

**For information
on 29 May 2006**

Legislative Council Panel on Economic Services

**Future Development of the Electricity Market in Hong Kong:
Views received during the Stage II Public Consultation**

Purpose

This paper informs Members of the views received during the Stage II Public Consultation on the Future Development of the Electricity Market in Hong Kong.

Background

2. The existing Scheme of Control Agreements between Government and the two power companies will expire in 2008. In order to ensure that Government's policy objective will continue to be met, i.e., the public can enjoy reliable, safe and efficient electricity supply at reasonable prices, while minimizing the impact on the environment caused by the generation and use of electricity, we have conducted a two-stage Public Consultation on Future Development of the Electricity Market in Hong Kong. The Stage I Public Consultation was conducted during 31 January 2005 to 30 April 2005 to seek the public's views on various issues and possible options. Over 900 submissions and messages were received. They have been published on the website of Economic Development and Labour Bureau (EDLB) and a summary was presented to the Legislative Council (LegCo) Panel on Economic Services on 27 June 2005. Taking into account the views received during the Stage I Public Consultation, we have drawn up a package of proposed regulatory arrangements. The Stage II Consultation Paper was issued on 30 December 2005 to seek further public views. In drawing up the proposals, we have endeavored to strike a balance between the interests of different sectors while bearing in mind the overall long-term interests of Hong Kong as a whole. The three-month consultation period ended on 31 March 2006.

The Stage II Public Consultation

3. Over 17,000 written submissions from different sectors of the community have been received. In addition, over 700 messages have been posted on the dedicated discussion forum on EDLB's website and the Public Affairs Forum of the Home Affairs Bureau. All written submissions, except a few which refused disclosure, will be uploaded to EDLB's website for public perusal. We have also attended a series of meetings, briefings and discussion forums, including the LegCo Panel on Economic Services, LegCo Panel on Environmental Affairs, District Councils (DCs), the Consumer Council, some green groups, as well as professional and academic institutions, to collect views and comments of different stakeholders and the community at large.

Submissions received

4. The written submissions received can be broadly categorized as follows –

- (a) about 10,000 emails submitted in three standard formats in response to the online campaigns organized by three green groups (GreenPeace, Friends of the Earth and WWF Hong Kong);
- (b) about 3,800 standard letters together with some 6,500 signatures submitted in response to the one-person-one-letter campaign organized by the Democratic Party;
- (c) about 3,400 written submissions from individuals and companies; and
- (d) about 100 written submissions from the academics, DC members, political groups, the Consumer Council, trade and industry organisations, trade unions, professional institutions, green groups and power companies.

Summary of Views

5. There is a general consensus that reliability and safety of supply is the most important and should be the key consideration in the future development of the electricity market. Other key issues of concern include future market development, regulation on return and tariff, as well as environmental impact of electricity supply. On these issues, the views

received are quite diverse. A brief summary of the key comments is as follows –

A. Objectives

- There is general support for Government's energy policy of maintaining reliable, safe and efficient electricity supply at reasonable prices while minimizing the environmental impact, with some submissions suggesting further elaboration in specific areas, viz. –
 - some individuals and companies suggest elaboration with regard to fuel mix, and energy efficiency and conservation. Respondents to an online campaign request that a comprehensive and integrated energy policy be set to address energy security, energy efficiency as well as protection of the environment and public health;
 - the power companies are of the view that the energy policy should be expanded to cover areas such as long-term fuel mix, environmental standards and the relative importance of different policy objectives;
 - the green groups generally consider that the energy policy should also include environmental objectives of energy conservation, demand side management and use of Renewable Energy; and
 - some political groups, DC members, and academics also share similar views.

B. Market Development

- Views are divided.
- Many submissions from individuals and companies have reservations about introducing new supply sources from the Mainland out of the concern that their supply reliability and environmental performance would be beyond our control, which may result in degradation of supply reliability and service quality. Some of them suggest that there should be a clear plan and target for future market

development, without compromising supply reliability and safety.

- The power companies are of the view that conditions for a regional competitive market involving Hong Kong and South China do not exist yet. They are cautious about moving towards an open electricity market and consider it important for any market transition to be introduced in an orderly manner according to a comprehensive transition plan. Some trade unions and professional institutions express similar views. Many financial institutions are concerned about the impact of market change on supply reliability.
- Respondents to the one-person-one-letter campaign request that the electricity market should be opened up to break the existing monopoly. A number of political groups, green groups and DC members, as well as the Consumer Council are supportive of further opening up our electricity market with some suggesting a faster pace and clear roadmap for implementation. While some of the trade and industry organisations and professional institutions support preparing the ground for possible new power sources from the Mainland, some of them express concern on the availability in the short term and the quality of such sources.
- Views of the academics are divided.

C. Increased Interconnection

- Not many individual citizens and companies have offered comments on the subject and their views are quite divided. Some support Government's proposal of increased interconnection while others have reservations or do not support increased interconnection out of concern of the impact on supply reliability and tariff increase.
- While a number of political groups indicate support for increased interconnection between the two power companies, views of the other stakeholder groups which have offered comments on the subject are divided.

- One of the power companies is of the view that there is no economic benefit in increased interconnection.

D. Environmental Issues

Renewable Energy (RE)

- There is generally more support among individuals and companies to promote greater use of RE. Respondents to some online campaigns support that RE investments should earn a higher level of permitted rate of return and request that the cooperation in RE development between Guangdong and Hong Kong be speeded up. Others suggest that fair access to the power grids be provided for small RE and clean energy suppliers.
- There is general support among stakeholder groups for introducing RE sources and allowing higher rate of return for RE investments. Some sectors, such as certain green groups and political groups, suggest more aggressive plans and targets for introducing RE sources. In particular, Green Sense indicates that they have collected around 80,000 signatures from teachers and students of 127 schools to support use of more RE sources.
- One power company doubts the benefits of introducing more RE due to its high cost and intermittent output.

Emission reduction

- While there is a general consensus that effective measures should be taken to reduce emissions, the views differ in areas such as whether return on emission reduction facilities should be allowed and whether the permitted return of the power companies should be linked to their emission levels.
- Some individuals and companies suggest setting clearer environmental requirements and targets, and providing incentives to encourage investment in emissions reduction facilities, etc. Many of them do not support linking the permitted rate of return to compliance with the emission caps.

- Respondents to some online campaigns support the proposal to link the permitted rate of return of the power companies to their emission levels, and some of them are of the view that the cost of emission reduction facilities should not be shouldered by consumers.
- The views of political groups, trade and industry organisations, and professional institutions are divided. The power companies are of the view that the emissions caps are imposed on them unilaterally and are unrealistic.
- There are also suggestions from some green groups and political groups for emissions trading and imposition of emission levy.

E. Economic Regulation

Bilateral agreement and its term

- The proposal to continue with the current bilateral agreement type of arrangements together with the relevant monitoring mechanisms such as annual tariff review and periodic financial review is generally accepted. Views are, however, divided over the term of the new agreement -
 - many individuals and companies do not support the shortened agreement period of 10 years, due to concerns about planning difficulties for investors and stability of long-term electricity supply;
 - some political groups and DC members support shortening the agreement duration to 10 years. However, some stakeholders, including certain trade and industry organisations, professional and financial institutions, consider the proposed term too short; and
 - the power companies consider the proposed 10-year agreement duration not acceptable.

Return

- Views over the level of return are diverse. Individuals and companies express concerns that the proposed range of 7% to 11% might be too low to attract continued investment and might affect supply reliability. There are also

financial institutions which are concerned that the lowered rate of return might impact on investment incentive and hence supply reliability.

- Some political groups and DC members suggest further lowering the rate to 7% to 8%. Respondents to the one-person-one-letter campaign are of the view that the permitted rate of return should be lowered to 7%.
- The power companies consider the proposed permitted rate of return of 7-11% too low.

Application of different rates of returns to different types of assets

- Individuals and companies do not support applying different rates of return to different types of assets due to the complexity of this approach and possible increase in administrative costs. Some academics and professional institutions are concerned that the proposal might distort investment priority and increase the administrative burden. The power companies do not agree to applying different rates of return to different assets.
- Many groups generally support allowing higher return for RE investments. The views over the return for emissions reduction facilities are varied. Respondents to some online campaigns support higher return for RE investments and zero return for emission reduction facilities.

Incentive schemes

- Apart from those on environmental performance as mentioned above, not many of the individuals and companies have commented on the incentive mechanisms for performance improvement. As for the other stakeholder groups who express their views on the subject, most of them are supportive of the proposals to provide incentives for encouraging the power companies to improve their operational and environmental performance. The power companies have indicated willingness to consider the performance incentive proposals.

Excess capacity mechanism

- Only a few submissions have comments on the proposal to tighten the excess capacity mechanism and most of them do not favor it out of concern of the lack of incentive for continued investment. There is however support from individual groups on the proposed tightening of the excess capacity mechanism.

Tariffs

- There is general support among individuals and companies that electricity tariffs be made up of the costs and agreed return for providing electricity supply, and subject to annual review. There is also general support to retain the Fuel Clause Account and maintaining a Tariff Stabilisation Fund.
- On Government approval for all tariff adjustments, views are divided. The Consumer Council, some political groups and DC members support this proposal. Some trade and industry organizations however object to it. Some respondents do not support the proposal due to increased regulatory uncertainty and risk to the power companies. The power companies are against the proposal.
- Only a few organizations have expressed views on increased transparency of tariff adjustments and they generally support the proposal. Respondents to the one-person-one-letter campaign also request the power companies to reduce tariffs as soon as possible.

F. Institutional Set-up

- Not many individuals and companies have offered comments on this subject and they generally support maintaining the current set-up while keeping under review the need for a separate regulatory authority. One of the power companies has indicated support for maintaining the current set-up and expressed reservation on establishing an independent regulatory body.
- A number of political groups and the Consumer Council are supportive of setting up a separate regulatory authority. Respondents to some online campaigns suggest the

establishment of an Energy Administration to coordinate the planning of the electricity market in terms of economic, social, environmental and regional development. Only a few submissions from the other stakeholder groups such as trade and industry organizations and professional institutions have provided views on this issue and their views are divided.

G. Safety Regulation

- Only a few submissions have offered comments on the subject and they are supportive of continuing with the existing arrangement to regulate by legislation.

Way Forward

6. We shall take into account the views received during the Stage II Public Consultation and discuss with the power companies to finalize the post-2008 regulatory arrangements for the electricity market.

Economic Development and Labour Bureau
22 May 2006