立法會
Legislative Council

LC Paper No. CB(1)554/11-12(05)

Ref : CB1/PL/EDEV

Panel on Economic Development
Meeting on 13 December 2011

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 raised 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 and the New Territories including Lantau, Cheung Chau and some outlying islands.

3. Electricity supply in Hong Kong is regulated through the Scheme of Control Agreements ("SCAs") signed between the Government and 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. To achieve the policy objective of providing reliable, safe and efficient electricity supply at reasonable prices, the SCAs include the following key

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[1] HEC is a subsidiary of Power Assets 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 (40%) and ExxonMobil Energy Limited (60%).

features –

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

(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;

(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;

(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 with the Tariff Stabilization Fund ("TSF") and lowering the cap of balance from 12.5% to 8% of annual local sales.

Five-year Development Plan

5. The Government approved the five-year Development Plan of CLP and HEC on 23 September 2008 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 –

Year	HEC (cents/kWh)	CLP (cents/kWh)
2004	103.3	87.2
2005	110.0 (+6.5%)	87.3
2006	117.4 (+6.7%)	87.1
2007	120.2 (+2.4%)	87.2
2008	127.4 (+6.0%)	91.1 [a] (+4.5%)
2009	119.9 (-5.9%)	88.4 [b] (-3%)/89.2 [b]
2010	119.9	91.5 (+2.6%)
2011	123.3 (+2.8%)	94.1 (+2.8%)

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

<u>Discussions at the Panel on Economic Development</u>

7. The former Panel on Economic Services[3] and the Panel on Economic Development ("the Panel") had been briefed by the two power companies and the Administration each December since 2000 on the tariff adjustment for the following year. Members have expressed views and concerns over a range of issues at these annual briefings, including the following –

(a) disappointment at decisions of HEC and CLP to raise tariff despite the companies' substantial earnings;

(b) HEC's customers were paying tariff at a much higher rate than those of CLP;

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

[3] The Panel on Economic Services was renamed as the Panel on Economic Development with effect from the 2007-2008 session.

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

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

(g) Government should enhance transparency by urging the two power companies to disclose financial information related to the tariff review;

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

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

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

(k) the need to strike a balance between commitment to environmental protection and cost control.

8. At the meeting of the Panel on 14 December 2010, some members expressed grave concern that both HEC and CLP would raise electricity tariff by 2.8% for 2011. Panel members also urged the Government to request the two power companies not to raise the tariff by using the reserve in TSF to offset the fuel cost increase, or opting not to achieve a maximum rate of return. With regard to the suggestions of increasing interconnection between the electricity grids of the two power companies and introducing new operators, members noted that the Administration would review the situation in 2016 before the expiry of the current SCAs in 2018.

<u>Council questions</u>

9. Members have raised questions at meetings of the Legislative Council ("LegCo") on issues relating to electricity tariffs. According to the Administration's reply to the question raised by Hon Jeffrey LAM Kin-fung

on 10 June 2009, the Government, pursuant to the SCAs, would take into account a number of factors in the annual tariff reviews including electricity demand and sales, operating costs, fuel prices, capital investments, measures to control cost and increase productivity, updated balances in the Fuel Clause Accounts and TSF, affordability of the consumers and permitted return to ensure that electricity would be provided at reasonable cost. Specifically, the Government together with the independent energy consultant it engaged would review carefully the data provided by the power companies, including fuel price projections to ensure that they were set at a reasonable level in line with the trend movement of fuel prices in the international market.

Recent developments

10. The Administration and the two power companies will brief the Panel on the tariff adjustment for 2012 at the meeting on 13 December 2011.

References

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Legislative Council Secretariat
7 December 2011