For discussion on
26 November 2012

Legislative Council Panel on Economic Development

The Scheme of Control Agreements with the Two Power Companies Interim Review in 2013

Introduction

This paper invites Members' views on the interim review of the Scheme of Control Agreements (SCAs) to be conducted by the Government with the two power companies starting in January 2013.

Background

2. The existing SCAs signed between the Government and CLP Power Hong Kong Limited, ExxonMobil Energy Limited and Castle Peak Power Company Limited (referred to collectively as "CLP" hereafter), and between the Government and the Hongkong Electric Company Limited and the then Hongkong Electric Holdings Limited (renamed as Power Assets Holdings Limited) (referred to collectively as "HEC" hereafter), came into effect on 1 October 2008 and 1 January 2009 respectively.

3. By signing the SCAs, the power companies undertake to provide sufficient facilities to meet present and future electricity demand of their respective supply areas. In return, they are entitled to receive a permitted return on their fixed assets. The SCAs also provide the framework for the Government to regulate the power companies and monitor their financial affairs and other matters specified in the SCAs to protect the interests of consumers. The current SCAs have a term of ten years and will expire in 2018. The Government may, but is not obliged to, at its own option extend the term for a further period of five years to 2023.

4. The full sets of the SCAs with the two power companies can be found in the website of the Environment Bureau

(http//www.enb.gov.hk). Some of the major terms of the SCAs are set out in the ensuing paragraphs.

Permitted rate of return

5. The SCAs set the permitted rate of return on the Average Net Fixed Assests (ANFA) of CLP and HEC at 9.99%, down from 13.5% to 15% in the previous SCAs, resulting in a cut of the two companies' earnings by over $5 billion every year. Separately, financial incentives are provided to the two power companies for improving their performance in energy efficiency. Also, financial incentives are provided to them for improvement in operational efficiency, supply reliability and customer services, while disincentives will be included where appropriate to discourage under-performance. The incentives ceiling is capped at 0.05 percentage point above the rate of return. In monetary terms, the above incentives amounted to $45 million for CLP and $20 million for HEC, based on performance in 2011.

6. To encourage more usage of Renewable Energy (RE), the SCAs provide that investments by the two power companies on RE facilities can earn a rate of 11%. Incentives of additional return are provided to further encourage investment in RE.

Emission performance linkage mechanism

7. As regards the link between the permitted rate of return of power companies and their emission performance, the SCAs provide a penalty level of 0.4 and 0.2 percentage points reduction of return on all non-RE fixed assets for exceedance of any of the emission caps of ≥30% and ≥10% respectively. On the other hand, the power companies can earn a relatively smaller financial incentive for their over-achievement of all the emission caps (0.1 and 0.05 percentage points increase of rate of return for over-achievement of ≥30% and ≥10% respectively).

Stranded costs

8. With Government's stated intention to introduce competition to the electricity market in as early as 2018 and in line with international practices, the SCAs provide that in the event of a change implemented by

the Government to the electricity supply market structure that causes material impact to the power companies, they shall recover from the market stranded costs that cannot be mitigated by measures required by the Government. The amount of stranded costs that can be recovered from the market and the mechanism are to be agreed between the Government and the power companies.

Tariff

9. The SCAs provide that if the proposed basic tariffs do not exceed those approved by the Executive Council for the relevant year in the prevailing Development Plan by more than 5% (down from 7% in the previous SCAs), power companies are entitled to implement the basic tariff rates for the year without the need for Government's approval. Through this mechanism, the Government will have a say on the tariffs charged as proposed by the power companies in the Development Plan. Should there be significant changes (exceeding 5% of the approved level), further approval by the Executive Council is required.

Mechanism for treatment of excess generating capacity

10. If a new generating facility is found to be excessive upon commissioning, a portion (50% for CLP and 50% for HEC) of the net asset value on mechanical and electrical equipment relating to that facility would be excluded from the company's ANFA for calculating the return. Such penalty will be removed when demand catches up with generation capacity. The mechanism will not apply to RE assets, and will cease to apply altogether should there be new supplies in the respective supply areas served by the two companies.

Tariff Stabilisation Fund

11. The SCAs provide for the maintenance of a Tariff Stabilisation Fund (TSF) for the retention of net revenue in excess of the agreed return for the power company, which when necessary will provide funds to ameliorate the impact of tariff increase for consumers. The cap on TSF balance is 8% of annual local sales, down from 12.5% in the previous SCAs.

Energy efficiency

12. The SCAs provide that the two power companies should set up a loan fund ($25 million and $12.5 million per annum for CLP and HEC respectively over a five-year period (amounting up to $125 million and $62.5 million in total) to provide loans to non-Government customers to implement energy saving initiatives identified in energy audits to promote energy efficiency. Education fund is also set up by the two companies ($5 million and $2.5 million per annum for CLP and HEC respectively) for energy efficiency and promotion activities.

Mid-term review in 2013

13. The Government is making preparation for the mid-term review of the SCAs with the two power companies respectively in early 2013 in accordance with the SCAs. We are currently engaging experts, academics, green groups and other stakeholders on the interim review and relevant energy matters to solicit their views. We already convened two engagement sessions with stakeholders in end October and will continue the engagement process before commencing the interim review.

14. The SCAs provide that the power companies and the Government shall have the right, during the year ending 31 December 2013, to request modification of any part of the SCAs. On the other hand, it is relevant to note that mutual agreement between the Government and the respective power companies is needed before any proposed modification to the SCAs may be implemented. We would report the outcome of the review at appropriate junctures.

Members' Advice

15. Members' views are invited on the 2013 interim review.

Environment Bureau
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