CB(1)482/12-13(01)

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25 January 2013

By E-mail

Mr Derek Lo
Clerk to Panel (Economic Development)
1 Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Mr Lo,

Panel on Economic Development
Follow-up to special meeting on 8 January 2013
Submission relating to
"Annual tariff reviews with the two power companies"

Thank you for your letter of 9 January 2013. Regarding questions from Greenpeace, I attach the replies from CLP Power HK Ltd. and HK Electric Co. Ltd. (Annexes A and B respectively), and from the Environment Bureau (Annex C) for your further action please.

Yours sincerely,

(Ms Vyora Yau)
for Secretary for the Environment

Annex A

Follow-up items as proposed by Greenpeace – Replies from CLP Power HK Ltd.

1. **In the last paragraph, page 2 of CLP's information paper CB(1)297/12-13(02), it is mentioned that "CLP will still carry a high Fuel Clause Recovery Account (FCA) deficit of more than HK$1 billion". What will be the actual tariff increase for 2013 should this deficit be reflected in the tariff increase? According to the wording "CLP will still carry", would it mean that the public will not need to pay it back and the entire HK$1 billion deficit is borne by the CLP shareholders?**

   On Page 10 of Annex CLP-B in the same information paper CB(1)297/12-13(02), the projected FCA balance deficit would be widened from HK$334 million at end 2012 to HK$1,034 million at end 2013. The FCA plays an important role in stabilizing tariff level and the change of FCA balance by HK$700 million alleviates tariff pressure by HK2.1¢/kWh in 2013.

   CLP makes no profit on the fuel clause charge. The fuel clause charge mechanism is operated under two principles: first, the actual fuel cost incurred will be reflected in the FCA; and second, any under- or over-recovery in one year will be made up in subsequent fuel cost account adjustment and recovered from the customers considering the projected FCA balance. It is important to recognize that the actual FCA balance will depend on the future fuel market situations which are highly volatile.

2. **How would the interest expense in relation to the Fuel Clause Recovery Account be calculated?**

   The interest expense in relation to the Fuel Clause Recovery Account is calculated based upon the effective borrowing rate. The interest receivable from the Fuel Clause Recovery Account will be credited as part of the SoC income.

3. **The Basic Tariff for 2013 is kept unchanged when compared to 2012. However, there are increases in Basic Tariff for some residential customers. Could CLP provide the additional revenue collected from its residential customers as a result of such increase in Basic Tariff? How would this additional revenue be used?**

   To promote energy saving, CLP has further enhanced the inclining tariff structure for residential customers. Indeed, low electricity consumption residential customers will see no increase or even a reduction because of the Energy Saving Rebate, whereas customers whose bimonthly consumption exceeds 1,800 units may see an increase in their tariff rate. We do not expect that the changes in the Tariff Structure will result in an increase in revenue from the residential sector.

4. **The Yacheng 13-1 gas field depletes earlier. How would the depreciation for the capital investment of the related gas transmission project under the SCA be calculated? Would the public need to continue paying the related cost?**

The SCA sets out the useful lives of fixed assets for the purpose of calculating depreciation expenses. The cost will be depreciated uniformly over the respective period of useful life. For fixed assets which cease to be used for Electricity-Related activities, they are to be written off and treated as disposal of Fixed Assets.

Although the Y13-1 gas field is depleting, we are exploring other nearby offshore gas resources which may be transported to Hong Kong by connecting to the existing pipeline. Since 2012, CLP has successfully contracted new supply from one of these fields in South China Sea, and we will continue to explore other potential new gas sources, while maximizing the utilization of Y13-1 gas and the pipeline.

5. **When will the feasibility study report of the offshore wind farm be completed? Could the report be submitted to the Legislative Council upon completion?**

In April 2012, CAPCO installed a Meteorological Mast at 9km off the coast of Clearwater Bay in Hong Kong southeastern waters for data collection to determine the feasibility for a proposed Wind Farm project in that area. As collection of data in the normal course was disrupted due to harsh weather conditions last year (more severe typhoons), it would take some more time to fully complete the feasibility study. Upon completion, the study report would be submitted to government for consideration.

6. **As for the project mentioned in item (c), paragraph 5 of the paper ENB CR3/4576/05(12)Pt.15, through what procedure it was decided to sub-contract the project work to CLP's subsidiary company? What is the construction cost? How much will the joint venture company (which CLP is one of the owners) charge Hong Kong customers for gas delivery in terms of $ per cubic meter? According to the gas supply contract signed, would the joint venture company compensate CLP for breaching the contract if the WEPII gas experiences early depletion similar to the Yacheng field?**

To bring natural gas from the WEPII to Hong Kong, the construction work of the sub-sea pipeline from Shenzhen to Hong Kong was done by expert construction companies contracted by PetroChina, the owner of the WEPII. CLP has been involved in project development, and some coordination works in Hong Kong waters. CLP has also agreed to form an equity joint venture (JV) with PetroChina and will hold 40% interest. Participation in the JV of the HKBL enables CLP to bring in local management experience to oversee the safe operation of this important gas link to our power station.

The branch line is a critical piece of energy infrastructure for Hong Kong and so managing it closely with our JV partner to ensure a stable gas supply for a reliable electricity supply to our customers and a high safety standard is of uttermost importance. The HKBL investment is not under the SCA. Its investment cost will be recovered through a gas transportation cost which is set based on National Development and Reform Commission's guideline.

Unlike the Yacheng supply arrangement, the WEPII gas supply can be provided by more than one gas source and therefore the same depletion scenario is not applicable.

7. **What is the amount of the "…..entire annual contract quantity of WEPII gas" in terajoules (TJ) of natural gas as mentioned in paragraph 17 of the paper ENB CR3/4576/05(12)Pt.15. To what percentage will this amount of gas account for CLP's electricity generation at that time?**

   WEPII gas usage will progressively increase to replace the depleting Yacheng gas supply and to meet the increasingly tightened emission reduction requirement in coming years. To minimize the fuel cost impact, we will continue to maximize the remaining Yacheng gas first, hence WEPII gas volume is not expected to reach its annual full offtake in 2013. The specific contract gas volume is covered by the confidentiality of the contract and cannot be disclosed to third parties.

8. **The last paragraph on page one, Annex CLP-C of CLP document CB(1)297/12-13(02) mentions about the three classes of commercial and industrial customers, namely General Service Tariff, Bulk Tariff and Large Power Tariff. Could CLP provide the annual electricity consumption of these three classes of customers, and their percentage contribution to CLP's total revenue?**

   These three classes of commercial and industrial customers, as a whole, represent about 3 quarters of CLP's local electricity sales and revenue in 2011.

9. **In the third paragraph, page 2, Annex CLP-C of CLP document CB(1)297/12-13(02), CLP says "If more units are used at peak times (by Large Power Tariff) customers, it will drive investment in extra generation and network capacity leading to higher costs for Hong Kong as a whole." Could CLP please provide the amount of fixed asset capital investment arising from such increase in power consumption by Large Power Tariff customers, which as a result had caused higher cost of electricity supply for Hong Kong customers to bear over the last two Development Plans?**

Sufficient generation and network capacity are needed to meet the customers' aggregate maximum electricity demand at peak times of the whole system as well as individual areas. Reserve capacity is also needed to cater for any loss of generating units or network circuits due to a forced or planned outage. The investment in adding generation and network capacity serves to fulfill the aggregate requirements of our customers. Therefore the specific investment due to more units used at peak times by Large Power Tariff (LPT) customers over the last two Development Plans cannot be singled out. Actually, no additional new-built generating capacity was approved in the last two Development Plans.

CLP Power has "Time of Use tariffs" for the high consumption commercial and industrial customers to encourage them to shift their electricity loading from peak time to off-peak period as well as demand charges which increase their costs for drawing power at peak times. Our dedicated Account Managers will provide the customers with professional support on efficient use of energy and offer practical advice on energy efficiency and conservation, tailored to meet their needs. In addition, they can also benefit from other energy efficiency services such as Meter Online Services and Energy Audit Services. All these measures help the LPT customers to manage their energy consumption efficiently and reduce their energy demand and, although the consumption pattern of each customer will vary, larger electricity consumption commercial and industrial customers tend not to increase their demand at peak times above the off-peak level as much as other customers.

Annex B

Follow-up items as proposed by Greenpeace - Replies from HK Electric Co. Ltd.

1. **Will HK Electric disclose the record of the interests collected under its Fuel Clause Recovery Account for the past 5 years?**

   While customers will be charged for interest arising from the debit balance of the Fuel Clause Recovery Account (FCA), the interest receivable will be treated as part of the Scheme of Control (SoC) income that would eventually be transferred to the Tariff Stabilization Fund (TSF) in accordance with the Scheme of Control Agreement. The purpose of the TSF is for mitigating tariff adjustment impact on customers. HK Electric would not earn any profit from the interest on FCA debit balance.

2. **When will HK Electric announce the arrangement for the refund of the Rates and Government Rent? Will HK Electric promise to return the full amount of refund, if any, to the public?**

   HK Electric has been negotiating with the Rating & Valuation Department on the final refund amount and with Environment Bureau on the proper treatment of the refund. Once there are clear decisions, the issue will be handled as soon as possible.

3. **The offshore wind farm project proposed by HK Electric was dropped during the review of its current Development Plan. Does it mean that the project has been shelved?**

   As the offshore wind farm project is still in the feasibility study stage, it has not been included in HK Electric's 2009-2013 5-year Development Plan. HK Electric is now making use of its offshore wind monitoring station completed in early 2012 at the proposed project site location to measure the daily and seasonal wind resources and their patterns and to collect the entire 1-year on-site meteorological and oceanographic data for designing the wind turbines and optimizing the wind farm array arrangement as part of the feasibility study.

4. **According to media reports, CLP had purchased electricity from HK Electric during its conveyor belt incident occurred in 2012 summer. At what price did HK Electric sell electricity to CLP? Is there any effect on the tariff due to the extra electricity sales revenue?**

   As part of the CLP's coal-fired generation was affected by its coal conveyor belt incident during July to September 2012, HK Electric made use of its spare generating capacity to sell the amount of electricity required by CLP. The sale of electricity was based on the principle that the total fuel costs for the two power companies during that period should be minimized (i.e. the generation cost incurred by HK Electric for supplying CLP should be lower than that incurred by CLP for supplying the same amount of electricity during the period). The charge that HK Electric received from CLP for the electricity sold is variable, and is calculated based on HK Electric's actual fuel cost and extra operating cost incurred for generating the required amount of electricity. There is no shareholder profit element in the charge. In accordance with the Scheme of Control Agreement, the total amount of the aforementioned charge received from CLP has been treated as an income (i.e. a credit item) under HK Electric's fuel cost account, to reduce the total fuel cost and thus the tariff paid by our customers. HK Electric has not earned any profit there from.

- End -

Follow-up items as proposed by Greenpeace
– Replies from Environment Bureau

Q1: **Comparing the approved 5-year Development Plans and the Annual Tariff Reviews of the two power companies, it reveals that all the estimates in the approved Development Plans were higher than the actual figures. As a result, it directly deprives the Executive Council of its power to approve electricity tariffs. It is because the Executive Council can exercise its approval authority only when the tariff increases by the two power companies exceed 5% of the projected level in Development Plan. Has Environment Bureau reviewed its cause?**

A1: In order to ensure a stable and reliable supply of electricity, as well as to reduce the impact on the environment, the two power companies must have long-term planning on the generating capacity, transmission and distribution installations and emission reduction facilities, etc. The installation of these facilities usually takes years to complete. The compilation of 5-year Development Plan (DP) is based on Hong Kong economic forecast, city and infrastructure development, and the two power companies' best estimates. Electricity demand and consumption are affected by a number of factors which are uncontrollable and unable to be accurately forecasted. They include change in weather, economic environment and population growth, etc. Moreover, some planned developments may be delayed or shelved due to different reasons. Hence, there are bound to be discrepancies between the electricity demand and consumption forecasts in the 5-year DP and the actual results.

The tariff level for each year as set out in the DP is just a projection. In fact, the tariffs to be charged to the customers each year have to be determined at the annual Tariff Review, during which the electricity demand and sales, operating costs, fuel prices, capital investment and other factors have to be considered.

Taking into account the wide range of uncertainties involved in the 5-year planning, we add an appropriate buffer on top of the projected level of Basic Tariff. Comparing with the previous agreements that the power companies might implement a tariff not exceeding the projected Basic Tariff rate by more than 7%, the current Scheme of Control Agreements (SCAs) have narrowed down the relevant flexibility to 5%, so that the Government can regulate tariff adjustments more effectively.

In fact, in discussing with the power companies on their tariff adjustment proposals in the past few years, the Government has never given up the opportunity to negotiate for a lower rate of tariff increases on the grounds that the proposed Basic Tariff did not exceed the projected Basic Tariff rate by more than 5%. The bare fact is that since the current SCAs have come into effect, the actual rates of Basic Tariff of the two power companies for each year are lower than the projections made in the 5-year DP. In other words, the so-called "flexible arrangement of 5%" has never been exercised.

Q2: Could Environment Bureau disclose the details of local electricity sales and exports to third parties outside Hong Kong (including electricity demand and modes of sales) projected by the two power companies over the Development Plan period covering 1 October 2008 to 31 December 2013?

A2: In the compilation of the 5-year Development Plan (DP) in 2008, the two power companies forecasted the electricity sales of following years based on the best available information at that time. CLP projected local sales to grow at an average annual rate of 1.9% for 2008-2013. HKE projected local sales to grow at an average annual rate of 1.1% for 2009-2013. Details of electricity sales forecast are provided below :

Electricity sales forecasts (GWh)			
	CLP		HKE
	Local	Mainland China(Note 3)	Local
2009(Note 1)	31,150	3,440	10,836
2010	31,760	965	11,047
2011	32,365	995	11,170
2012	32,995	1,025	11,295
2013	(Note 2)		

Note 1: CLP's 5-year DP commenced on 1 October 2008, while HKE's commenced on 1 January 2009. The relevant figures refer to the electricity sales forecasts for 2009.

Note 2: The two power companies consider that the disclosure of 2013 electricity sales forecasts would not be in the interests of their customers as it might indicate to suppliers the two power companies' demand of future years and increase their bargaining power in prices setting leading to higher tariffs to be borne by Hong Kong citizens.

Note 3: In the compilation of the 5-year DP, some Mainland companies had not yet signed electricity purchase contracts for 2010 and beyond with CLP. As a result, CLP's forecast electricity sales to Mainland China in 2010 and beyond are significantly lower than that for 2009.

Q3: **Regarding the project mentioned in item (c), paragraph 5 of the paper ENB CR3/4576/05(12)Pt.15, has the Government ever considered to include it as an infrastructure project funded by the Government, and to assess its impact on reducing electricity tariff?**

A3: Hong Kong Branch Line is part of the Second West-East Natural Gas Pipeline (WEPII). On one hand, PetroChina Company Limited (PetroChina), owner of WEPII, positions itself to be the major owner of the HKBL, to ensure the implementation of the gas supply arrangement to Hong Kong via WEPII. On the other hand, in order to ensure timely availability and security of gas supply for CLP to meet the electricity demand in Hong Kong, CLP considers that influence over the HKBL project can only be realistically achieved through a reasonable ownership stake in the project. Hence, CLP and PetroChina agree to form a Sino-foreign equity joint venture to jointly develop, construct, own and operate the HKBL. We consider this a reasonable arrangement.

Q4: **The 5-year Development Plans of the two power companies contain many projects which are added to support Government's infrastructure development, such as item 15 on second page of CLP-A and item T&D.4 on second page of HEC-A. Has the Government ever considered constructing these items by other contractors, outside SCA, by means of open tender like other infrastructure projects so as to avoid the increase in fixed asset investments in billions by the two power companies and to avoid the rise in Basic Tariff?**

A4: According to the Scheme of Control Agreements, the two power companies need to submit regularly a Development Plan (DP) to the Government for approval of their capital expenditure. With the assistance from independent energy consultants, the Government would critically review the two power companies' capital investment from the perspective of the need, timing and cost effectiveness, to ensure that the projects are needed to cope with the electricity demand, maintain the reliability of the systems and comply with the environmental or other technical requirements.

The capital expenditure items in the current 5-year DP are for the reinforcement, extension or upgrading of the power companies' electricity generation, transmission and distribution systems, and associated supporting projects for meeting their existing or new customer demand. Since the projects generally involve the modification of the two power companies' existing transmission and distribution equipment, and taking into consideration system safety and reliability, future responsibilities of system operation and maintenance, etc., it is considered inappropriate for any third party to carry out and manage the projects. Item 15 on page 2 in CLP-A and item T&D.4 on page 2 in HEC-A referred in the question are projects for extending and reinforcing power companies' existing high-voltage electricity transmission and distribution network to support public infrastructure projects, including MTRC's new West and South Island Lines, new Express Railway Line stations, water works, etc. That part of the power supply system the construction of which fall within the scope of these infrastructure projects will not be included in the capital expenditure of the two power companies.

Electricity supply is an important infrastructure to the society and an essential service in the daily life of public. Electricity tariff also affects the development of industries and businesses in Hong Kong as well as the daily expenses of households. The Government has all along been performing the gate-keeping duties with the best endeavour to ensure a right balance among the policy objectives of electricity supply in Hong Kong, i.e. reliability, safety, environmental-friendliness and reasonable prices, in order to safeguard the interests of the public. In addition to the DP, the Government also reviews the actual and forecast capital expenditure and time schedule through annual Tariff Review with the two power companies, to avoid investments which are premature, excessive or unnecessary.