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Legislative Council

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Panel on Economic Development

Minutes of meeting
held on Tuesday, 10 December 2013, at 4:30 pm
in Conference Room 1 of the Legislative Council Complex

Members present : Hon James TIEN Pei-chun, GBS, JP (Chairman)
Hon Jeffrey LAM Kin-fung, GBS, JP (Deputy Chairman)
Hon CHAN Kam-lam, SBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon WONG Ting-kwong, SBS, JP
Hon Ronny TONG Ka-wah, SC
Dr Hon LAM Tai-fai, SBS, JP
Hon Paul TSE Wai-chun, JP
Hon Albert CHAN Wai-yip
Hon Steven HO Chun-yin
Hon Frankie YICK Chi-ming
Hon YIU Si-wing
Hon Charles Peter MOK
Hon CHAN Han-pan
Hon Kenneth LEUNG
Hon Dennis KWOK
Hon Christopher CHEUNG Wah-fung, JP
Dr Hon Fernando CHEUNG Chiu-hung
Hon SIN Chung-kai, SBS, JP
Dr Hon Elizabeth QUAT, JP
Hon TANG Ka-piu
Hon CHUNG Kwok-pan

Member absent : Dr Hon LEUNG Ka-lau

Members attending	**:**	Hon LEE Cheuk-yan Hon WONG Kwok-hing, BBS, MH Hon Cyd HO Sau-lan Hon Michael TIEN Puk-sun, BBS, JP Hon WU Chi-wai, MH Dr Hon KWOK Ka-ki Hon KWOK Wai-keung Ir Dr Hon LO Wai-kwok, BBS, MH, JP
Public officers attending	**:**	Agenda Item III Mr WONG Kam-sing, JP Secretary for the Environment Miss Vivian LAU Lee-kwan, JP Deputy Secretary for the Environment Mr Donald NG Man-kit Principal Assistant Secretary for the Environment (Electricity Reviews) Miss Ada CHEN Kit-yi Senior Assistant Law Officer (Civil Law) Agenda Item IV Mr WONG Kam-sing, JP Secretary for the Environment Miss Vivian LAU Lee-kwan, JP Deputy Secretary for the Environment Ms Vyora YAU Siu-man Principal Assistant Secretary for the Environment (Financial Monitoring)
Attendance by invitation	**:**	Agenda item IV CLP Power Hong Kong Ltd. Mr Richard LANCASTER Chief Executive Officer – CLP Holdings

Mr Paul POON
Managing Director

Ms Quince CHONG
Chief Corporate Development Officer

Mr T K CHIANG
Planning & Development Director

Mr Stephen CHAN
Deputy Director (Strategic Development)

The Hongkong Electric Co., Ltd.

Mr C T WAN
Managing Director

Mr CHAN Loi-shun
Executive Director

Mr T C YEE
General Manager (Corporate Development)

Ms Mimi YEUNG
General Manager (Public Affairs)

Mr K M WONG
Group Manager, Finance & Accounting

Clerk in attendance : Mr Derek LO
Chief Council Secretary (1)5

Staff in attendance : Mr Daniel SIN
Senior Council Secretary (1)7

Ms Michelle NIEN
Legislative Assistant (1)5

I Information paper issued since last meeting

(LC Paper No. CB(1)455/13-14(01) — Administration's paper on tables and graphs showing the import and retail prices of major oil products from November 2011 to October 2013)

1 Members noted the above paper issued since the last regular meeting.

II Items for discussion at the next meeting

(LC Paper No. CB(1)454/13-14(01) — List of outstanding items for discussion
LC Paper No. CB(1)454/13-14(02) — List of follow-up actions)

2. Members agreed that the following items should be discussed at the special meeting scheduled for 16 December 2013 –

(a) Proposed establishment of a Maritime and Aviation Training Fund;

(b) Replacement of four patrol launches for Harbour Patrol Services; and

(c) Proposed legislative amendments to the Competition Ordinance relating to the Competition Tribunal.

III Creation of two supernumerary posts for the review of the future regulatory framework for the electricity market

(LC Paper No. CB(1)454/13-14(03) — Administration's paper on Creation of two supernumerary posts for the review of the future regulatory framework for the electricity market)

3. Secretary for the Environment ("SEN") introduced the paper which sought Panel members' views on the proposal to create two supernumerary directorate posts (i.e. one Administrative Officer Staff Grade C post in the Environment Bureau, and one Assistant Principal Government Counsel post in the Department of Justice) for a period of two years from mid-February 2014 to take forward the review of the future regulatory framework for electricity market after the expiry of the current Scheme of Control Agreements ("SCAs") in 2018.

4. Mr SIN Chung-kai queried whether the Administration would undertake to address fully the issues of opening up the electricity market, opening up the power grids and reducing the power companies' reserve electricity generation capacity, if the staffing proposals were approved. SEN responded that the Administration was aware of the views in the community on these issues, and would examine these relevant issues in the review.

Adequacy of the staffing proposal

5. Mr TANG Ka-piu supported the staffing proposal. He expressed doubts on whether the two posts would be sufficient to enable the Administration to negotiate for a new regulatory framework with the two power companies which were well supported in different professional disciplines.

6. SEN responded that apart from the two supernumerary posts, there were other teams within the Administration to provide support for the review. Deputy Secretary for the Environment ("DSEN") supplemented that the Administration would seek resources as necessary for the implementation of measures arising from the review of future regulatory framework for the electricity market.

7. Mr WONG Kwok-hing supported the staffing proposal. He queried whether it was too late for the Administration to create two supernumerary posts at this stage to develop options to regulate the two power companies. Mr WONG also asked whether the situation reflected the Administration's lack of planning in regulating the electricity market, and whether the two supernumerary directorate posts were sufficient to enable the Administration to develop the new regulatory framework within the targeted time frame.

8. SEN said that the Administration had conducted some preliminary studies in the past and a short term supernumerary post had been created to undertake the related work. SEN said that the addition of the two proposed supernumerary posts would enable the Administration to work more intensively on the review.

9. Dr Elizabeth QUAT supported the staffing proposal. She doubted whether the creation of two supernumerary directorate posts would be sufficient to enable the Administration to achieve the stated objectives effectively. She commented that the Administration should ensure that the ensuing negotiation with the two power companies should be open and transparent. SEN agreed that the review should be conducted in a transparent manner as far as practicable.

Impact of new regulatory framework on employment

10. Members noted that one of the main duties of the proposed Administrative Officer Staff Grade C post was to formulate possible options for the future regulatory framework of the electricity market, taking into consideration the financial, technical, legal and economic implications. Mr TANG Ka-piu suggested that the post holder should examine the employment implications as well. Mr TANG explained that there was quite a large number of staff working for the two power companies. As the CLP Power Company Ltd. ("CLP") was seeking closer co-operation with Mainland's power companies, Mr TANG expected that Hong Kong would become more dependent on energy supply from China. Any changes to the regulatory framework for the electricity market might affect the employment of staff of the two power companies. Mr WONG Kwok-hing asked what legal implications would be entailed by the review.

11. SEN advised that about 5 000 people were working for the two power companies and the Administration would examine the implications of any possible changes from various angles. DSEN supplemented that it was difficult to tell at this stage what form of regulatory framework should be adopted after 2018. The Administration would draw reference from overseas experience and would examine various complex legal and policy issues (such as third party access to the power grids owned by the power companies) in the process.

Opening up of the electricity market and power grids

12. Mr LEE Cheuk-yan asked how many studies had been conducted previously on the opening up of the electricity market and the power grids, and whether the study reports could be made available for members' reference. Mr LEE commented that the problem was not the need for directorate staff to carry out more studies, but a lack of political will of the Administration to open up the electricity market and to tackle the problems arising therefrom.

13. DSEN said that a thorough study on opening up the power grids, with a two-stage public consultation had been conducted before the Administration had concluded the current SCAs with the two power companies in 2008. The outcome of the study and the public consultations had been reported to the Legislative Council. DSEN said that there had been new developments in the electricity market over the past few years, and some neighbouring areas around Hong Kong had enhanced its power grid, which might make it possible for Hong Kong to import electricity. Further studies would be useful in the light of these developments.

Reducing the power companies' permitted rate of return

14. Dr Elizabeth QUAT asked if the Administration would seek to reduce the power companies' permitted rate of return, review the methodology of evaluating the power companies' Average Net Fixed Assets, and tighten the emission requirements and the penalty provisions for failing to meet the emission requirements. Dr QUAT commented that while the power companies had argued that the public had to pay for clean energy, they did have the corporate social responsibility to share out the cost of producing environmental pollution. Dr QUAT asked what stance the Administration would take on this issue.

15. SEN said that the Administration's policy was to ensure that the energy needs of the community were met safely, reliably, efficiently and at reasonable prices, while minimizing the environmental impact of electricity generation. SEN added that the Administration would formulate options for future regulation of electricity market, and relevant issues such as the permitted rate of return, options for opening up of the electricity market, etc., would be considered.

Effectiveness of the proposed supernumerary posts

16. Dr Fernando CHEUNG doubted the effectiveness of the staffing proposal. He said that the Administration had failed to arrive at any agreement with the power companies to reduce the permitted rate of return and other major issues under SCAs in the 2013 interim review. He did not expect the Administration could achieve any meaningful results in the negotiation on new SCAs to be implemented in 2018. In the end, the Administration would likely extend the current SCAs for five more years without any compromise from the two power companies.

17. Dr Fernando CHEUNG commented that the studies or review to be carried out by the two proposed supernumerary directorate posts were likely to be wasted efforts. He asked under what circumstances the Administration would extend the two SCAs with the power companies.

18. DSEN said that the current SCAs provided that no changes could be introduced to the agreements during the mid-term review without mutual agreement by all relevant parties. Such restrictions did not apply to the review of the regulatory framework post 2018, and the Administration would have more room and bargaining power in conducting the review.

Fuel mix for electricity generation

19. Mr Jeffrey LAM asked when the Administration would formulate plans of future fuel mix for electricity generation and whether public consultation would be conducted. Mr LAM asked whether nuclear energy would continue to be used as a type of fuel for generating electricity. He commented that the Administration's decision on fuel mix would affect the power companies' decision on their capital investment strategies.

20. DSEN said that the Administration planned to consult the community on options for future fuel mix for electricity generation as early as possible. She added that the Administration was aware of how the decision on fuel mix would affect power companies' capital investment plans, and was in close liaison with the power companies in developing the fuel mix options.

21. Mr Albert CHAN said that he objected to the staffing proposal. Mr CHAN considered the proposal unreasonable as the Administration had not previously sought additional manpower to examine the regulation of the electricity market in the 1990s, when the situation was as complicated as today's.

22. The Chairman asked other Panel members for their stance on the item. The following 13 members supported the staffing proposals –

Mr Jeffrey LAM Kin-fung
Mr Andrew LEUNG Kwan-yuen
Mr WONG Ting-kwong
Dr LAM Tai-fai
Mr Frankie YICK Chi-ming
Mr Charles Peter MOK
Mr Kenneth LEUNG
Mr Dennis KWOK
Mr Christopher CHEUNG Wah-fung
Mr SIN Chung-kai
Dr Elizabeth QUAT
Mr TANG Ka-piu
Mr CHUNG Kwok-pan

23. Mr Albert CHAN and Mr Ronny TONG did not support the staffing proposal. Dr Fernando CHEUNG abstained from voting. The Chairman concluded that Panel members on the whole supported the staffing proposal and recommended that the proposal be submitted to the Establishment Subcommittee and the Finance Committee for consideration and approval.

IV 2014-2018 Development Plans and 2014 Tariff Review of the two power companies

(LC Paper No. CB(1)454/13-14(04)	— Presentation materials provided by CLP Power Hong Kong Ltd.
LC Paper No. CB(1)454/13-14(05)	— Presentation materials provided by The Hongkong Electric Company Ltd.
LC Paper No. CB(1)454/13-14(06)	— Supplementary Information from Power Companies on their Development Plans and Annual Tariff Reviews – Elaboration on the Notes on Confidential Information
LC Paper No. CB(1)454/13-14(07)	— Paper on 2014-2018 Development Plans and 2014 Annual tariff reviews with the two power companies prepared by the Legislative Council Secretariat (background brief)
ENB CR 1/4576/08 (13) Pt.14 ENB CR 2/4576/08 (13) Pt.10	— Legislative Council Brief on 2014-18 Development Plan and 2014 Tariff Review of the Two Power Companies)

24. The Chairman reminded members that the two power companies had provided confidential documents relating to the 2014 electricity tariff adjustment and their Five-year Development Plans. The documents were deposited in the reading room inside the Legislative Council Archives for members' perusal.

25. The Chairman noted that as many members had indicated their intention to speak on the item, he sought members' views whether the meeting should be extended by 15 minutes if situation warranted. Members agreed.

26. SEN introduced the item, followed by Managing Director of The Hongkong Electric Co., Ltd. ("MD/HEC") and Managing Director of CLP Power Hong Kong Ltd. ("MD/CLP").

[*Post-meeting note*: The speaking note of SEN was issued to members vide LC Paper No. CB(1)524/13-14(01) on 11 December 2013; the speaking notes of MD/CLP and MD/HEC were issued to members vide LC Paper Nos. CB(1)592/13-14(01) and CB(1)592/13-14(02), respectively, on 19 December 2013.]

Power companies' proposed rates of tariff adjustment

27. Mr WONG Kwok-hing criticized CLP for maximizing the level of tariff increase permissible under SCA, which far exceeded the rates of the salary increase of most employees in the coming year. He said that CLP's argument for the proposed tariff increase was not reasonable. Besides, CLP had profited by selling electricity to the Mainland, but the facilities used for generating the exported electricity were paid for by Hong Kong customers as these facilities were included among the assets for calculating the permitted return. Mr WONG criticized CLP as exploiting its customers and asked if CLP would revise its rate of tariff adjustment downward. He also queried why the Administration would approve CLP's unreasonable tariff adjustment proposals.

28. MD/CLP said that the proposed increase in electricity tariff was due to the overall increase in non-fuel-related operating costs, and the investment as outlined in the new Five-Year Development Plan. He supplemented that the balance in the Tariff Stabilization Fund ("TSF") was about to be exhausted. However, CLP would continue to implement the Energy Saving Rebate, for which about 33% of residential customers and 43% of small business customers would benefit. Depending on their consumption, these customers would not see an increase in 2014 tariff and might enjoy savings in electricity bills.

29. As regards the profits from the sale of electricity to the Mainland, MD/CLP said that 80% of the profit derived from electricity sales to the Mainland would be credited to TSF which would help relieve the pressure of tariff increase.

30. SEN said that the Administration had played its gate-keeping role very rigorously. He pointed out that the power companies had already minimized the level of tariff increase and their reserve capacity would go down.

31. Dr LAM Tai-fai commended The Hongkong Electric Co., Ltd. ("HEC") for not proposing any increase in tariff for 2014, but criticized CLP for maximizing the rate of increase, regardless of the hardships faced by the different sectors of the community and without regard to CLP's own corporate social responsibilities.

32. Dr LAM pointed out that CLP proposed an increase of 3.9% in electricity tariff and projected that the average increase in Basic Tariff would be 1.8% per year. However, CLP had not mentioned the corresponding forecast increase in the Fuel Clause Charge ("FCC") over the same period, which might give a false impression that CLP's projected increase in the average total tariff would be moderate. Dr LAM queried whether CLP's customers could only expect an average annual increase in total tariff of 1.8%.

33. MD/CLP said that the figure of 1.8% increase per year referred only to the projected rate of increase in Basic Tariff per year in the coming five years. Since CLP started using clean natural gas as early as 1996 and had relatively more natural gas-fired generating units, the company had shouldered more than 90% of the cost of the increase in natural gas consumption. He expected that FCC would also increase when the company had to double the consumption of natural gas for electricity generation to meet new emission requirements in 2015, and when the company started using the natural gas supply from the Second West-East Natural Gas Pipeline in accordance with the memorandum of understanding signed between the Central People's Government and the HKSAR Government, which was more expensive than that from the current source of natural gas.

34. Mr SIN Chung-kai commented that even when HEC was not proposing any increase in electricity tariff for 2014, its net tariff was higher than CLP's by 27%. Mr SIN noted that HEC had indicated that its forecast net tariffs in the coming five years would remain unchanged. Mr SIN pointed out that HEC had increased its Basic Tariff by 7.1 cents/unit which, in percentage terms, was much higher than CLP's. If it turned out that fuel cost in the coming five years had been under-estimated, then there would be an increase in HEC's net tariffs.

35. Mr SIN Chung-kai noted that CLP's Fuel Clause Recovery Account ("FCA") had a balance of $1.2 billion in 2013. He said that the interest earned from this balance should be credited for the benefits of the customers, but CLP used a very low interest rate to calculate the return.

36. MD/HEC said that between 2009 and the present, inflation was 13% but HEC had only increased Basic Tariff by 0.2 cents per unit. The company had in fact experienced heavy fuel cost escalation pressure due to the doubling consumption of natural gas from 2010 in order to reduce emission and with the price of gas under the new contract being four times that of the old contract. Meanwhile, the balance of HEC's TSF was about to be exhausted. HEC had already taken serious cost control measures to minimize the level of tariff increase.

37. Mr TANG Ka-piu expressed concern about the magnitude of accumulated increase in CLP's net tariff in 2018 calculated from 2013, which amounted to 39.3%. He asked if the Administration considered the estimate plausible.

38. SEN pointed out that the switch of natural gas source and the projected increase in natural gas consumption in electricity generation to meet new emission requirement starting from 2015 were the two main factors affecting CLP's future tariff movement. However, the Administration noted that CLP

would increase the Energy Saving Rebates for low-consumption domestic and small business customers, so that about one-third of residential customers and 43% of small business customers would not see an increase in 2014 tariff and might even enjoy savings in their electricity bills.

39. Mr TANG Ka-piu asked if the Administration would introduce more stringent energy saving indicators and progressive electricity tariff rates to encourage energy saving by the power companies as well as their customers.

40. SEN said that the Administration had been working closely with the power companies to introduce measures to reduce the pressure on tariff increase. The reduction in the power companies' reserve capacity would also help mitigate tariff increase.

HEC's capital expenditure and permitted return

41. Mr WONG Kwok-hing quoted a media report which revealed that HEC originally planned to build six gas-fired units on a piece of land in Lamma Island. However, only one unit was eventually built and most of the site was left vacant. Mr WONG said that HEC was unfair to its customers by counting the land cost towards its asset base for calculating the permitted return.

42. Dr Fernando CHEUNG queried why the Administration should approve HEC to build a new gas-fired unit when it had a large amount of reserve capacity. Dr CHEUNG asked the justification for HEC to incur $13 billion in capital expenditure when it did not forecast an increase in demand for electricity in the coming five years. Mr SIN Chung-kai made a similar view.

43. SEN said that some of HEC's generating units were scheduled to be retired in the coming years. A new gas-fired unit was necessary for HEC to maintain the reliability of power supply.

44. MD/HEC supplemented that in 2017 one coal-fired unit would retire while another one equipped with flue gas desulphurization facility would have its life extended. In 2018 another coal-fired unit would retire. The reserve margin would drop to 24%. That would not be too satisfactory. Furthermore one of the only two gas-fired units would also retire in 2020. If a new gas-fired unit could not be timely commissioned, HEC's gas generation would drop to 15%. The company would not be able to meet the emission requirements.

45. Dr Fernando CHEUNG commented that if it was the intention of the Administration to open up the power grids after 2018, there would be no need for a new gas-fired unit as the power grids of HEC and CLP would be interconnected.

46. Ms Cyd HO queried whether the current projection of HEC's tariff had factored in the capital expenditure for the construction of the proposed "L10" gas-fired unit. Ms HO noted that HEC would extend the service life of an existing coal-fired unit installed with flue gas desulphurization facility. She expressed concern that the life extension of the power plant would incur capital expenditure on its own, and would put pressure on tariff later on.

47. DSEN explained that the actual commencement of the proposed "L10" project and the inclusion of this estimated capital expenditure into HEC's 2014-2018 Development Plan would be subject to a written confirmation from the Government following the review on the fuel mix for electricity generation in Hong Kong, and the review on the future regulatory framework for the electricity market after the expiry of the current SCAs.

48. MD/HEC confirmed that the current tariff projection had already factored in the capital expenditure of the "L10" project.

49. Mr Kenneth LEUNG asked if HEC had undertaken any cost control measures to reduce overhead. MD/HEC said that HEC had exhausted all possible means to control costs in the past five years. Given the gradual exhaustion of TSF and that there was no more room for HEC to introduce any further efficiency enhancement measures to cut cost, the company had to increase Basic Tariff to meet rising operating costs.

Maintaining stable and reliable electricity supply

50. Mr Jeffrey LAM said that many generating units being operated by the two power companies were aged and needed major refurbishment or upgrade. He asked if these aged facilities would still maintain the required level of reliability and efficiency. Mr LAM further enquired whether the two power companies had backup facilities to maintain a stable supply of electricity if these aged facilities broke down. He also asked how the Administration would ensure stable and reliable supply of electricity.

51. MD/HEC said that two HEC coal-fired units would have retired by 2018. In 2020, a gas-fired unit would also retire. When these units were all decommissioned, the reserve capacity of HEC would drop to around 11% of the historical maximum demand. It was therefore necessary for HEC to commission a new gas-fired unit by 2020 to maintain the electricity supply reliability. If all the units were to be replaced with new units according to their service lives, there would be much greater pressure on tariff increase. To minimize the increase of electricity tariff, HEC would extend the service life of an existing coal-fired unit (L2) which was already equipped with flue gas desulphurization facility.

52. DSEN said that the Administration had engaged an independent consultant to assess the power companies' electricity generation capability and the need for building new facilities. The Administration considered that the electricity supply of the two power companies reliable.

Fuel Clause Charge

53. Mr Ronny TONG expressed concern about the rapid increase in the projected FCC in CLP's Development Plan (from 22.4 cents/kWh in 2013 to 56.4 cents/kWh in 2018) as compared with HEC (from 33.1 cents/kWh in 2014 to 34.9 cents/kWh in 2018). He queried whether the Administration would adopt any measure to curb the sharp increase. Mr TONG also commented that the power companies had previously over-estimated the fuel cost which resulted in over-charging customers on electricity tariff. He queried whether the power companies' projections in the Five-year Development Plans were realistic.

54. DSEN said that the two power companies' projections of fuel prices were in fact quite close to each other. The independent consultant engaged by the Administration had advised that the power companies' projections were reasonable. DSEN further explained that the overall projected level of CLP's FCC was higher than that of HEC's because CLP's current natural gas supply source was about to deplete and the price of natural gas from the new supplier, which was in line with prevailing market situations, was significantly higher.

55. Secondly, DSEN added that with the implementation of new air pollutants emission requirements in 2015, CLP would need to use more natural gas for electricity generation, and, together with the higher natural gas price, the rate of FCC would likely increase. DSEN considered that the projected FCCs of both power companies were, on the whole, reasonable based on best available information.

56. Dr Elizabeth QUAT commented that CLP's projection of a $1.5 billion deficit in FCA was not credible. The company had predicted a deficit in FCA in 2012, but it turned out that a $1.2 billion surplus in the FCA balance was achieved. She said that the surplus or at least the interests should be returned to customers.

57. As regards rebating the FCA surplus to CLP customers, MD/CLP explained that FCA was operated on the basis of the actual fuel expenses. FCA would be credited when the actual fuel cost was lower than the estimated fuel cost. The balance in FCA would be used to stabilize the FCC fluctuation. CLP would not benefit from any FCA surplus. MD/CLP also added that interest accrued by the surplus in FCA was calculated based on the prime rate (currently at around 5%).

Fuel mix review and the use of nuclear power

58. Mr CHUNG Kwok-pan asked if the Administration or CLP would consider increasing the proportion of nuclear power in the fuel mix either by increasing importation of electricity from Daya Bay Nuclear Plant or other nuclear plants being constructed in Guangdong Province.

59. SEN said that the option of using a higher proportion of nuclear power in the fuel mix for electricity generation and the relevant cost implications would be considered in the review of fuel mix.

60. MD/CLP responded that the company was negotiating with the Daya Bay Nuclear Plant for short term additional import of a small amount of nuclear power. There was no need for extra facilities as the infrastructure for importing electricity from Daya Bay was already in place, and there was no increase in risk to nuclear safety. MD/CLP considered this a feasible option.

61. In response to Mr Dennis KWOK, SEN said that the Administration would shortly conduct public consultation on the review of fuel mix for electricity generation. He added that apart from environmental issues, the public consultation would also cover the cost implications of various fuel mix options.

Using cheaper sources of natural gas by CLP

62. Dr Elizabeth QUAT commented that the Administration should take steps to press CLP to minimize or even freeze tariff increase when there was substantial surplus. She asked why CLP did not source cheaper natural gas from other suppliers such as the China National Offshore Oil Corporation ("CNOOC").

63. MD/CLP said that the existing natural gas contract was signed about 20 years ago when the price was comparatively low. As the natural gas supply from Yacheng was about to deplete, a new supply source had to be commissioned. The natural gas price charged by the new supplier, which was in line with the prevailing market rates, would not be as low as the current supplier. Furthermore, MD/CLP said that CLP's future consumption of natural gas would be substantially higher than the current requirement in order to meet the new emission requirements starting from 2015. These two factors explained the relatively high fuel cost in the coming years. MD/CLP added that in 2012 a five-year contract was signed with CNOOC for short term supply of natural gas from another gas field near Yacheng up to 2017. However, the price of this short term supply would still not be as low as the original Yacheng gas contract price.

64. Ms Cyd HO commented that the cost of using liquefied natural gas ("LNG") was lower than natural gas from the Second West-East Natural Gas Pipeline. She queried whether CLP could mix LNG with natural gas for electricity generation.

65. Mr LEE Cheuk-yan expressed concern about CLP's rapid increase in electricity tariff in the coming five years. While noting that the increase was attributed to the increasing proportion of natural gas used for electricity generation and the projected high cost of the fuel, Mr LEE asked if CLP could use other cheaper alternatives such as LNG or whether it was bound to purchase from Mainland sources under the memorandum of understanding between the Government and the Mainland. Mr LEE also queried the need for CLP to incur more than $30 billion in capital expenditure in the next five years, and to increase tariff in order to maintain a balance in TSF.

66. MD/CLP replied that TSF balance had now fallen to a historic low of $8 million and could not perform its price stabilizing function. He reiterated that CLP had adopted measures to reduce the extent of tariff increase by optimizing the natural gas supply from Yacheng, using more low sulphur coal, improving efficiency of electricity generation facilities and negotiating with Daya Bay Nuclear Power Plant for additional supply of a small amount of nuclear power.

67. Mr Kenneth LEUNG asked if CLP had assessed whether it could source other natural gas supply from the open market, and hedge on fuel cost in order to reduce FCC. MD/CLP said that CLP would purchase natural gas from three sources in accordance with the memorandum of understanding signed between the Government and the Mainland authorities. Only the Second West-East Natural Gas Pipeline would be ready to supply natural gas in time to enable CLP to meet the new emission targets in 2015. The natural gas price from the Second West-East Natural Gas Pipeline was in line with international market price. MD/CLP added that other measures would be implemented including seeking short and long term contract for supply of low sulphur coal at competitive prices. As regards fuel price hedging, MD/CLP said that the option was too risky financially for CLP customers and the public.

New air quality objectives

68. Mr Dennis KWOK noted that the Administration would introduce new air quality objectives, and, with the increasing use of natural gas for electricity generation, Mr KWOK asked when the Administration would expect the new objectives be met. SEN responded that the Administration expected that the objectives could be met by 2020.

Government subsidy to power companies to stabilize tariff

69. Mr WU Chi-wai commented that HEC's increase of Basic Tariff was rather high. He noted that HEC had assumed that FCC would remain relatively low in the coming five years, which could cancel out the effects of rising Basic Tariff, and allow the net tariff to remain stable. Mr WU expressed concern that if HEC under-estimated FCC, the net tariff would still increase as HEC could not rely on TSF to stabilize the tariff fluctuation.

70. MD/HEC responded that the projected FCC was estimated by the company's consultants based on available market information and the forecast fuel demand. It was found that the forecast fluctuations of FCC and Basic Tariff would cancel out each other, and HEC was therefore able to keep the net tariff unchanged in the coming five years.

71. Mr WU Chi-wai asked if HEC would explore with CLP to interconnect their power grids to lower its required reserve capacity. MD/HEC said that the company had worked out arrangements with CLP for many years to reduce the reserve capacities of both systems since the two systems were first interconnected back in the early 1980s. While the sharing of reserve capacity benefits of the existing interconnection had been fully realized, he did not see any further cost saving through further interconnection of the two power grids.

72. Mr WU Chi-wai also noted that CLP expected the fuel cost to increase significantly in the next five years, due to the increasing use of natural gas in electricity generation, and the higher cost of natural gas from the new supplier. Mr WU asked if the Administration would subsidize the operation of the power companies if they had exhausted all reasonable means of cost control, so as to keep the tariff rates low.

73. SEN advised that even if the Administration were to intervene to reduce the impact of tariff fluctuation on the public, the measures to be implemented should be focused and targeted at helping the vulnerable community rather than being applied across the board. In fact, with measures such as the Energy Saving Rebate, which was first introduced in 2013, 33% of CLP's residential customers and 43% of its small business customers would not have their tariff increased in 2014.

Other issues

74. Mr CHAN Kam-lam expressed concerns about how the Administration would conduct the review of SCAs. He said that the Administration would put itself in a disadvantaged position when it approved the power companies' capital expenditure at this stage. Mr CHAN explained that it would be difficult for the

Administration to stop the power companies from demanding higher electricity tariff to compensate for their capital investment, and the only term that the Administration could manoeuvre was the permitted rate of return.

75. Mr CHAN Kam-lam expected that the rate of increase of net tariff after 2018 would be even higher, and he asked how the Administration would reduce the power companies' capital investment such as by extending the service life of their power plants. SEN said that the Administration had worked closely with the power companies to minimize the capital expenditure in the Five-year Development Plans.

76. The Chairman announced that the meeting would be extended by 15 minutes.

77. Dr LO Wai-kwok noted that the Administration had set a target of reducing carbon intensity by 50% to 60% by 2020 as compared with 2005. He also said that the Administration had agreed with the Guangdong authorities in November 2012 on air pollutants emission reduction targets up to 2020. Dr LO asked whether the targets were still valid as they would have bearing on the review on fuel mix for electricity generation. SEN agreed that emission standards and fuel mix were closely related and the issues would be further discussed in the coming review.

78. SEN added that Hong Kong SAR Government had reached agreement with the Guangdong authorities on attaining certain targets of air pollutants emission by 2020, and that an interim review would be conducted in 2015. Emission from power plants formed a major part of the efforts in reducing overall emissions, and the Government had imposed new statutory emission requirements for power plants.

79. Noting that the fuel mix, types of generating units used and the customer base of HEC and CLP were very different, Dr LO Wai-kwok asked how the Administration would require the two power companies to share the burden of reducing emission. He also asked whether the natural gas supply of Yacheng could be further extended.

80. Chief Executive Officer - CLP Holdings responded that CLP had been taking gas from the Yacheng field since 1996. The field was originally intended to last for 20 years and under the projection, it would last only up to 2015. CLP had, since 2001, been exploring new natural gas supply sources which included the supply from the Second West-East Natural Gas Pipeline, and the supply from a new LNG facility to be developed in Shenzhen.

81. Dr LAM Tai-fai said that in CLP's presentation of its 2014-2018 Development Plan, it was mentioned that the average increase in Basic Tariff per year in the coming five years would be 1.8%. He emphasized that the figure quoted represented the average annual increase of Basic Tariff only, as the increase in net tariff would be much higher. He said that the Administration or CLP should make this clear publicly as he noted that some media had already mistakenly reported that CLP's net tariff would be increased by 1.8% per year in the next five years.

V Any other business

82. There being no other business, the meeting ended at 6:35 pm.

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