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Legislative Council

LC Paper No. CB(1)831/05-06
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Panel on Economic Services

Minutes of meeting held on
Friday, 23 December 2005, at 4:30 pm
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 Dr Hon LUI Ming-wah, SBS, JP Hon CHAN Kam-lam, SBS, JP Hon SIN Chung-kai, JP Hon Howard YOUNG, SBS, JP Hon LAU Chin-shek, JP Hon Miriam LAU Kin-yee, GBS, JP Hon Abraham SHEK Lai-him, JP Hon Andrew LEUNG Kwan-yuen, SBS, JP Hon WONG Ting-kwong, BBS Hon Ronny TONG Ka-wah, SC Hon Albert Jinghan CHENG Hon KWONG Chi-kin
Members attending	:	Hon WONG Kwok-hing, MH Hon LEE Wing-tat
Members absent	:	Dr Hon David LI Kwok-po, GBS, JP Hon Vincent FANG Kang, JP Hon CHIM Pui-chung Hon TAM Heung-man

Public Officers attending	:	**<u>Agenda item IV</u>** Mr Stephen IP Secretary for Economic Development and Labour Ms Sandra LEE Permanent Secretary for Economic Development and Labour (Economic Development) Mr Howard LEE Deputy Secretary for Economic Development and Labour (Economic Development) Ms Brenda CHENG Principal Assistant Secretary for Economic Development and Labour (Economic Development)
Attendance by invitation	:	**<u>Agenda item IV</u>** <u>The Hongkong Electric Co., Ltd.</u> Mr K S TSO Group Managing Director Mr A J HUNTER Group Finance Director Mr C T WAN Director & General Manager (Corporate Development) Mr Steve NG Deputy Chief Accountant <u>CLP Power</u> Mrs Betty YUEN Managing Director Mr S H CHAN Planning Director Ms Jane LAU Director – Group Public Affairs

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)409/05-06 - Minutes of meeting held on 20 October 2005
LC Paper No. CB(1)564/05-06 - Minutes of meeting held on 29 November 2005)

The minutes of the meetings held on 20 October and 29 November 2005 were confirmed.

II Information papers issued since last meeting

(LC Paper No. CB(1)449/05-06(01) - Tables and graphs showing the import and retail prices of major oil products from November 2003 to October 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 23 January 2006

(LC Paper No. CB(1)576/05-06(01) - List of outstanding items for discussion
LC Paper No. CB(1)576/05-06(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 23 January 2006:

(a) An electricity item; and

(b) Purchase of Equity in the Digital Trade and Transportation Network Limited

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IV Annual tariff reviews with the two power companies

Presentation by Hongkong Electric Co. Ltd. (HEC)

4. Mr K S TSO, Group Managing Director of HEC highlighted that in 2005, shareholders of HEC had funded a special rebate of 7.1 cents per unit of electricity to lower the average net tariff and sustain the ongoing economic recovery process in Hong Kong. The local economy had since recovered significantly, and with Hong Kong's Gross Domestic Product (GDP) growth expected to be over 7% for 2005, HEC's shareholders could not be expected to maintain the same level of contributions in 2006. In addition, HEC would be introducing the use of natural gas in 2006. It was environmentally friendly but expensive. As such, HEC would need to adjust its Fuel Clause Surcharge upward from 2.2 cents to 4.9 cents per unit. Moreover, in accordance with the Scheme of Control Agreement (SCA), HEC was entitled to increase its average basic tariff to reflect its revenue on investment. Based on the three factors above, HEC would have to increase its average net tariff by a percentage remarkably higher than the present proposal. However, to moderate the tariff increase and to alleviate the pressure of tariff on consumers, HEC's management had decided to freeze the basic tariff and to continue to offer a special rebate of 1.9 cents per unit in the coming year. The two initiatives had enabled HEC to limit its increase on the average net tariff to only 7.2% with effect from 1 January 2006. In so doing, HEC's shareholders would forego more than $700 million in 2006, which would be the fourth consecutive year that HEC's shareholders would not be able to achieve the permitted level of return and the total amount foregone by shareholders from 2003 to 2005 was already more than $2 billion. Mr TSO stressed that HEC had taken every effort to limit the increase to the minimum and the present level of adjustment had balanced the interests of shareholders and customers appropriately.

5. With the aid of PowerPoint, Mr C T WAN, Director & General Manager (Corporate Development) of HEC introduced HEC's proposed adjustments to the individual tariff components for 2006 as follows:

Tariff components (cents/kWh)	Current	Effective 1 January 2006
Average Basic Tariff	114.9	114.9
Fuel Clause Surcharge	2.2	4.9
Average Special Rebate	(7.1)	(1.9)
Rate Reduction Rebate	-	-
Average Net Tariff	110.0	117.9

He also remarked that:

(a) HEC would freeze the basic tariff increase as justified under SCA due to increase in depreciation after the commissioning of gas-fired Unit L9 and investment in transmission and distribution facilities to maintain reliability;

(b) HEC would start using environmentally-friendly but more expensive natural gas and reduce fuel clause account debit balance. As a result, there was a need to increase the fuel clause surcharge by 2.7 cents per unit;

(c) As special rebate was a non-recurring measure to help recovery of the economy, HEC would reduce the special rebate by 5.2 cents per unit, taken into account the projected growth in GDP. However, shareholders would continue to provide on average 1.9 cents special rebate to customers;

(d) Shareholders had foregone a total of more than $2 billion between 2003 and 2005 and would forego more than $700 million in 2006 to alleviate the pressure of tariff on customers, and hence, HEC could not earn the entitled return as permitted under the SCA for fourth consecutive years.

(e) For 70% of domestic customers using less than 500 units per month, the increase would be less than $29.5 per month and for 70% of non-domestic customers using less than 1 700 units per month, the increase would be less than $146.2 per month.

(f) HEC would continue to offer concessionary tariff scheme for eligible customers.

Presentation by CLP Power (CLP)

6. Mrs Betty YUEN, Managing Director of CLP remarked that CLP would continue to freeze its tariff in 2006 and keep the tariffs at 1998 levels. She said that high volatility and soaring fuel prices over the past three years had put enormous pressure on electricity companies worldwide, including CLP. As such, CLP had to increase its Fuel Clause charge slightly by 1.8 cents per unit, which would be offset by a 2006 Special Rebate to be funded by the Development Fund (DF). This had enabled CLP to keep its tariff at the present level in 2006.

7. With the aid of PowerPoint, Mr S H CHAN, Planning Director of CLP highlighted that stable tariff and reliable electricity supply were important to Hong Kong's social and economic growth. All along, CLP had been providing Hong Kong with reliable, efficient and environmentally-friendly power service at a reasonable cost. With no indigenous fuel supply, Hong Kong depended entirely on imports to meet its energy needs and 65% of which were used to generate power. He also indicated that

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the rising worldwide demand for fuels, particularly in the Mainland, was creating a market environment that placed challenges on power companies for securing a stable fuel supply and managing costs effectively. Nevertheless, CLP had managed to freeze its tariffs since 1998 despite the challenging business environment posed by global fuel price rises. The proposed adjustments to the individual tariff components for 2006 would be as follows:

Tariff components (cents/kWh)	Current	Effective 1 January 2006
Average Basic Tariff	88.1	88.1
Fuel Clause	0.2	2.0
SCA Rebate	(1.1)	(1.1)
2006 Special Rebate	-	(1.8)
Average Net Tariff	87.2	87.2

Mr CHAN drew members' attention that CLP's tariff compared favourably to major metropolitan cities and was among the lowest compared to those in de-regulated markets. He stressed that prudent financial management, fuel diversification strategy and continued productivity improvement had enabled CLP to overcome cost challenges and freeze its tariffs for eight consecutive years. CLP would continue to act responsibly to maintain tariffs at a reasonable level.

(*Post-meeting note:* The presentation materials provided by HEC and CLP were issued to members on 28 December 2005 vide LC Paper No CB(1)612/05-06.)

Discussion with Members

HEC's tariff adjustment

8. Mr WONG Kwok-hing expressed strong discontent against the tariff increase proposed by HEC. He pointed out that including the present adjustment, HEC had increased its tariffs with an accumulated rate of 24.8% since 2000. He was gravely concerned that HEC had raised its tariff in past years when Hong Kong suffered from economic recession and deflation as well as at a time when Hong Kong started to pick up its economy. HEC now even proposed to increase its tariff by 7.2% which was higher than the expected GDP growth of about 7%. He considered that compared with CLP, HEC was not conscientious at all. Mr WONG also rebutted HEC's misleading comment that its shareholders had contributed $2 billion to freeze the tariffs. He pointed out that the amount referred to was in fact the maximum level of profits to be reaped in accordance with the permitted rate of return provided under the SCA. Noting that HEC would increase its Fuel Clause Surcharge as a result of using natural gas, Mr WONG considered that improving air quality was the social obligation

of a responsible corporate and it was unreasonable for HEC to pass on the necessary expenses to its customers. Mr WONG enquired about measures, such as introducing more competition, to be taken by the Administration to prevent HEC in taking advantages of the consuming public by increasing its tariffs unreasonably.

9. Echoing Mr WONG's view, Mr LAU Chin-shek was gravely concerned that irrespective of whether Hong Kong was under inflation or deflation, HEC would raise its tariffs. He understood that for 2006, most of the employees would not enjoy a salary increase while some might have only a 2% adjustment which was far below HEC's 7.2% tariff increase. He was also worried about the possible knock-on effects caused by the present increase on the prices of other consumer products or services.

10. Mr K S TSO stressed that HEC was bound by the SCA and it was incumbent upon the management of HEC to pursue its right under the SCA. Indeed, HEC's shareholders had foregone its permitted profits of over $2 billion between 2003 and 2005 through various rebates and other measures to contain tariff increases. As the local economy had recovered significantly, HEC could not expect its shareholders to maintain the same level of contributions for the coming year despite they would forego some $700 million for 2006 under the present proposal.

11. Secretary for Economic Development and Labour (SEDL) fully understood that Members and the general public did not welcome a tariff increase. He explained that during the annual tariff review with the two power companies, the Administration had made its best effort to keep the tariff levels as low as possible having regard to the relevant provisions in the SCAs.

12. Noting that HEC's average net tariff per unit was 34% higher than that of CLP after the adjustments, Mr SIN Chung-kai was concerned whether this was due to HEC's structural problem and operational inefficiency since both power companies were operated with a similar cost structure. In this connection, Mr LEE Wing-tat was concerned why HEC's customers had to pay higher tariff when there was no difference on the quality of services provided by the two power companies.

13. Mr A J HUNTER, Group Finance Director of HEC remarked that the difference in tariffs between HEC and CLP was caused by three factors. First, CLP had a higher load factor than HEC due to different customer mix. About 75% of HEC's customers came from the commercial sector which consumed electricity normally from 8:30 am to 6:30 pm. Unlike CLP which had a larger mix of industrial customers such as the Hong Kong International Airport and the container terminals which operated and used electricity round-the-clock, there was no apparent industry on Hong Kong Island. In the absence of a 24-hour style industrial operation, HEC sold less electricity for the same installed capacity. Secondly, CLP provided services to some 80% of Hong Kong's electricity consumers and hence, was able to enjoy a higher degree of economy of scale. CLP sold almost three times more electricity than HEC. Thirdly, HEC's generation facilities were located on an outlying island with additional capital and operating costs. Unlike the transmission network of CLP which mainly comprised overhead lines, the transmission network of HEC had to rely

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on submarine cables and underground cables which were relatively more costly to be set up and maintained. The above structural differences had resulted in a tariff difference between HEC and CLP. In reply to Mr SIN's further enquiry on the feasibility of introducing rates differentiated by the Time of Use (TOU) to encourage consumers to use electricity during off-peak periods, Mr C T WAN advised that HEC did not have different rates for electricity consumptions during on-peak or off-peak periods as most of its commercial customers did not operate during off-peak hours.

14. Referring to HEC's high asset investment for the period from 2004 to 2008 which was about $12 billion, Mr LEE Wing-tat was worried that HEC would continue to raise its tariff for 2007 and 2008. He understood that the permitted rate of return provided under the current SCAs was not a guarantee return and it was not necessary for HEC's shareholders to attain the maximum level pitched at 13.5% on average net fixed assets (ANFA). Mr LEE urged the Administration to ensure that HEC would not achieve a maximum rate of return for the next two years.

15. The Permanent Secretary for Economic Development and Labour (Economic Development) (PS/ED) said that in the past few years, the Administration had continued to exercise tight control over HEC's investment as well as operational and maintenance expenses with a view to moderating its tariff increase. Deferral of HEC's gas-fired Unit L9 twice and the exclusion of L10 from the current Financial Plan were the results of such efforts. The Administration had also examined maintenance proposals carefully to ensure that they were necessary for a reliable electricity supply.

16. Notwithstanding that the Government must abide by the terms of the current SCAs, SEDL remarked that the Administration had taken every effort to keep the tariff increase to the minimum. As a result, the tariff increase currently proposed by HEC was significantly lower than their original proposal.

17. Despite HEC's sales of electricity was only one-third of that of CLP, Mr LEE Wing-tat remarked that HEC had made a profit of $6.3 billion in 2004, which was equivalent to 70% of CLP's respective profit of $8.6 billion. On HEC's profits in 2004, Mr K S TSO clarified that out of the $6.3 billion, only $5.4 billion was related to electricity business in Hong Kong. Noting the reply, Mr LEE Wing-tat further commented that HEC's profit was still equivalent to 60% of CLP's and sought the Administration's explanation on why under the same profit control regime, HEC could yield a higher level of profit by selling just one-third electricity of CLP's sales volume

18. The Deputy Secretary for Economic Development and Labour (Economic Development) (DS/ED) explained that the permitted return under the SCAs was calculated on the basis on asset investment but not the volume of electricity sales. As pointed out by Mr HUNTER earlier on, the infrastructural investment required for HEC was much higher due to the geographical constraint of Hong Kong Island. The level of permitted return for HEC was therefore proportionally higher.

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19. Noting that in response to high fuel prices, HEC and CLP proposed to increase fuel clause surcharges by 2.7 cents and 1.8 cents respectively, Mr Fred LI requested HEC to account for the difference between the two power companies.

20. In response, Mr A J HUNTER explained that HEC's fuel clause surcharge was not the total cost of fuel that it had incurred. He said that a standard cost of fuel was included under HEC's basic tariff. When the actual cost of fuel was above the standard cost for a particular year, there would be a fuel clause surcharge. Otherwise, HEC would offer a fuel clause rebate for its customers. This explained why there was a difference on the fuel clause charges between the two power companies. Mr HUNTER further advised that the fuel clause surcharge of 4.9 cents per unit for 2006 was a relatively precise figure as this was a reflection of the actual contract price concluded by HEC for 2006.

21. Ir Dr Raymond HO enquired whether there would be any changes to HEC's tariff after the commissioning of the gas-fired Unit L9. In reply, Mr K S TSO confirmed that there would not be any significant impact on HEC's tariff as a result of commissioning L9 because its capacity was only about 300 MW vis-à-vis HEC's total generation capacity of 3 425 MW.

22. In reply to Mr Jeffrey LAM's request for offering tariff concessions to shop owners in Causeway Bay and Wanchai areas for the period when the Sixth Ministerial Conference was held in Hong Kong, Mr K S TSO said that while HEC could consider his suggestion but the cost so incurred to HEC might have to be borne by other customers.

23. Mr WONG Kwok-hing was very dissatisfied about HEC's response to his questions earlier on and said that he had to strongly reprimand HEC for being heartless to increase its tariff while the company had already been earning huge profits. He queried whether the Government could safeguard public interests by lowering the permitted rate of return before the expiry of the current SCAs.

24. In response, SEDL explained that the major reason for the present adjustment was due to the increase in international fuel prices. He assured members that the Administration would continue to examine carefully the data submitted by HEC in the coming years' tariff reviews with a view to alleviating the burden on consumers.

CLP's tariff adjustments

25. Mr CHAN Kam-lam was very concerned that the objective of ensuring "a stable and reliable supply of electricity" had always been used as excuses to justify tariff increases. Indeed, customers had, all along, been required to shoulder the costs of maintaining the excess generating capacity to ensure a stable and reliable electricity supply. He queried about the need for maintaining excess generating capacity and the resultant impacts on customers.

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26. While CLP might have some excess in its reserve generating capacity many years ago, Mrs Betty YUEN said that the situation had improved in recent years following the increases in its sales volumes. She further advised that the present reserve capacity of CLP was below 30%, which was close to the international standard of 25%. Unlike some cities in the United States of America which could keep a lower reserve capacity of 20% due to the availability of strong interconnection support in nearby cities, Hong Kong could not rely on the Mainland for the supply of electricity during emergency. Hence, CLP must keep a higher level of reserve capacity. Mrs YUEN highlighted the analogy between the reserve capacity of an electricity supply system and the spare tyre of a vehicle. Mr CHAN Kam-lam however disagreed and pointed out that the spare tyre of a vehicle would remain in service if it had not yet been used but customers were required to pay for excessive reserve capacity that they could never use.

27. Noting that CLP would provide a rebate for 2006 out of the DF, Mr SIN Chung-kai enquired about the total amount of the rebate so involved. He was also concerned whether CLP's shareholders could still be able to achieve the permitted rate of return in the forthcoming year and if yes, whether CLP's shareholders would provide further contribution for its customers and offer a higher rebate.

28. Despite CLP had frozen its tariffs since 1998, Mr LAU Chin-shek was concerned that the balance of the DF of CLP still stood at $3 billion high. He urged CLP to consider offering further rebates from its DF. He also sought information on the rate of return that CLP's shareholders could earn under the proposed tariff adjustment for 2006.

29. Mr Fred LI also urged CLP to offer a higher rebate from its $3 billion DF as the Special Rebate of 1.8 cents per unit for 2006 only incurred a cost of $500 to $600 million. He noted that CLP Holdings Limited was considered by the fund industries around the world as one of the best stocks because of its stable yearly return of 13.5% on ANFA.

30. Mrs Betty YUEN recapped that CLP would offer a Special Rebate for 2006 to be funded by the DF to offset an increase in the Fuel Clause charge of 1.8 cents per unit due to high fuel prices. She further advised that the actual amount to be made would depend on CLP's sales volume of electricity which was predicted to be increased by 2% to 3% in 2006. Under such forecast, some $500 to $600 million from the DF would be used. On shareholders' contribution, Mrs YUEN highlighted that under the SCA, CLP shareholders were required to pay their customers an interest of 8% per annum on the average balance of the DF. The amount would be deducted from the permitted return they could earn for a particular year. For 2004, the net return for CLP's shareholders was in the region of 13% on ANFA. Mrs YUEN stressed that CLP was committed to achieving quality management to provide reliable and environmentally-friendly services at reasonable costs while balancing the interests of its shareholders and customers. She assured members that CLP's tariff was very competitive and it was even lower than those in the liberalized markets the power companies of which had in fact passed on the increase in fuel prices to their customers.

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In reply to Mr SIN's further enquiry on TOU rates, Mrs YUEN advised that CLP offered off-peak charges to its large non-domestic customers.

CLP's Development Fund

31. Mr Abraham SHEK commended the work of SEDL who had helped uphold the spirit of contract while balancing the interests of customers and shareholders of the power companies. Mr SHEK was concerned why there was a need for CLP to keep its DF at its current high level of $3 billion. He urged CLP of offer higher rebates so that the DF could be properly disposed of before the current SCA expired in 2008.

32. Mrs Betty YUEN pointed out that the DF was intended to stabilize electricity tariff. Accordingly, CLP had exercised prudent management over the past years to ensure that the balance of the DF stood at a consistently stable and healthy level. Indeed, for companies with a large scale of operation like CLP, the balance of $3 billion in the DF could only sustain the cashflow requirement of the company for just about one and a half month. In reply to the Chairman, Mrs YUEN advised that it was not uncommon for the company to transfer out of the DF an amount up to $1 billion to stabilize the level of tariff.

33. Mr Abraham SHEK remained unconvinced. He saw no reason for CLP to make use of customers' monies in the DF to conduct its own business and fund its operational expenditures.

34. Mrs Betty YUEN further explained that $3 billion was a book-keeping balance which enabled CLP to borrow fewer loan from banks. She recapped that CLP shareholders were required to pay their customers an interest of 8% per annum on the balance in the DF. On whether the DF would be exhausted in the next five years, Mrs YUEN predicted that tariffs in coming years would be subject to pressures of various rising costs. Nevertheless, Mrs YUEN assured members that CLP had always acted in the best interest of its customers. The success in prudent cost control and DF management had enabled CLP to stabilize its tariff.

35. Members noted that CLP had used some $500 million from the balance of the DF to rebate its customers for 2004. In response to the Chairman and Mr LAU Chin-shek's enquiries, SEDL and PS/ED advised that while offering a further $500 million rebate on top of its present one might not have immediate adverse impact on CLP, this would reduce the level of DF balance and weaken its ability to moderate tariff increase for 2007 and 2008 should there be significant fluctuation in fuel prices or sales level. The Administration had agreed with the two power companies during the 2003 Interim Review to institute specific discussions regarding the way to deal with any balance in the DF twelve months before the expiry of the current SCA in 2008. Returning all monies in the DF to its customers could be one of the ways to deal with it.

36. Mr LAU Chin-shek did not subscribe to the Administration's explanation. He considered that there would not have much impact on CLP's operation even after it

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had offered a further rebate of $500 million since a new agreement would have to be made by 2008.

37. Mrs Betty YUEN remarked that the DF was set up to serve as a cushion against tariff fluctuations. Indeed, DF was highly vulnerable to sales fluctuations, which might occur as a result of a variety of external factors such as the general economic environment, weather changes, increase in fuel prices and so on. Despite the economy had gainfully recovered, CLP's sales was slower than economic growth. Mrs YUEN said that it was not a good practice for CLP to offer higher rebate for 2006 and then raise its tariff for subsequent years.

38. Mr WONG Ting-kwong appreciated CLP's effort in bringing about a tariff freeze while maintaining a healthy balance of 13.5% in the DF. He encouraged CLP to work harder with a view to lowering its tariff.

39. Mrs Betty YUEN said that CLP had agreed with the Administration to cap the DF balance at 12.5% of the company's annual local sales. PS/ED supplemented that the agreement was made during the 2003 interim review of the SCAs with the two power companies. She said that whether there would be a fund to offset tariff increase would be considered in the context of the review of the post-2008 electricity market.

40. Mr Fred LI shared similar concerns on the DF. He was worried that before 2008, CLP had no incentive for improvement but simply relied on the balance in the DF so as to reach the permitted return. SEDL remarked that the two power companies must work very hard in lowering their operating costs. SEDL assured members that the Administration would ensure that monies in the DF would be properly disposed of.

CLP's electricity sales to the Mainland and environmental protection

41. Ir Dr Raymond HO declared interest that he was the Chairman of Guangdong Daya Bay Nuclear Plant and Lingao Nuclear Plant Safety Consultative Committee. Noting that currently, CLP was selling electricity to the Mainland while deploying nuclear energy from Daya Bay to generate electricity for Hong Kong, Ir Dr HO was concerned whether changes, if any, to these two aspects would affect CLP's financial performance such that it might not be able to continue to offer rebates and/or freeze its tariff in coming years.

42. Mrs Betty YUEN advised that CLP had sold electricity to Guangdong Province using the reserve capacity when there was surplus capacity after satisfying the demand and needs in Hong Kong. She considered that the sales of electricity to Guangdong Province would continue in the near future. She briefed members that there was persistent shortage in electricity supply in Guangdong Province for the past few years. Attempts had been made to transmit electricity from the western provinces but the delivery was subject to weather changes and other difficulties which could unlikely be overcome in the foreseeable future. Moreover, the electricity

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supply system in many parts of the Guangdong Province needed to be revamped, including their transmission networks, tariff setting mechanism, safety and environmental standards etc. As such, Mrs YUEN envisaged that it took a decade or two before the power plants in Guangdong Province could achieve a comparable standard as that in Hong Kong.

43. In reply to Ir Dr Raymond HO's further enquiry about the level of fixed asset investment on liquefied natural gas, Mrs Betty YUEN said that the level of investment was relatively low as the plant only involved a pier plus two to three gas tanks, and might vary accoding to different locations.

44. Mr LAU Chin-shek agreed with Mr WONG Kowk-hing that it was the social responsibility of the power companies to reduce emissions of pollutants in the course of power generation. They should not pass the associated costs onto their customers while reaping a higher return on the relevant capital investment for shareholders.

45. Mrs Betty YUEN considered that one of the biggest challenges of the electricity supply industry was to minimize impacts on the environment during power generation. She introduced CLP's fuel diversification strategy and advised that the fuel mix for CLP's power generation was one-third each for coal, natural gas and nuclear energy. With the adoption of natural gas and nuclear energy which had lower emissions, CLP was able to reduce its emissions by 40% to 75% since 1990s although electricity sales had increased by 65% over the same period.

46. Mr Abraham SHEK was very concerned that CLP's local customers were required to share the costs in reducing emissions for power generated for sales to the Mainland.

47. In response, Mrs Betty YUEN highlighted that CLP had spared no effort in protecting the environment. In fact, CLP was the pioneer company to introduce the cleaner nuclear energy and natural gas as fuels. To continue this area of work in the future, CLP was working on developing a liquefied natural gas receiving station despite there was fierce competition for natural gas in international markets. At its own initiatives, CLP deployed ultra-low sulphur coal in power geneartion. It had engaged in a long-term contract for ultra-low sulphur coal with an Indonesian supplier. On sales of electricity to the Mainland, Mrs YUEN recalled that many Hong Kong businessmen who operated factories in Guangdong Province was hard hit by the frequent interruption of electricity supply to their Mainland operation. Some of them had turned to CLP for assistance. On costs shared by local customers, Mrs YUEN stressed that in supplying electricity to Guangdong Province, the level of coal so deployed only constituted a small part of CLP's total coal consumption. However, 80% of the profit so generated would be transferred to CLP's DF and benefited the local consumers in the end. Mrs YUEN also drew members' attention that in terms of environmental impacts, power generated by CLP would be much cleaner than those generated by Guangdong, and hence contributed to improving the air quality in South China.

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Electricity supply in overseas countries

48. Mr LAU Chin-shek asked about the levels of profit made by overseas power companies which had raised their tariffs. In reply, Mrs YUEN said that tariffs in liberalized markets were relatively less stable than those in regulated markets. Hence, the levels of their profit for different years might fluctuate significantly and they could be above or below CLP's profit levels. Moreover, in some liberalized markets, power companies might only engage in either electricity production or transmission. Thus, a direct comparison between CLP and these power companies might not be appropriate. Mrs YUEN further stressed that the quality of service of a power company could best be reflected by its operational efficiency and not by its profit levels. With no indigenous fuel supply, CLP had to purchase fuels from the international market and the cost of fuel, including importation, was thus much higher. Despite this, CLP was able to maintain a tariff which was the lowest compared to those in overseas countries with indigenous fuel supply such as the United Kingdom or USA. Mrs YUEN highlighted that CLP's continued productivity improvement and operational efficiency had enabled it to overcome challenges of high fuel costs.

49. While agreeing that it was not meaningful to make a direct comparison on the tariff levels between CLP and overseas power companies in selected places which would increase their tariffs in 2006, Mr CHAN Kam-lam considered it useful to examine whether these power companies had lowered their tariffs during the past eight years when CLP just froze them.

50. While she did not have the information relating to annual tariff changes of individual overseas power companies in hand, Mrs Betty YUEN said that the present tariff levels were the best reflection of the operational efficiency of each company. Despite power companies in Hong Kong had to shoulder a much higher operating cost in terms of land premium and infrastructure costs in importing fuels, CLP could still manage to set its tariff at a lower level than those in de-regulated markets with indigenous fuel supply.

51. Mr CHAN Kam-lam was unconvinced. He said that unlike overseas power companies which had to set up a relatively larger scale of infrastructure in order to transmit electricity to individual households which extended over a vast geographical area, Hong Kong power companies could easily access to a large number of customers with lower infrastructural cost. On fuel import costs, Mr CHAN pointed out that similar to Hong Kong, many Southeast Asian countries and Japan also depended on imports to meet their energy needs. He understood that the power companies concerned could secure coal supply contracts for several years in very good terms.

52. Mrs Betty YUEN remarked that for comparison purpose, it might be more relevant to make reference to other densely populated cities such as New York or London where electricity transmission networks mainly comprised underground cables which were more costly to be constructed and maintained than overhead lines in remote areas. She confirmed that CLP's tariff was much lower than those in New York and London.

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53. In reply to Mr CHAN Kam-lam's enquiry, DS/ED advised that there were different regimes adopted by overseas power companies in determining the return on investment in electricity supply industry. The asset base approach is more commonly used. Some markets adopted performance-based ratemaking regimes, e.g. Composite Price Index – X but the base price needed to be reviewed periodically having regard to the return on asset level being earned and other relevant factors.

54. Mr Fred LI sought information on the return on investment made by the two power companies in electricity supply for overseas countries.

55. Mr A J HUNTER informed members that HEC had made comparable levels of return on their investment relative to the risks involved in electricity supply related investments in Australia, Thailand and UK. However, none of these markets could be compared directly with Hong Kong because of their differences in market environment, modes of operation and risk factors.

56. Mrs Betty YUEN shared similar view and added that unlike Hong Kong which was a regulated market, some of the overseas markets were liberalized with different market structures. As such, the level of profits made by CLP overseas might be higher or lower than that made in Hong Kong.

Scheme of Control Agreements

57. Mr Fred LI urged the Administration to address the shortcomings of the current SCAs during its negotiations with the power companies on the new regulatory regime for the post-2008 electricity market. He was particularly concerned about the level of permitted rate of return and considered that it should be lowered to a single digit percentage.

58. Acknowledging concerns expressed by members and the general public on the weaknesses of the current SCAs, SEDL said that it was now timely to review the future development of the electricity market in Hong Kong after the existing SCAs expired in 2008. He informed members that further to the Stage I Consultation launched in January 2005, the Administration would promulgate the Stage II Consultation on future development of the electricity market in Hong Kong in the following week. Having considered comments received during the Stage I Consultation, the second consultation would map out the proposed post-2008 regulatory arrangements for the electricity market and address various concerns, including the basis for determining the permitted rate of return, introduction of competition, incentives for environment protection, tariff setting and stabilization mechanism etc.

> (*Post-meeting note:* The consultation paper on future development of the electricity market in Hong Kong – Stage II Consultation was circulated to all Members on 30 December 2005 vide LC Paper No CB(1)626/05-06.)

Action

59. Ir Dr Raymond HO also considered that the existing SCA might not be sufficiently flexible to respond to changes in the social and economic environment. For example, there might be room for improvement to the SCAs in considering useful life and depreciation periods of fixed assets.

60. In response, DS/ED advised that the SCAs provided for an annual Auditing Review under which the technical performance of the power companies would be reviewed. He said that the Administration would follow the established practice in computing the useful life and depreciation periods of fixed assets and did not envisage that there would be major changes.

V Any other business

61. There being no other business, the meeting ended at 6:30 pm.

Council Business Division 1
Legislative Council Secretariat
2 February 2006