the guiding principles, the DTTN System should act as a neutral facilitator for market forces to develop business opportunities.

22. Mr Abraham SHEK said that he had also received a copy of the said complaint letter and the view of the expert that he had sought echoed with the Government's

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explanation.

23. Mr SIN Chung-kai however considered that Global e-Trading Services Limited had expressed concerns about possible anti-competitive conduct posed by Tradelink and DTTNCo in its letter and requested the Administration to provide a written response to the concerns raised therein.

24. In response, DS/ED3 reassured members that the OA concluded between DTTNCo and the Government had been structured to ensure that entry into the DTTN service market would be free from any artificial barrier. She highlighted that no exclusive franchise was granted to the DTTNCo and the use of DTTN services was voluntary. The DTTNCo and its services were subject to market forces and industry scrutiny. Moreover, the DTTNCo should grant a non-exclusive, royalty-free, non-revocable and worldwide licence to anyone who applied to use its intellectual property rights. On the specific complaint made by Global e-Trading Services Limited, DS/ED3 understood that the Commerce, Industry and Technology Bureau and COMPAG were looking into the matter.

25. While expressing no objection in principle to the establishment of DTTNCo, Mr Ronny TONG questioned the need and rationale for FSI to become a DTTNCo shareholder as this might amount to competing business opportunities with the private sector. He was concerned about the relationship between DTTNCo and Tradelink and considered that Government's involvement as a shareholder in both Tradelink and DTTNCo might give the companies unfair advantages over prospective competitors. The unique status of the companies meant that they might be able to conduct businesses more conveniently.

26. DS/ED3 advised that there was a strong industry consensus for the DTTN System to be operated by a separate corporate entity to ensure its neutrality, hence the incorporation of the DTTNCo. Pursuant to the signing of the Shares Acquisition Agreement (SAA), the FSI now held 29.17% of DTTNCo shares, with the balance of 70.83% held by Tradelink. DS/ED3 highlighted that the present proposal was drawn up in response to industry demand for strong and effective monitoring over the operation of the DTTNCo and the services it provided. As such, there was no question of Government engaged in competing business opportunities with the private sector.

27. Noting that the Panel had received written views from 12 industry players/organizations urging Panel members to support the Government's proposals, Mr TONG was concerned about the potential conflict of interests so arisen as some of them might eventually become the shareholders of DTTNCo.

28. DS/ED3 recapped that the parties which had submitted views to the Panel included industry players as well as non-profit making institutions and professional bodies, many of which had not indicated interests in becoming shareholders of DTTNCo. They held the same view that without Government's equity investment in the DTTNCo, there would be scant industry support for the DTTN services. Industry

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players like Hong Kong General Chamber of Commerce and the Indian Chamber of Commerce Hong Kong who had indicated interest in becoming shareholders were not among the 12 which had pledged support for Government's investment in DTTNCo.

29. Noting that the Government's shareholding in DTTNCo would eventually be diluted from 29% to 21%, Mr WONG Ting-kwong enquired about the details of the potential buyers.

30. In reply, DS/ED3 informed members that at present, the total issued share capital of the DTTNCo was HK\$108 million. FSI shareholdings in the DTTNCo represented 29.17% of the company's issued share capital, with the balance of 70.83% held by Tradelink. DTTNCo would need HK\$150 million to fund its capital investment and initial working capital requirements. The recruitment of other shareholders would dilute the respective shareholding of the FSI and Tradelink. It was envisaged that the eventual proportion of shareholding would be 21% by FSI, 51% by Tradelink, and 28% by others. DS/ED3 said that further delay in the purchase of the DTTNCo shares by FSI might adversely affect the recruitment of other industry shareholders.

Members' stance

31. On behalf of the Democratic Alliance for the Betterment and Progress of Hong Kong, Mr CHAN Kam-lam expressed support for the Government's proposal to purchase equity in DTTNCo. He considered that Government's eventual shareholding of 21% in DTTNCo could help boost industry's confidence in using the DTTN system. In fact, the proposal from Tradelink was selected by LOGSCOUNCIL as the closest available one to the blueprint envisaged in the DTTN Report in terms of compliance with the guiding principles, service coverage and technical standards.

32. On behalf of the Alliance, Mr Abraham SHEK supported the Administration's proposal. Given the importance of import and export trades to the economy of Hong Kong, the development of DTTN services was an imperative initiative to improve information connectivity and enhance the competitiveness of the logistics industry in Hong Kong. He believed that the Government's involvement in the DTTNCo could help maintain the technical standards and specifications of the DTTN System thereby boosting the confidence of the logistics industry, particularly SMEs, in using the services. While upholding the principle of "Big Market, Small Government", Mr SHEK considered it a right direction for the Government to participate in DTTNCo to provide a stable and reliable environment for information flow.

33. The Deputy Chairman declared that he was the Deputy Chairman of the Hong Kong Shippers' Council. He agreed that the development of the DTTN System could strengthen Hong Kong's position as the regional logistics hub and improve the overall competitiveness of the logistics industry. It could also promote change to the traditional paper-based transaction, and adoption of information technology and e-commerce by enterprises. The value of the DTTN System would be especially

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significant to the SMEs which did not have the expertise and resources to develop their own system from scratch. He understood that according to the industry, the real and perceived neutrality and non-exclusivity of the infrastructure could only be realized when the Government became a DTTNCo shareholder.

34. On behalf of the Democratic Party, Mr SIN Chung-kai expressed reservation on the proposed Government's involvement in DTTNCo through purchase of its equity. He hoped to see that new developments could be made to the proposal before it was considered by FC on 17 February 2006. While supporting the development of the DTTN System *per se*, Mr SIN was concerned about the proposed shareholding structure and considered that the relationship among DTTNCo, Tradelink and the Government under the proposal might lead to unfair competition in the service market.

35. Mr WONG Ting-kwong said that initially, he did not consider it necessary for the Government to acquire equity in the DTTNCo under the principle of "Big Market, Small Government". Noting that the Government's proposal was made in response to the industry demand, Mr WONG said that he was now in support of the proposal.

Summing up

36. The Chairman said that other than the above remarks made by members, Ms Miriam LAU had expressed support for the Administration's proposal at the last meeting held on 24 October 2005. On the way forward, he said that whilst there were still divergent views on the Administration's proposal, more members had indicated support for the Government's proposal at the meeting. He asked the Administration to consider members' views and decided whether the proposal should be submitted to the FC for consideration. If so, Panel members could give their own views at the FC meeting. SEDL noted the Chairman's remark and thanked members' support for the proposal.

V Future Development of the Electricity Market in Hong Kong (Stage II Consultation)

(LC Paper No. CB(1)626/05-06(01) - Information paper provided by the Administration

LC Paper No. CB(1)779/05-06(01) - Letter dated 11 January 2006 from
and (02) Hon Fred LI and the
(*tabled at the meeting and Administration's reply*)
subsequently issued on 24 January
2006)

Introduction by the Administration

37. At the invitation of the Chairman, SEDL informed members of the launch of the Stage II Consultation on the future development of the electricity market in Hong Kong after the existing Scheme of Control Agreements (SCAs) expired in 2008. He said that the Administration had received 766 written responses from different sectors

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of the community during the Stage I Consultation. Having carefully reviewed comments received and conducted further studies on the financial aspects of economic regulation and the supply/demand situation in the Mainland, the Administration had mapped out the proposed post-2008 regulatory arrangements for the electricity market. Details were set out in the Stage II consultation paper. SEDL then highlighted the proposed future regulatory regime which aimed to achieve the policy objective as regards reliable, safe and efficient supply at reasonable prices. The permitted rate of return was proposed to be adjusted downward to an average of some 9% to 10% with a view to lowering the tariffs. The proposed future regulatory regime also aimed to further the environmental objectives promulgated in the 2005 Policy Address, with regard to emissions reduction and use of renewable energy (RE).

38. Regarding the introduction of new supply sources, DS/ED2 advised that according to the Administration's study and recent contacts with the Guangdong authorities, it would be prudent at this stage not to predicate future development, at least in the short term, of the electricity market in Hong Kong on supply from the Mainland. Having regard to the prevailing situation, the Administration proposed to continue the existing practice of exercising economic regulation by means of bilateral agreement signed between the Government and each of the power companies. The agreements would however last for a shorter period of ten years, with an option to extend for another five years, subject to a review before the end of the 10th year. The Administration would continue to monitor closely developments in the electricity market in Guangdong so as to identify possible sourcing opportunities in a timely manner. Meanwhile, the Administration would develop regulatory arrangements and formulate legislative proposals to cater for possible supply from the Mainland.

39. DS/ED2 further advised that unlike the current SCAs under which one single rate was applied to the aggregated value of average net fixed asset (ANFA) in the entire supply chain, covering generation, transmission and distribution, the Administration proposed to apply different rates of return between 7% to 11% (an average of 9% to 10%) to different types of assets in the new economic regulatory regime. DS/ED2 said that a simulated calculation showed that if the tariff for 2006 were to be determined by the new method, there would be a reduction of tariffs by 10% to 20%. However, the actual reduction would be affected by a number of factors, including, inter alia, the prevailing sales forecast, tariff level, average net fixed assets balance, asset mix, etc. On environmental regulation, DS/ED2 said that to ensure and facilitate the introduction of RE with a view to meeting the target of having 1% - 2% of the local power needs met by RE by 2012, the proposed rate of return for RE infrastructure would be 11% which was highest among all types of assets. To avoid the costs of emissions reduction facilities being passed onto consumers as far as possible, it was proposed that this type of assets would be subjected to the lowest rate of return. In addition, the Administration proposed to provide a financial incentive in the form of "bonus" return to encourage the power companies to use RE in its supply and reduce their emissions to levels below those required in the Specified Process Licences.

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Discussion

40. The Chairman suggested and members agreed to extend the meeting to 1:00 pm.

Tariff and return

41. On the future regulatory arrangements for the electricity market in Hong Kong, Mr LAU Chin-shek said that the general public was more concerned whether there would be a tariff reduction in future and the extent of the reduction. He sought information on the extent of tariff reduction in 2009 if the proposed regulatory regime was put in place.

42. DS/ED2 recapped that with reference to a simulated calculation, if the tariff for 2006 were to be determined by the new method by applying the average permitted rate of return of some 9% to 10% , there would be a substantial reduction of tariffs by 10% to 20%.

43. With a 40% reduction in the permitted rate of return from 13.5% to an average of 9% to 10%, the Chairman queried why the tariff rate could only be reduced by 10% to 20%.

44. DS/ED2 explained that tariffs charged by the power companies included the costs of making available the supply (operating costs and fuel charges), plus the agreed return to the companies for providing the service. As such, the proposed 40% reduction in the rate of return would translate into a 10% to 20% reduction in tariff.

45. Mr SIN Chung-kai remarked that the general public would be very pleased to note that the tariffs could be reduced by 10% to 20% under the proposed regulatory regime. He however was worried that prior to the expiry of the SCAs in 2008, the two power companies would continue to raise their tariff rates for 2007 and 2008. He asked if the Government would consider adopting the 9% permitted rate of return when conducting the annual tariff review with the two power companies prior to 2008. He also asked the Administration to specify in the future bilateral agreement that the tariff rates would be reduced by 10% - 20% when the new regulatory regime was put in place. He remarked that some academics had expressed concern about the illusion of a tariff reduction associated with the Administration's proposal. They were worried that the tariff rates might not be lowered despite a reduction in the permitted rate of return as proposed by the Administration.

46. The Chairman also pointed out that if power companies, like Hongkong Electric Co. Ltd. (HEC) continued to raise its tariff for 2007 and 2008 at a similar rate as it did for 2006 which was about 7%, there would be an accumulated increase of tariff by 21% by the end of 2008. Under such circumstance, the present tariff rate would not change much even it was lowered by 10% to 20% in 2009.

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47. DS/ED2 explained that the actual tariffs in 2009 would depend on a number of factors, including electricity demand and sales, capital investments, operating expenditure, and fuel prices etc. As these factors were subject to changes, it was not appropriate to predict the 2009 tariffs at this stage. Nevertheless, DS/ED2 assured members that under the proposed regulatory regime, the existing tariff setting process would largely be improved.

48. Mr LEUNG Kwok-hung reflected the views of the Small and Medium Enterprises that tariff in Hong Kong was too high. He remarked that a rate of return at 7% to 11% would enable power companies to make substantial profits and suggested to lower the rate to 5% to 8%. Mr LEUNG considered that effective regulation of public utilities was fundamental to public governance. He urged the Administration to take the opportunity to review the regulatory regime for the electricity market in Hong Kong. Concrete measures should be put in place to facilitate interconnection and third party connection/access to the power grids of the existing two power companies. Arrangements should also be made to lower the tariffs and reduce the discrepancies between the tariffs of the two power companies.

49. SEDL remarked that he fully understood the expectation of the general public and Members that the proposed future regulatory regime should bring about tariff reduction. In reply to Mr SIN's question on how the proposed regulatory regime would ensure a tariff reduction in the end, he assured members that the Government would spare no effort in monitoring the performance of the power companies and ensuring that they would not over-invest in fixed assets. As in the past years, the Administration would continue to make its best effort to keep the tariff levels as low as possible during the annual tariff reviews for 2007 and 2008. SEDL said that under the new regime, Government's approval would be required for all tariff adjustments to ensure that they were cost-justified, reasonable and affordable to consumers.

50. On measures to guard against over-investments by the power companies, Mr LEE Wing-tat remarked that not much work had been done by the Administration. He recalled that in 1995-96, over investment by CLP Power (CLP) in new generating units had aroused wide public concern. Upon repeated requests by the Council, the Government subsequently requested CLP to exercise contractual deferral options to safeguard the interest of CLP's customers.

51. Noting that Hong Kong manufacturers based in the Mainland might be reluctant to move back to Hong Kong due to high tariffs, Mr Howard YOUNG sought the Administration's evaluation on the impact of electricity tariffs in manufacturers' consideration in moving the production base back to Hong Kong.

52. Agreeing that a reduction in tariff would benefit manufacturers as well as general consumers, SEDL however pointed out that compared to electricity tariff, there were other more important factors such as factory costs and staff salary etc., which would affect the choice of production base for manufacturers.

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Rate of return

53. Mr LAU Chin-shek enquired whether the power companies would still reap a return of some 9% under the new regulatory regime if (i) the companies over-invested in fixed assets, (ii) the operating costs escalated due to poor management by the power companies, or (iii) the overall economy was dooming. He expressed grave concern if the general public was required to pay higher tariffs due to Government's ineffective monitoring effort in situations under (i) and (ii).

54. Mr Fred LI noted from the Administration's reply to his earlier enquiry that the rate of return for RE infrastructure, generation assets, transmission and distribution assets and emission reduction facilities were 11%, 10%, 9% and 7% respectively. He was concerned that the power companies might over-invest in fixed assets in order to reap a higher return. Mr LI sought information on measures to be taken by the Administration in monitoring against power companies' attempts to over-invest in fixed assets.

55. DS/ED2 highlighted that 7% to 11% was the suggested range of the rate of return under the proposed regulatory regime. The suggested rate was not a guaranteed rate of return. Indeed, past experience showed that there were occasions where power companies did not earn the highest rate of return allowed under the SCAs. On worries about over-investment by power companies, DS/ED2 assured members that under the future bilateral agreements to be signed between the Government and each of the power companies, a specific provision would be included to the effect that all development plans relating to electricity supply of the power companies would need to be approved by the Government with a view to ensuring that the power companies would only invest in essential infrastructure for providing reliable, safe and adequate power supply. To further guard against over-investments by the power companies, the Administration proposed to continue, and tighten, the existing excess capacity mechanism, whereby all capital expenditure on machinery and equipment of the generation facility found to be excessive would be deducted from the rate base (i.e. ANFA) in calculating the company's return.

56. Mr Fred LI further queried why the Administration did not consider adopting other rate base approaches that had been used by other jurisdictions in regulating return. Miss TAM Heung-man suggested that the Administration could consider using both the fixed assets and equity base approaches as basis for determining return.

57. DS/ED2 advised that the Administration proposed to adopt a two-pronged approach, using fixed assets and performance as the base for determining return. In fact, many overseas electricity markets had adopted the fixed asset approach using ANFA as the base for considering return and this approach was supported by feedback from the Stage I consultation. The Administration had also considered the equity base approach. However, it lacked incentive for efficient financing and shareholders might not be inclined to use debt financing even when it was available and cheaper. As such, equity base was not commonly used as the rate base for determining return in other regulatory regimes. Overseas experience also showed that either fixed assets or

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equity would be used as the rate base for determining return but not both.

58. Miss TAM Heung-man raised further queries about the justification for the Administration's proposal to apply different rates of return to different types of assets. Mr CHAN Kam-lam also considered that the public might find the varying return for different types of assets difficult to understand and suggested that a single rate of return of 8% be adopted across the board for all types of assets. DS/ED2 added that applying different rates of return to different types of assets could help achieve different policy objectives such as minimizing impact on the environment, avoiding the cost of emission reduction facilities being passed onto consumers as far as possible, and reflecting the different investment risks associated with the different operations in the supply chain. SEDL also pointed out that there were different views on how the permitted rate of return should be determined. The Administration would further consider the mechanism for determination having regard to comments and views received during Stage II consultation.

59. Ir Dr Raymond HO queried the basis for determining the varying return for different types of assets. He opined that whilst installation of emission reduction facilities might be more conducive to minimizing impact on the environment, this type of assets was subject to the lowest rate of return, not to mention its high cost of procurement. In terms of environmental benefits within the local context, installation of emission reduction facilities would be a better choice than developing RE but the return for the latter type of assets was much higher. He also enquired whether incentives would be provided to power companies engaging in emissions trading.

60. SEDL and DS/ED2 pointed out that there were different views regarding the responsibility of emissions reduction. Some held "polluters-pay" principle that it was not necessary to provide return to the power companies while others agreed that an incentive should be given to encourage the power companies to invest, or to continue to invest, in emissions reduction facilities. Striking a balance, the Administration proposed to subject this type of assets to the lowest rate of return to avoid the costs of emission reduction facilities being passed onto consumers as far as possible. On emissions trading, DS/ED2 said that this was one of the optional measures for the two power companies to achieve their 2010 reduction targets. The Governments of HKSAR and Guangdong were contemplating the details.

61. Mr LEE Wing-tat remarked that customers had all along been required to shoulder the costs of maintaining the excess generation capacity to ensure a 99.9% reliability of electricity supply. While a high rate of service availability was crucial to the operation of the business sectors, it was questionable whether there was a need for pitching the service availability rate at such a high level for general households, bearing in mind the resultant impact on tariffs. On the reserve capacity requirements, Mr LEE also commented that a reserve margin of about 30% was too high and indeed might be the highest in the world. Mr CHAN Kam-lam considered that it was necessary to cap the excess capacity to avoid over-investment.

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62. Ir Dr Raymond HO held a different view. He considered that a reliable supply of electricity was of paramount importance to Hong Kong, both for business operations which relied on the continuous supply of electricity as well as the general public whose safety might be at stake if there was a suspension of power supply. He appreciated the achievement of Hong Kong in reaching a service reliability rate of 99.999% and reminded the Administration not to compromise this high standard in liaising with the two power companies on the future agreements.

63. DS/ED2 advised that reliable and safe power supply hinged on the adequacy of electricity facilities and management of the power systems. The power systems in Hong Kong were planned and built in compliance with a set of well-established and internationally recognized planning criteria and engineering standards. The management and maintenance of the power systems, instead of new investments in fixed assets, contributed to the high standard in supply reliability. On excess capacity, DS/ED2 said that a reserve capacity of 30% was on par with situations in overseas countries, which could provide immediate support when there was unforeseen outage of generating units, fluctuation in demands, etc.

Interconnection and new source of electricity supply from the Mainland

64. Mr Fred LI expressed support for interconnection and considered that competition from new suppliers entering the market could help improve the services of the two power companies. Miss TAM Heung-man remarked that over a longer term, Hong Kong should integrate with Guangdong Province in respect of electricity supply with a view to introducing competition.

65. DS/ED2 agreed that Hong Kong should assess the prospect of importing electricity from Guangdong for supply to Hong Kong. As such, the Administration proposed to prepare the ground for possible new supply sources from the Mainland and to make arrangements with regard to grid access and interconnection during the 10-year period of the future agreements.

66. Given that competition in the electricity market would help lower electricity tariffs, Mr WONG Kwok-hing commented that it took too long for the Administration to introduce measures to facilitate entry of new electricity suppliers, including possible new supply sources from the Mainland. As a result, the two power companies in Hong Kong would continue to monopolize the market for another ten years. He requested the Administration to expedite the process by cutting red-tapes so that new supply sources could be made available in 4 to 5 years' time. As the Administration proposed to seek the agreement of the two power companies to provide connection/access to their grids for other supply sources, including those from the Mainland, and request the two power companies to jointly take forward and plan for increased interconnection at an "optimum" level, Mr WONG asked what measures the Government would take if the two power companies did not give their consent to proceed as requested. Separately, Mr WONG was pleased to note that the new regulatory authority under consideration would include representatives from labour unions.

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67. The Chairman enquired about the details of the duration of the bilateral agreements proposed by the Administration. He also asked whether the Administration would liaise with the relevant Mainland authorities on importing electricity from Guangdong for supply to Hong Kong after the end of the new agreements or liaison would be held in the meantime.

68. DS/ED2 stressed that under the proposal, the permitted rate of return and electricity tariffs could be lowered even without the availability of new supply sources from the Mainland and entry of new electricity suppliers. In fact, the arrangements between the Government and the power companies were not franchises and did not provide exclusive rights to the companies in electricity supply. Interested parties were at liberty to enter the Hong Kong electricity market.

69. As regards the duration of the future bilateral agreements, SEDL explained that the agreements would be for ten years, with an option to extend for another five years, subject to a review before the end of the 10th year to ascertain whether it was appropriate to continue economic regulation by a bilateral agreement approach having regard to the prevailing market conditions. DS/ED2 added that in considering the duration of the future agreements, it was necessary to strike a balance between allowing flexibility for changes and providing a relatively stable and certain environment for long-term investment by power companies. As such, the Administration proposed that the future agreement would initially last for 10 years which was shorter than the current 15 years. During this period, the Administration would continue to monitor closely developments in the electricity market in Guangdong so as to identify possible sourcing opportunities in a more timely manner. It would also enhance liaison with the Mainland authorities and explore how technical constraints to the development of relevant infrastructure on the Mainland side of the border might be addressed, and make preparations, including developing regulatory arrangements, with regard to grid access to new electricity suppliers and enhanced interconnection between Hong Kong and Guangdong for possible supply from the Mainland.

70. Mr Jeffrey LAM echoed that a stable and reliable power supply was very important to sustain business development in the South China region. As grid access and interconnection might affect the reliability of power supply, Mr LAM was concerned about the line of responsibility in the unlikely event of loss of electricity supply subsequent to the introduction of new suppliers from the Mainland. He also opined that even if new supply sources were made available from the Mainland, Hong Kong should have its own power supply system in case there were faults in power supply in the Mainland.

71. To access existing grids of the power companies, DS/ED2 advised that new suppliers from the Mainland should put in place viable development and supply plans which met relevant safety, reliability and environmental requirements. Interface between different parties would necessitate development of regulatory arrangements, one of the options being legislation, to ensure that, inter alia, the responsibility and

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accountability for supply planning was clearly defined.

72. Referring to the views received during the Stage I consultation paper, Mr LEE Wing-tat felt astonished to note that most respondents did not support increased interconnection because it might affect reliability and increase tariffs, and expressed reservation on introducing competition into the electricity market, out of concerns about supply reliability and availability of surplus electricity in the Mainland. He requested the Administration to analyze the profile of the 766 respondents who had submitted written views to ascertain whether they were staff of the two power companies. He was very concerned whether the Administration would draw on these views in concluding the way forward on the future development of electricity market in Hong Kong. Mr LEE said that according to a survey conducted by the Democratic Party, over 60% of respondents supported interconnection and liberalization of the electricity market.

73. SEDL assured members that views received during Stage I consultation would by no means be used to conclude the way forward. On the profiles of the respondents, he advised that the Administration had made the 766 submissions available on the Government's website for public perusal.

Bargaining power of the Government in the negotiation for future agreements

74. Noting that in the near term, no competition would be introduced into the electricity market in Hong Kong, Mr KWONG Chi-kin was worried that this would weaken the bargaining power of the Government in its negotiation with the two power companies. He was also concerned that if CLP really pulled out of the Hong Kong market as it had threatened earlier, power supply in Hong Kong would be at stake.

75. Mr CHAN Kam-lam was also very concerned that CLP had mentioned about signs of collapse in its partnership with the Government. He called on both sides to remain calm and maintain harmony in discussing the proposed arrangements. On the issue of continual commitment to Hong Kong, Mr CHAN was concerned whether regulatory measures were in place if the power companies cut down its investment and could not meet the future forecast demand.

76. SEDL remarked that CLP had clarified that it had no intention to leave the Hong Kong market and the company was just trying to express its concerns on the Administration's proposals. In fact, power sector investments in terms of electricity grids and transmission lines were immobile, with asset lives extending over a long period of time. It might not be viable for power companies to remove their assets. While power companies could make a reasonable return on their investments, SEDL however pointed out that they did have social responsibilities. The general public considered that the existing permitted rate of return of 13.5% was too high and they wished to see that the rate could be reduced in order to lower the tariffs. SEDL believed that the Administration would maintain a working relationship with the power companies and it would liaise with them in a pragmatic and reasonable manner.

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77. Mr Ronny TONG shared members' concerns. As the Government had indicated that it was prudent at this stage not to predicate the future development of the electricity market in Hong Kong on supply from the Mainland, Mr TONG was concerned that the general public was unconvinced that the power companies would accede to the Administration's proposal. He sought information on the recent reports that a Mainland company intended to import electricity from Guangdong for supply to Hong Kong.

78. SEDL remarked that the Government's plan was to explore and make preparations for the import of electricity from Guangdong on a large-scale basis for supply to Hong Kong. As far as he understood, the recent proposal mentioned by Mr TONG was a small-scale project involving electricity supply to Sha Tau Kok only. Despite the present assessment which showed that substantive importation of electricity from the Mainland could not be carried out in the near term, the Administration was determined to explore introducing further power supply from the Mainland at the earliest opportunity. Meanwhile, the Government would prepare the ground for electricity supply from new sources in respect of technical and safety requirements, regulatory arrangements, legislation etc with a view to making available grid access to new suppliers once they were ready.

79. Mr Ronny TONG considered that the Administration should introduce concrete measures for implementation rather than putting forward visionary statements. He asked whether the Government would consider setting up an independent committee to study the liberalization of the electricity market in Hong Kong.

80. SEDL stressed that the Government had studied the issue and would make preparations to liberalize the electricity market when new supply sources were ready. On substantive measures, he assured members that the Government would assist where necessary and when requested by either party for grid connection/access with the existing power companies and would act as a facilitator so that both sides could reach an agreement over the amount of access charges. The Government would also initiate and draw up the regulatory framework regarding provision of grid access for other new supply sources in the long run, which might involve setting up a separate regulatory authority.

Renewable energy

81. Noting that the Administration proposed to provide financial incentives to the power companies to encourage them to use RE in electricity generation, with a view to achieving the target of having 1%-2% of the local power needs met by RE by 2012, Miss TAM Heung-man was concerned that the target was too conservative. Sharing similar view, Mr KWONG Chi-kin reflected the worries of Green Peace that the power companies might invest in RE infrastructure in order to boost their return on fixed asset investments. He understood that the wind turbine to be commissioned by HEC on Lamma Island could only cater for the electricity demand of 250 four-member families for one year. Mr KWONG urged the Administration to ensure that the power companies would engage in genuine development and application of RE.

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82. DS/ED2 said that the proposal was made with reference to the RE target by 2012 as set out in the First Sustainable Development Strategy promulgated by the Government in May 2005. He added that having regard to the topographical constraints and limitations in Hong Kong to the application of RE, consideration should nevertheless be given to tapping wind energy, solar energy and energy-from-waste. To encourage the development and application of RE in Hong Kong, a higher rate of return for RE infrastructure than all other assets would be given. Moreover, financial incentives would be provided to the power companies to encourage them to use RE in electricity supply.

83. Mr Howard YOUNG considered that among different types of RE, energy-from-waste was the most cost-effective one because at the same time, it helped contain the problem of waste treatment. He suggested that a higher return should be provided to the application of RE using energy-from-waste. DS/ED2 said that under the present proposal, a rate of return of 11% would be given for RE assets across the board. Nevertheless, the Administration would consider the suggestion of Mr YOUNG together with other views received during the consultation.

Development Fund (DF) of CLP

84. Noting that the balance of CLP's DF was about \$3 billion, Mr Fred LI was worried that before 2008, CLP would use the balance in the DF to achieve the permitted return for its shareholders rather than returning the monies in the DF to its customers. The Chairman also expressed concern about the disposal of monies in the DF.

85. In response, DS/ED2 advised that the balance in CLP's DF would continue to be used to ameliorate tariff increases due to fuel cost increase or other factors. In addition to returning monies in the DF to its customers before the expiry of the current SCAs, DS/ED2 said that there were also views suggesting that some balance in the DF should be transferred to the future Tariff Stabilization Fund under the proposal. Nevertheless, the Administration would discuss with CLP on the way to deal with any balance in the DF around September 2007.

86. At 1:00 pm, the Chairman suggested and members agreed that the meeting be extended to 1:15 pm. During the period of extension, the Chairman advised that he had received a note from Mr SIN Chung-kai, proposing that a subcommittee be formed under the Panel to follow up on matters relating to the future development of the electricity market in Hong Kong. However, as no motion should be proposed during such period of extension, the Chairman suggested and members agreed that Mr SIN's suggestion be deferred to the next meeting for consideration.

VI Any other business

87. There being no other business, the meeting ended at 1:15 pm.