

Letterhead of The Conservancy Association

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7 June, 2000

Honourable Members of the Legislative Council

Dear Honourable Members of the Legislative Council,

Position Paper on Power Interconnection

In view of a discussion on the power interconnection issue of the Economic Services Panel of Legco on the coming Friday, the Association would like to express our concern and comment on the subject.

The Conservancy Association finds that the power interconnection is absolutely a cost-effective and environmentally-friendly solution to the problem of excess capacity. As the consultation report suggests, billions of dollars can be saved if power interconnection is pursued. Also reclamation is no longer necessary. Efficient use of energy also means a step towards the sustainable development of Hong Kong.

Enclosed please find our position paper on power interconnection for your reference and we sincerely ask for your concern over the power interconnection.

Thank you for your kind attention.

Yours sincerely,

Lister Cheung
General Secretary

Putting Sustainable Energy in Practice
Position Paper by the Conservancy Association on Interconnection and
Competition in Electricity Supply
January 2000

The Conservancy Association has examined the consultancy report commissioned by the government on "Interconnection and Competition in the Hong Kong Electricity Supply Sector" and would like to state the Association's position as follows.

The problem of excess capacity at Blackpoint power station is well known. The Association observes that a solution to this problem has emerged in the consultancy study which, if implemented, would not only be more environmentally friendly, but also more cost effective than the current regime. In short, a more sustainable energy policy is within reach for Hong Kong. What is needed is for government to turn that into reality by effecting interconnection between China Light and Power (CLP) and Hong Kong Electric Company (HEC).

The solution would comprise four components, namely:

- (i) upgrading the interconnection between the CLP and HEC grids via the addition of a 275kV large capacity interconnector by 2004;
- (ii) the installation by CLP of Blackpoint units 7 and 8 in 2006 and 2007 using funds from HEC;
- (iii) deferring the expansion of the HEC Lamma Power Station indefinitely; and
- (iv) transferring from CLP to HEC the entitlement of permitted return under the Scheme of Control Agreements (SCA) arising from the new assets of Blackpoint units 7 and 8.

According to the consultancy report, implementing the first three components in the above solution (labelled as Scenario B in the report) is "the most economic alternative as well as the most sound option from a technical point of view". Such alternative is estimated to save consumers between \$1.2 billion to \$1.6 billion for the period up to 2008 compared to the alternative of maintaining the status quo.

Such substantial savings can be achieved if government is willing to reform the antiquated system under which the electricity supply industry is currently regulated - the two Scheme of Control Agreements (SCAs) signed between the Government and CLP and HEC in 1992 and 1993 respectively.

When the two SCAs were drafted earlier this decade, a line was apparently drawn across the Victoria Harbour to split Hong Kong into two, as if the SAR were two distinct territories unrelated to each other. This has gone against all rational

planning in energy, especially set against a territory as small as Hong Kong, with an area not much larger than 1,000 square kilometers.

Power supply is an industry that benefits hugely from economies of scale. A large grid is simply better than a small grid. Compared to a split one, a large grid covering the entire SAR will require smaller overall reserve capacity and yet generate greater system stability. It will not only lower operational costs and enhance operational performance, but also make possible more efficient planning and investment - such as more flexibility in selecting economical and environmentally friendly sites for power plants, and greater choice of optimal transmission routes.

The above factors, or rather the lack of them, have given the government an opportunity now to achieve substantial savings by changing the status quo and pursuing the alternative solution of interconnection between CLP and HEC, thus allowing Hong Kong to enjoy the benefits of a larger grid.

We appreciate that the two utilities cannot be forced to act and the government has a duty to honour a signed contract. This however does not mean that the interconnection solution is impossible. It only requires that any agreement to implement interconnection has to be a voluntary three party deal - CLP, HEC and the Government. This is not impossible - indeed, a fine example has been set in the telecommunications industry when government successfully negotiated an end to the monopoly agreement with Hong Kong Telecom over international telephone calls.

The Association calls on the government to stand firmly on the side of consumer interests rather than narrow corporate interests. We believe the public, business and green groups alike will back the government in negotiating for a deal of this nature. A competitive economy requires a competitive infrastructure. Not only will a more efficient power sector help achieve this, it will, as an immediate bonus, also incur less environmental damage to the Lamma Island.

To make this voluntary deal possible, government should begin by addressing the legitimate commercial interests of CLP and HEC. In our view, the commercial interests of the two corporations can be addressed by the fourth component in the alternative solution mentioned above - transferring from CLP to HEC the entitlement of permitted return arising from the new assets of Blackpoint units 7 and 8.

As the government consultants pointed out in their study, the interconnection option would produce the most overall savings for consumers. This will be in the form of the biggest reductions in revenue for the two utilities. Evidently, these revenue reductions would not be evenly distributed between HEC and CLP. If the

present SCAs remain unchanged, in the period up to 2008 HEC would experience a decrease in revenue of approximately \$2,000 million relative to the status quo whereas CLP would experience an increase in revenue of over \$700 million on a present value basis. It is no surprise that HEC has been much less enthusiastic about interconnection than CLP. To address this imbalance Government has to take a lead. There are many possibilities for doing so. Transferring from CLP to HEC the entitlement of permitted return arising from the installation of Blackpoint units 7 and 8 is one of the more logical options. After all HEC would have forfeited the chance to build the Lamma expansion in the interconnection option and CLP would have to delay the installation of the Blackpoint units further should there be no interconnection.

We would urge therefore that a voluntary agreement be reached among all parties. And we would reinforce the point that the government should take the lead to persuade the utilities not to unduly profit from an irrational demarcation of supply territories specified in the SCAs, but to come to an agreement that benefits Hong Kong as a whole.

In the wider context, a competition policy for the power sector will have to be established beyond the expiry of the SCAs in 2008. The consultants have concluded that an interconnected Hong Kong-South China grid would be the way to go. To allow an irrational and uneconomic regulatory regime to function would be against the interest of Hong Kong.

In accordance with the analysis by the government consultants, should the interconnection option between the HEC and CLP grids be implemented by 2004 and a competition policy that allows for full interconnection with Guangdong be adopted after 2008, the extension of the Lamma Power Station may never be needed.

We do not underestimate the difficulty in negotiating a voluntary deal. The window of opportunity is narrow - if agreement cannot be reached in about six months time, there might be little option but to approve HEC's expansion in Lamma so as to secure Hong Kong Island's power supply in the 2004 summer peak. But Hong Kong is a can-do city. We would once again, therefore, call on the three parties - the government, CLP and HEC - to act responsibly, to put Hong Kong's interest first and to work out a solution urgently.