WORLD GREEN ORGANISATION

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Clerk to Panel on Economic Development By Email

Dear Sir/Madam

WGO's submission to public consultation on the mid-term review of the Scheme of Control Agreements

In response to the invitation for submissions to the public consultation on the mid-term review of the Scheme of Control Agreements (SCAs), World Green Organisation(WGO) is pleased to prepare the following comments and suggestions for your consideration.

A. Basic Tariff

a) New Energy Saving Clause

- The SCAs allow the power companies to earn revenue mainly based upon the values of their fixed assets, such as the generation and transmission units of the power companies. New articles related to energy saving are added in the 2008 SCAs, allowing the two power companies to earn extra rate of return by assisting their customers to save 1.5 million kWh per year in total.

- To further encourage energy saving, WGO suggests adding specific targets in the SCAs in the interim review. The experience of the U.S. indicated that utilities may not aggressively pursue energy efficiency[1]. Therefore, setting energy saving targets with reference to energy saving potential is necessary. It is recommended to conduct an initial market assessment prior to the establishment of targets.

- The current reward for enhanced productivity and energy efficiency is negligible. Greater financial incentives should be provided such that shareholders are more willing to invest in related programs.

[1] Future Energy enterprises, LLC: Profitable Utility Demand-Side Energy Efficiency in Hong Kong (February 2008)

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b) Electricity Demand Projection

- Electricity demand projection for the coming year is one of the considerations taken into account under the current electricity tariff adjustment mechanism. It is of vital importance to ensure the electricity demand project is realistic, aiming at avoiding a significant level of over-estimation in order to prevent a huge increase of electricity tariff or under-estimation that affects the stability of energy.

- For example, CLP projected in 2010 that the 2011 local electricity sale was 31,390 million kWh. However, the actual local electricity sale of the year was 31,168 million kWh according to the CLP figures in 2011. Though the difference of the sales will be rebated to customers, both power companies should improve the accuracy in projection in order to prevent a significant increase in electricity tariff in the first place.

- A raise in electricity tariff will trigger an increase of other operational costs, pushing up the overall inflation rate and affecting all walks of life in Hong Kong.

c) Downsizing the Renewable Energy Plan – Offshore Wind Farm

- The current SCAs provide a greater incentive for power companies to generate electricity through renewable energy sources. The SCAs state that if the proportion of the volume of electricity generated by the utilities' Renewable Energy (R.E) System approved by the government is more than 5% of the total volume of electricity generated, the two utilities can receive an extra rate of return of 0.05%.

- With the power companies' plans on developing Renewable Energy systems, one on Nine Pin Island and another in the south to Lama Island, the power companies are expected to make more profit after the commencement of the systems. WGO fully supports the supply of RE to Hong Kong. However, the government should consider other cost-effective options, for example, importing RE from Pearl River Delta or joint project in PRD. This will help Hong Kong reduce carbon emissions. In this case, the government should urge the power companies to consider scaling down the scheme in order to avoid a rapid expansion of utilities asset value and relief the pressure on the tariff inflation next year.

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d) Reserve Margin

- According to a research of WGO, in general, the reserve margins of both power companies in HK on average are higher than that of other utilities around the world. Although the scale and geographic of power plants might vary, in many cases, cities that emphases energy saving achieve a single digit percentage of reserve margin.

Table: Reserve Margin of electricity companies around the globe

Country/Area	Reserve Margin (Year)
Chile	70% (2001)
Singapore	55% (2011)
Mexico	45% (2006)
UK	43% (2011)
Italy	42% (1999)
HK CLP	31% (2010)
HK HKE	25% (2009)
Australia/Queensland	21% (2005)
Canada/ Ontario	20% (2005)
Canada/Alberta	20% (2005)
Hungary	19% (2005)
Ireland	19% (2005)
Oman	17% (2005)
Australia/Victoria	16% (2005)
Brazil	15% (2005)
Abu-Dhabi	14% (2009)
Spain	13% (2006)
Norway	5% (winter 2006/2007)
US/California	3%

Source: World Green Organisation

- The reserve margin, the excess generating capacity in the amount of expected peak demand, is part of the formula calculated in the power companies' rate of return. Maintaining the reserve margin at a reasonable level can further reduce the pressure in tariff increase. WGO, therefore, suggests the government to urge the power companies to study the operational efficiency, reducing the reserve margin to around 20%.

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B. Fuel Clause Charge

a) Natural Gas Stabilization Fund

- Fuel clause charge has played a very significant role in electricity tariff increase in recent years. Taking the tariff adjustment in 2013 as an example, CLP increased the fuel clause charge by 26% in the 2013 tariff adjustment, while the basic tariff on average of the company remained unchanged. HKE increased the fuel clause charge by 8.6% and the basic tariff went up by 0.6%. With the expectation that fuel cost of the power companies are on the rise in coming years, lowering the fuel clause charge remains a matter of concern.

- The increase of the fuel clause charge is mainly contributed by the surging price of natural gas. To help lower the tariff increment contributed by fuel clause, WGO suggests the government to set up a Natural Gas Stabilization Fund. The fund acts as a buffer to offset part of the increase in the fuel clause by covering part of the fluctuation in the price of natural gas. WGO estimates that the tariff increment could be reduced to 4%, which is close to the inflation rate, provided that the government spends 3 billion HKD on the fund per year.

- Under the current SCAs, fuel costs are passed to the customers on the basis of actual spending. In other words, the Stabilization fund will benefit customers directly and the two utilities will not be benefited from the funding. The arrangement in sponsoring the fuel cost by the government is, therefore, equivalent to providing financial aid to the public.

b) CLP and HKE Joint Fuel Procurement

- As fuel costs are charged on the basis of actual spending, the two power companies are not motivated to purchase cheaper fuel to generate electricity. The government should urge the two power companies to join hand and procure the fuel in bulk in order to seek a more competitive price that resulted in fuel cost reduction.

- The Government should keep track with the price trend of the natural gas in the international market in order to monitor the purchasing price of fuel

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by two utilities.

Yours sincerely

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