CLP Power 2012 Tariff Review – Clarifications

In view of the recent discussions and the legislators' call for information to understand more about the reasons for CLP's tariff increase for 2012, supplementary information is provided to facilitate a more informed discussion on the issue.

CLP's Tariff Pressure
CLP has been diligent and prudent in controlling our costs. Even after the increase proposed for 2012, the Basic Tariff level is still below the level approved by the Government and the Executive Council for 2012 as listed in the 2008 Development Plan. The new tariff also remains below our Basic Tariff level of 1997.

Out of the 85 cents of the new Basic Tariff, more than 4 cents represent costs associated with the Emissions Control facilities that have been completed in early 2011 in order to meet the Government's emissions caps, which we have a legal obligation. Such costs include the relevant operating expenses, materials (eg. limestone, urea) and depreciation costs of the project.

In addition, we have also begun to construct facilities needed to receive new gas before the second half of 2012, and continue to make necessary investment to meet customers demand and support major Government infrastructure projects. All these contribute to the unprecedented pressure on our Basic Tariff and thus tariff adjustment is required.

CLP's Operating Costs
Concerns have been voiced over the 11.2% increase in operating costs in 2012 which may appear to be a high number compared with 2011. This is because of two major factors:

- There are a number of additional incremental costs that we have to incur in 2012, such as those required to run the newly commissioned Emissions Control facilities, in order to meet the Government's emissions caps
- The operating costs of 2011 form an artificially low base year (only 1.4% up on 2010 costs), which is a result of exceptional items, such as the $50m received from insurers in respect of claims as well as below trend net fixed asset disposals.

Adjusting for these factors, the increase in our operating costs for 2012 will be around 6%, close to the general rate of inflation. These operating costs in total are around $3.9 billion, representing only some 15% of our total expenditure. They are core operating costs covering labour, materials, Government rent and rates, pumped storage, etc, which are essential for the company's daily operation.

CLP's Capital Expenditure for the proposed increase in Generation Capacity
In accordance with the approved 2008 Development Plan, CLP has been undertaking feasibility studies to explore options for a necessary increase in generating capacity for meeting electricity demand by the middle of this decade.

Regular discussions with the government on the issue have been underway for at least 18 months. As such, feasibility studies, with a total cost of $78m, have already progressed in 2011. Additional study and preparatory work have to be continued in

2012, so as to ensure our supply reliability in view of the expected increase in demand.

In line with accepted practice under the Scheme of Control for many years, we treated these preliminary costs as capital investment, as opposed to immediate expenses, so that they can be recovered over the expected 25-year life of the new plant. This has already helped spread out the cost impact, which results in lesser impact on the current tariff than if the costs were treated as immediate expenses.

Using Tariff Stabilization Fund (TSF) to reduce tariff increase

There is a general query about CLP's willingness to make use of the TSF balance to help reduce the tariff increase. As a matter of fact, CLP has already drawn down an amount of some $1,200m from the $1,900m TSF balance at the start of the 2008 Development Plan, to less than $700m this year. Even after the proposed increase in the Basic Tariff announced on 13 December, it is projected that the TSF balance will be further lowered to $300m by the end of 2012, which is less than one-sixth of the amount it was in 2008. This is also the lowest level in more than 25 years, equal to only a few days of sales revenue. This exceptionally low level of the TSF account means that it can no longer serve the purpose of stabilizing tariff fluctuation.

Fuel Costs

Our customers are currently paying very low prices for natural gas, which was secured by CLP some 20 years ago. The current market prices are much higher, some two to three times more expensive than we have enjoyed. Furthermore, the need to comply with the Government's newly imposed 2015 emissions caps, means that we have to use more than double the amount of natural gas in our fuel mix by then. A doubling of volumes and close to a tripling on unit prices for natural gas translates into a six-fold increase in our fuel costs when fully implemented.

CLP's Fuel Clause Account (FCA) has been in deficit for five consecutive years, with a further deficit forecast of over $800m* by the end of 2012. The FCA deficit is a liability of our customers and will only increase pressures on tariff in future. As a responsible company, we must give very prudent consideration on any decision for further deepening such a deficit.

* With the further reduction of the Fuel Clause Charge increase for 2012 announced on 21 December, deficit forecast of the FCA will further rise to $1,400m by the end of 2012.

Rent & Rates

Regarding the discussions on the refund of the Government's Rents and Rates, CLP has an ongoing legal case which is still being contested by Government through a judicial process.

If there is any refund of money from the Government from this case, it will be used up to help cut the overall operating expenses, therefore reducing pressure for tariff adjustment.