

For information
on 27 March 2006

LEGISLATIVE COUNCIL PANEL ON ECONOMIC SERVICES

**INFORMATION AND CONSULTATION AGREEMENT WITH
THE HONG KONG AND CHINA GAS COMPANY LIMITED**

Introduction

This paper informs Members of our plan to extend the Information and Consultation Agreement (ICA) between the Government and The Hong Kong and China Gas Company Limited (HKCG) and the improvements to be made upon the extension.

Background

2. The Government and HKCG first entered into an ICA relating to the Company's core gas business and gas-related activities in Hong Kong in April 1997. The ICA is a voluntary agreement with terms and conditions mutually agreed between both parties. The first ICA expired on 2 April 2000 and was extended for three years by a Supplemental Agreement on 30 March 2000. It was further extended for another three years by a Second Supplemental Agreement on 2 April 2003.

The Objective of the ICA

3. The objective of the ICA is to increase transparency in the HKCG's tariff setting mechanism, and provide justification thereof, in the event of tariff adjustments. The ICA also stipulates certain procedures for the Company to –

- (i) consult the Government in the event of tariff adjustments and major system additions (e.g. addition to infrastructure); and
- (ii) disclose certain corporate information to the public on an annual basis.

Experience to Date

4. Pursuant to the ICA, HKCG consulted the Government and briefed the Energy Advisory Committee (EnAC) and Legislative Council Panel on Economic Services in late 1997 on the adjustment to their tariff and fixed monthly service charge for the year 1998. HKCG has not made any adjustment to its tariff and fixed monthly service charge since then.

5. In October 2004, HKCG briefed EnAC and the Panel on their Plan to introduce natural gas as an alternate feedstock to naphtha for production of towngas in 2006. HKCG has already reported to Members that they would pass any net savings from feedstock costs onto consumers via the Fuel Cost Variation mechanism, after deducting the capital investment and the financial returns on the supply infrastructure and modifications to its gas production plants.

6. Since HKCG's natural gas supply will be covered by a 25-year term contract, its future fuel cost should be more stable. The cost of natural gas is also significantly cheaper than naphtha as crude price continues to stay at a high level. HKCG has indicated that there would be around 5% savings in net gas charge if crude oil price is at about US\$35 per barrel. The savings would likely approach 10% if the crude oil price upon the importation of natural gas in the last quarter of this year is similar to the current level.

7. Pursuant to the ICA, HKCG has published each year, a booklet "Towngas Corporate Information" providing information relating to the financial, operational, environmental and safety matters in the preceding year. The Company has been receptive to suggestions from the Government as regards information to be included in this booklet.

8. Overall speaking, the ICA has served its objective of enhancing transparency. Gas tariff has remained stable. Indeed the net gas charge will be lowered later this year with the introduction of natural gas as a feedstock. HKCG's major initiatives and performance in the past three years in other areas including environment, safety and technical are summarised at Annex 1 for information.

Recent Development

9. The current ICA will expire on 2 April 2006. Following discussions, we have agreed with the HKCG that –

- (i) the ICA should be extended for a period of 3 years with effect from 3 April 2006 to meet its objective (paragraph 3 above); and
- (ii) improvements should be made to the ICA with a view to furthering its objective.

Improvements to the ICA

10. To enhance the information for the monitoring by the Government, HKCG will provide the Government –

- (i) annually with a breakdown of their planned and actual capital expenditure by major asset categories, with highlights of major new projects, in addition to the annual totals currently provided; and
- (ii) on or before 15th day of each month with the total cost and total quantity of each feedstock used in the preceding month and the corresponding forecast for the current month in relation to the Fuel Cost Variation Charge, including the percentage savings in gas charge resulting from the use of natural gas as feedstock in respect of the preceding month.

11. To enhance transparency for the monitoring by the public, HKCG will disclose the following additional information in the booklet “Towngas Corporate Information” published annually and in other appropriate disclosure channels such as the Company’s website –

- (i) increasing the transparency of the fixed monthly maintenance charge paid by domestic customers by including elaboration on the scope of work, total number of on-demand maintenance visits, etc.;

- (ii) enhancing transparency of the Fuel Cost Variation Charge (FCVC) by disclosing the FCVC formula and the annual savings, if any, as a result of using natural gas as an alternative feedstock later this year;
- (iii) highlighting the Company's commitment to safety by incorporating the Company's safety policy, safety promotional activities and education, incident statistics such as number of emergency incidents per km of distribution pipeline per year, etc.; and
- (iv) emphasising the Company's environmental performance by including the annual emissions of NO_x, SO_x and CO₂ in the Company's environmental report in addition to the disclosure in its booklet.

Next Step

12. We have briefed the Energy Advisory Committee on 15 March 2006. The improvements, as set out in Annexes 2 and 3, will be incorporated into a legal agreement to be signed between the Government and the HKCG. It will take effect from 3 April 2006 for a period of three years. Copies of the agreement will be sent to the Legislative Council Panel on Economic Services for reference after the signing. It will also be uploaded to the Economic Development and Labour Bureau's website.

Members' Advice

13. Members are invited to note the planned extension to the ICA and the improvements to be made.

Economic Development and Labour Bureau
20 March 2006

HKCG' Major Initiatives and Performance in the Past Three Years

Environmental Initiatives

- Emission will be substantially reduced following the planned use of natural gas as part of the feedstock for the production of town gas by Q4 this year. Upon full implementation, the emission of CO₂, NO_x and SO_x is expected to be reduced by about 26%, 42% and 40% respectively.
- The following achievements were made at the Gas Plants from 2003-2005 :
 - 750,000 tonnes of water saved by using Reverse Osmosis (RO) plant and recycling water from compressors
 - 5,252,000 kWh of electricity saved through sharing plant components
 - 26,000 tonnes of CO₂ from Tai Po Gas Plants recovered for producing dry ice/CO₂ gas
 - 288 tonnes of spent catalyst/metals and 2,800 units of metal/ plastic drums recycled respectively
 - the consumption of chemicals reduced by 1,582 tonnes (from 2004-2005)
 - de-NO_x system (low NO_x burner and NH₃ injection) installed to unit 1&2 of Tai Po phase I plants in 2005
- Over 800 tonnes (60,000 units) of discarded gas appliances were recycled in each of 2004 and 2005.

Safety Initiatives

- The replacement of cast iron pipes was accelerated and completed within the 24 months from January 2003 to December 2004, thereby enhancing the network safety.
- The number of active site inspections was increased and the number of third party damage was reduced from 46 cases in 2002 to 17 cases in 2005.
- Tai Po Gas Plants have been implementing F&IU (Safety Management) regulation at the production works since 2002 and it was certified to OHSAS18001 and ISO9001/2 qualification in 2005.

Technical Initiatives

- Gas supply reliability has been enhanced with the migration to a 3rd generation Supervisory Control and Data Acquisition (SCADA) System.
- Management of gas network data has improved through upgrading the computer mapping system to a 2nd generation Geographic Information System (GIS).
- Preparedness for emergency and response time for gas incidents have improved with the completion of the New Grid Control and Customer Service Hotline Centers placed in proximity.

Productivity and Customer Service

- Towngas' productivity (in terms of the ratio of customers to employees) rose by 13.7 % from year 2002 to 2005.
- There were a total of 3,456 written compliments about Towngas' service in 2005, more than doubled that of 2002, while in the same period the number of complaints dropped by 35% from 34 to 22.

Community Service

- Towngas has been actively involved in charity work and its Volunteer Team has provided free services and programs for the needy and the elderly.
- In April 2004, Towngas launched a Concession Scheme for People with Disabilities. Benefits offered by the Concession Scheme include 50% discount on the first 10 units of town gas, waiver of monthly maintenance charge, initial charge and security deposit, and free appliance maintenance service etc.

The ICA : Major Amendments

(a) The term of the Agreement shall be extended for a period of 3 years commencing from 3 April 2006.

(b) Subclause 4.3 of the Agreement shall be amended as follows:

“4.3 In addition to the information provided in accordance with Subclauses 4.1 and 4.2, the Company shall, on or before 30 November of each year, provide the Government with figures showing its planned capital expenditures by major asset categories, with highlights of major new projects, and network repairs and maintenance expenditure in respect of the following financial year and, on or before 30 June of each year, provide the Government with figures showing the actual expenditures incurred for each of the items above in respect of the preceding financial year. The information provided under this Subclause 4.3 shall not be disclosed by the Government to any third party, without the prior written consent of the Company.”

(c) The following shall be added to the Agreement as Subclause 4.4 :

“4.4 In addition to the information provided in accordance with the preceding Subclauses, the Company shall, on or before 15th day of each month, provide the Government with the following information :-

- (a) total gas sales by sectors for the preceding month;
- (b) total costs of naphtha, natural gas and landfill gas used for feedstock, all in naphtha energy equivalent, for the preceding month;
- (c) total quantities of naphtha, natural gas and landfill gas used for feedstock, all in naphtha energy equivalent, for the preceding month;

- (d) an estimate of the Fuel Cost Variation Charge applicable for the current month together with the estimated total costs and quantities of naphtha, natural gas and landfill gas used for feedstock, all in naphtha energy equivalent;
- (e) percentage savings in gas charge resulting from use of natural gas as feedstock, in respect of the preceding month;

The information provided under this Subclause 4.4 shall not be disclosed by the Government to any third party, without the prior written consent of the Company.”

- (d) Schedule 3 is to be amended and replaced by the new Schedule 3 (Annex 3) which is attached to the agreement.

NEW SCHEDULE 3

Financial, operational, environmental and safety information to be provided by the Company under Subclause 4.1

(1) Financial

- (i) annual review of the business of the Company;
- (ii) profit and loss account of the Company;
- (iii) balance sheet;
- (iv) auditor's report;
- (v) number of directors within different bands of remuneration and the analysis of directors' remuneration including -
 - (a) directors' fee;
 - (b) basic salaries and allowances;
 - (c) contributions to pension schemes for directors;
 - (d) directors' bonuses;
 - (e) sign-on fees and terminal payment; and
- (vi) *revenue and expenditures of the Fixed Monthly Service Charge Account.*

(2) Operational

- (i) service standards;
- (ii) efficiency (including measures to improve efficiency);
- (iii) customer liaison;
- (iv) performance pledges;

(v) ***Maintenance Service under Fixed Monthly Service Charge including -***

(a) ***Scope of the service;***

(b) ***Statistics of actual work done as follows :***

- ***regular safety inspection visits;***
- ***on-demand maintenance visits;***
- ***maintenance - related calls; and***

(vi) Fuel Cost Variation Charge ***including -***

(a) ***description of Fuel Cost Variation Charge formula;***

(b) ***annual savings, if any, to customers as a result of using natural gas.***

(3) Environmental

(i) environmental policy and objectives;

(ii) relevant environmental aspects and environmental performance of the company's activities and facilities;

(iii) environmental actions, programmes and education;

(iv) environmental promotional activities;

(v) energy saving;

(vi) significant environmental achievements;

(vii) awareness and outreach programmes such as community environmental programmes; and

(viii) ***statistics of environmental performance.***

(4) Safety

- (i) *safety policy and objectives;*
- (ii) *safety promotional activities and education;*
- (iii) production plant safety;
- (iv) *statistics of network safety including -*
 - (a) *incidents in respect of third party damage;*
 - (b) *trench inspections;*
 - (c) *emergency incidents per km of distribution pipeline per year;*
- (v) customer safety *including -*
 - (a) *statistics of gas incidents;*
 - (b) *response time for gas incidents;*
- (vi) occupational safety; and
- (vii) safety service pledge.