

**Submission to the Legislative Council Panel on Economic Development  
on Interim Review of the Scheme of Control Agreements  
with Two Power Companies in 2013**

1. The Consumer Council (CC) welcomes the Government's proactive stance in reviewing the arrangements of the Scheme of Control for the Hong Kong electricity sector, and its commitment to maintaining robust oversight of the arrangements into the future.
2. The Government's broad policy has always been to enhance competition in the economy. Although for a historical reason, the Scheme of Control Agreements (SCAs) forms the regulatory framework which encourages the power companies to provide reliable service to commercial and residential consumers. CC views that the current regulatory regime is not fair to consumers in that the two power companies are allowed to earn a high risk-free permitted rate of return on their Average Net Fixed Assets. Moreover, they are able to transfer all business risks associated with fuel price fluctuations, operational cost and forecasting error in relation to the electricity demand to consumers. CC views that a price-cap (CPI – X) approach could be an alternative regulatory scheme to be considered.
3. CC notes that some issues about the current SCAs could affect the welfare of consumers. CC believes, therefore, that the opportunity presented by the review of the SCAs should be used to increase information transparency in the system for an informed debate by stakeholders and the general public to facilitate search for a better regulatory regime for the Hong Kong electricity market in future.

**Issues of Concern**

4. CC notes that some issues related to the practices of two power companies under SCAs and affecting the level of tariff of consumers have recently been raised and discussed in the public arena:
  - (a) Firstly, China Light & Power (CLP) purchased from Daya Bay Nuclear Power Plant substantial amount of electricity for the supply in Hong Kong in 2012 under contract between them. On the other hand it sold off to Mainland China considerable amount of electricity produced with its excess capacity built up in the past.

- (b) The second issue is whether the two power companies should use financial instruments to hedge against the increase in fuel prices rather than use the fuel clause recovery account balance under SCAs as a buffer to balance the unexpected discrepancy between the actual fuel cost and the projected fuel cost arising from the adjustment of fuel prices.
- (c) The third one is about the differential treatment between commercial customers and residential customers in terms of the application of demand management methods. As a result, residential customers are charged higher incremental rates as their usages increase whereas commercial customers have discounts or rebates on charges as their usages increase.

### **Enhancing Market Transparency**

- 5. CC holds the views that the power companies should enhance its transparency in fuel cost, and is concerned whether consumers are being overcharged as a result of the three practices of the two power companies mentioned above. According to information obtained by CC about fuel prices in the open-trading market, it is noted that for the first three quarters of 2012 the average fuel cost of Australian thermal coal has decreased 12.5% and the average fuel cost of Indonesian liquefied natural gas has increased only 2%<sup>1</sup>. On the other hand, CLP announced that next year its electricity tariffs will increase by 5.9 percent. CC believes it is necessary for the power company to provide sufficient information on the benchmark of fuel prices in the international market that they use, to enable customers to monitor the trend of fuel costs.
- 6. In the last review in 2006, the Government indicated that it would request the power companies to make available more information to the public, such as details of new development projects, electricity sales and growth rates, provided that no commercially sensitive information would be disclosed.
- 7. The forecast on future peak demand and average demand, the model or methodology used in making the forecast and the relevant economic

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<sup>1</sup> The price of natural gas in US decreased 17.2% for the same period.

forecast inputs used in the forecasting model will affect what is ultimately presented as the quantity of demand for the next five years which is in turn linked to the amount of fixed investment in power generation or distribution infra-structure in the next five years. The public needs to know the information basis about the next year forecast on the demand of electricity to assess whether there is justification for the current fuel charge prediction. As such, the power companies should have the obligation to provide the necessary information to the public to show that investment is needed to meet the expected demand for electricity.

8. CC views that electricity is supplied as a de facto monopoly, and supports the Government policy to introduce more transparency to the market. In considering how far transparency should go in relation to costing and pricing information on electricity, the wider community's interests should not be wholly subsumed by arguments as to 'commercial confidentiality'.

#### **Accountability, Fairness and Green**

9. CC urges the LegCo or the Government to seek clarification from CLP that the arrangement of purchasing electricity from Daya Bay Nuclear Power Plant and selling off electricity to Mainland China are not against the principle of minimizing cost to consumers. CC understands that CLP serves as an agent of the public to purchase electricity from Daya Bay Nuclear Power Plant and also as an agent to produce electricity through its facilities. For both services, CLP has already been compensated through the permitted return under the SCA. Therefore in principle, CLP should not have extra gain in profits from the decision to buy electricity from Daya Bay Nuclear Power Plant or the decision to produce electricity through its power plants in Hong Kong.
10. It is noted that the actual demand of electricity is well below the predicted demand forecasted by the two power companies in the last 4 years. By avoiding any excess investment, CC views that the Government approved development plan and investment plan under SCAs proposed by the two power companies for the next 5 years should be substantially revised by taking into account the discrepancy of the predicted demand and actual demand of electricity.
11. CC understands that the two power companies use the fuel clause

recovery account to absorb the discrepancies between the forecast fuel costs (related to usage and the fuel price) and the actual fuel costs. CC suggests that the Government review whether the current recovery account balance arrangement appropriately shares the cost of risk to consumers arising from fuel price fluctuations under the current market environment on one hand, and the risk to the two power companies of loss associated with error in forecast of the usage made by the two power companies on the other.

12. Regarding the demand management methods applied differently to commercial customers and residential customers, CC is of the view that the two power companies should be obliged to use demand management to curb the increasing demand for electricity, and a fair system should be in place so that residential users would benefit equally from the cost saving of respect of electricity supply resulting from the demand management policy.
13. Further, CC is of the view that despite the financial incentive provided under SCAs for the two power companies to have more usage of renewable energy, there has been very little progress in adopting renewable energy in the last five years. Despite the technical issue and the cost effectiveness issue of introducing renewable energy, the Government should urge the two power companies to take up more social obligation by devoting their efforts on exploring the future development and application of renewable energy. The two power companies also need to provide more information about their commitments to provide Hong Kong consumers with a choice of cleaner energy in future.
14. The Government has stated its intention to introduce competition to the electricity market as early as 2018. CC believes that it would be necessary to require the two power companies to publish a comprehensive range of performance and financial data for public scrutiny. Full disclosure by way of separate account reporting by different segments could enhance transparency and provide the necessary information for formulating the possible market reform of the electricity sector beyond 2018.