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Panel on Economic Development
Meeting on 8 December 2009

Background brief on Annual tariff reviews with the two power companies

Purpose

This paper sets out the background of the Government's annual tariff reviews with the two power companies and summarizes Members' concerns on related issues.

Regulation of electricity supply in Hong Kong

2. Electricity supply in Hong Kong has all along been provided by the private sector. The Hongkong Electric Company Ltd. (HEC)[1] supplies electricity to customers on the Hong Kong Island, Ap Lei Chau and Lamma Island, while CLP Power Hong Kong Ltd. and Castle Peak Power Company Ltd (CAPCO)[2] (referred to collectively as "CLP" hereafter) jointly supply customers in Kowloon, the New Territories and some outlying islands.

3. Electricity supply in Hong Kong is regulated through the Scheme of Control Agreements (SCAs) signed between the Government and the individual power companies. The SCAs set out the rights and obligations of the power companies and provide a framework for the Government to monitor the power companies' financial affairs and technical performance. Key features of the SCAs which contribute to achieving the Government's policy objective of providing reliable, safe and efficient electricity supply at reasonable prices include:

(a) an obligation for the power companies to provide sufficient facilities to meet present and future electricity demand;

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[1] HEC is a subsidiary of the Hongkong Electric Holdings Limited.

[2] CLP Power Hong Kong Ltd is a subsidiary of the CLP Holdings Limited. CAPCO is a joint venture generating company established between CLP Power and ExxonMobil.

(b) an obligation for the power companies to supply electricity at lowest possible cost; and

(c) provision for periodic financial review and annual tariff review by the power companies and for annual audit of the technical and financial performances of the power companies.

4. New SCAs were entered between the Government and the individual power companies on 7 January 2008. Changes to the previous SCAs relating to tariff include:

(a) a reduction in the permitted rate of return from 13.5% -15% to 9.99% on the average net fixed assets (ANFA);

(b) introduction of a linkage mechanism between the permitted rate of return and the emission performance of the power companies;

(c) introduction of financial incentives to encourage more usage of renewable energy (RE);

(d) lowering of the Executive Council's approval threshold for adjustment of basic tariff from 7% to 5%; and

(e) replacement of the Development Fund (DF) with the Tariff Stabilization Fund (TSF) and lowering the cap of balance from 12.5% to 8%.

Five-year Development Plan

5. The Government approved the five-year Development Plan of CLP and HEC on 23 September and 16 December 2008 respectively. According to CLP's Development Plan which lasts from 1 October 2008 to 31 December 2013, the capital project expenditure will amount to $39.9 billion, and the projected average annual increase in basic tariff for the period is below the forecast inflation of Government's Medium-Range Forecast. For HEC's Development Plan lasting from 1 January 2009 to 31 December 2013, the capital project expenditure will amount to $12.3 billion, and it projects on average a decrease in basic tariff per annum during the period.

Tariff adjustments since 2004

6. The Government conducted tariff reviews with the two power companies annually and the average net tariffs charged by HEC and CLP since

2004 are set out below:

	2004	2005	2006	2007	2008	2009
HEC (cents/kwh)	103.3	110 (+6.5%)	117.9 (+7.2%)	120.2 (+2.5%)	127.4 (+6.0%)	119.9 (-5.9%)
CLP (cents/kwh)	87.6	87.5	87.5	87.2	91.1[a] (+4.5%)	88.4[b] (-3%)

Note: a – from January to September 2008
b – from October 2008 to December 2009 during which the Rate Reduction Reserve rebate of 0.8 cents/kWh ceased from 6 May 2009 with the depletion of the Rate Reduction Reserve.

Members' views and concerns

7. From 2000, the Panel on Economic Services[3] was briefed by the two power companies and the Administration each December on the tariff adjustment for the following year. Members have expressed grave concerns over a range of issues at these annual briefings. The major ones include the following:

(a) disappointment at HEC's decisions to raise tariff at times of economic downturn despite the company's substantial earnings;

(b) the tariff gap between HEC and CLP such that HEC's customers was paying tariff at a much higher rate;

(c) suggestion of setting up a tariff determination mechanism;

(d) introduction of electricity suppliers from the Mainland to enhance competition and lower the tariffs;

(e) the implementation of increased interconnection between the two power companies to minimize investment on new generating units;

(f) Government should enhance monitoring of the power companies' investment on generating facilities;

(g) treatment of excessive generating capacity, and sales of surplus electricity to the Mainland;

(h) separation of power production and transmission to facilitate market entry;

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[3] The Panel on Economic Services was renamed as the Panel on Economic Development with effect from the 20072008 session.

(i) power companies should exercise greater versatility in handling the coal procurement contracts in the interests of customers; and

(j) Government should monitor the timing of adjusting Fuel Clause Charges made by the power companies.

Recent development

8. In response to a question raised by Hon KAM Nai-wai at the Legislative Council (LegCo) meeting on 28 October 2009, the Administration advised that according to the 2009 interim results announced by the two power companies, the TSF balance for HEC at end June 2009 was about $600 million while the total balance of Scheme of Control reserve accounts for CLP at end June 2009 was about $1.3 billion. With the fall of international coal prices in 2009, the Fuel Clause Account deficit balances of HEC and CLP were reduced to about $800 million and $300 million respectively by the end of June 2009.

9. According to the Administration's reply to the above LegCo question, the Government is currently conducting the annual reviews with the two power companies on their respective tariffs for 2010. In discussing the magnitude of adjustments to the Fuel Clause Charges, the Government will take into account the updated projections of fuel prices and Fuel Clause Account balances of the respective companies to ensure that they are at a reasonable level.

Latest position

10. The Administration and the two power companies will brief the Panel on tariff adjustment for 2010 at the meeting on 10 December 2009.

References

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LegCo question: Electricity tariffs of the two power companies (Page 14) (English version to follow)
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