立法會
Legislative Council

LC Paper No. CB(1)260/12-13(10)

Ref: CB1/PL/EDEV

Panel on Economic Development
Meeting on 11 December 2012

Background brief on
Annual tariff reviews with the two power companies

Purpose

This paper sets out the background of the Government's annual tariff reviews with the two power companies and summarizes Members' concerns raised on related issues.

Regulation of electricity supply in Hong Kong

2. Electricity supply in Hong Kong is regulated through the Scheme of Control agreements (SCAs) signed between the Government and individual power companies, namely, The Hongkong Electric Company Ltd. ("HEC")[1] which supplies electricity to customers on the Hong Kong Island, Ap Lei Chau and Lamma Island, and CLP Power Hong Kong Ltd. and Castle Peak Power Company Ltd. ("CAPCO")[2] (referred to collectively as "CLP" hereafter) which jointly supply electricity to customers in Kowloon and the New Territories including Lantau, Cheung Chau and some outlying islands. The SCAs set out the rights and obligations of the power companies and provide a framework for the Government to monitor the power companies' financial affairs and technical performance. To achieve the policy objective of providing reliable, safe and efficient electricity supply at reasonable prices, the SCAs include the following key features –

---

1 HEC is a subsidiary of Power Assets Holdings Limited.

2 CLP Power Hong Kong Ltd. is a subsidiary of the CLP Holdings Limited. CAPCO is a joint venture electricity generating company established between CLP Power (40%) and ExxonMobil Energy Limited (60%).

(a) an obligation for the power companies to provide sufficient facilities to meet present and future electricity demand;

(b) an obligation for the power companies to supply electricity at lowest possible cost; and

(c) provision for periodic financial review and annual tariff review, and for annual audit of the technical and financial performances of the power companies.

3. The existing SCAs were entered into between the Government and individual power companies on 7 January 2008. The following changes to the previous SCAs were made –

(a) the duration of the SCAs was shortened to ten years, with an option exercisable by the Government to extend for five years, i.e. until 2023, after a review of the prevailing market conditions including whether new supply sources were available;

(b) the annual permitted rate of return was reduced from 13.5% - 15% to 9.99% on the average net fixed assets ("ANFA");

(c) a linkage mechanism between the permitted rate of return and the emission performance of the power companies was introduced. The penalty level was set at 0.4 and 0.2 percentage points reduction of return on all non-renewable energy fixed assets for exceeding any of the emission caps of ≥30% and ≥10% respectively. A smaller financial incentive was provided for over-achievement of the emission caps (i.e. 0.1 and 0.05 percentage points increase of rate of return for over-achievement of ≥30% and ≥10% respectively);

(d) financial incentives were provided to encourage more usage of renewable energy;

(e) the portion of the net asset value on machinery and electrical equipment relating to new generating facility found to be excessive upon commissioning to meet the latest electricity demand for exclusion from the companies' ANFA would be set at 50% for both power companies (previously 40% for CLP and 50% for HEC);

(f) the threshold above which the Executive Council's approval was required for adjustment of the Basic Tariff was lowered from 7%

to 5%, limiting the room for the powers companies to adjust their tariffs;

(g) a Tariff Stabilization Fund ("TSF") was maintained for the retention of net revenue in excess of the agreed return for the power companies and the cap on TSF balance was reduced to 8% of annual local sales from 12.5% under the previous SCAs;

(h) the Government would have unfettered discretion to introduce changes to the electricity regulatory framework, starting 1 October 2018 for CLP and 1 January 2019 for HEC, after taking into consideration market readiness and other relevant factors. The changes may include the introduction of legislation to replace the SCAs regime;

(i) with the Administration's stated intention to introduce competition to the electricity market in as early as 2018 and in line with international practices, the Administration had discussed with the power companies on the mechanism to allow the power companies to recoup the costs for the assets that would become stranded after the opening of the market. Both parties agreed that in the event of a change implemented by the Government to the electricity supply market structure that caused material impact to the power companies, the companies should recover from the market stranded costs that could not be mitigated by measures required by the Government. The amount of stranded costs that could be recovered from the market and the mechanism were to be agreed between the Government and the power companies;

(j) recognizing that the relatively longer period of time to recoup investments in the power sector was a genuine concern, CLP and HEC would be allowed to earn the same permitted rates of return on their ANFA (including those incurred or invested in the eleventh year to the fifteenth year if approved by the Government), as mutually agreed for the SCAs, up to 2023; and

(k) the Government and the power companies would discuss the market readiness, potential changes to the electricity regulatory framework and transition issues before 1 January 2016.

The Five-year Development Plan

4. The Government approved the five-year development plans of CLP and HEC on 23 September 2008 and 16 December 2008 respectively. According to CLP's development plan which lasts from 1 October 2008 to 31 December 2013, the capital project expenditure will amount to $39.9 billion and the projected average annual increase in the Basic Tariff for the period is below the forecast inflation of Government's Medium-Range Forecast. For HEC's development plan lasting from 1 January 2009 to 31 December 2013, the capital project expenditure will amount to $12.3 billion, and it projects on average a decrease in the Basic Tariff per annum during the period.

The tariff adjustment mechanism

5. Electricity tariff is made up of two parts, namely, the Basic Tariff and the fuel clause charge. To ensure that tariff adjustment is reasonable, the Administration would play a gate-keeping role in which cost relating to the Basic Tariff is controlled by way of ensuring that any necessary developments and service improvements of the power companies would proceed within the scope of their five-year development plans approved by the Government, and by vetting in the context of the annual tariff review individual expenditure items, including capital investment, of the two companies to screen out items that are excessive, premature or unnecessary. As to the fuel clause charge, the Administration would urge the two power companies to, as far as practicable, use the Fuel Clause Recovery Account ("FCA")[3] and TSF[4] as buffers to mitigate the cost impact of any switch from old fuel contracts to new contracts, and any significant fuel price fluctuations in the international market. It would also examine whether any special income of the two companies can be used to offset cost increase.

---

3 FCA is operated on a rolling basis. It is an account maintained by the two power companies through which the difference between the standard fuel cost (as reflected in the Basic Tariff) and the actual fuel cost is captured and passed on to consumers by way of rebates or charges.

4 The purpose of TSF is to accumulate the excess of net revenues of the power companies over the permitted return, so as to provide funding, where necessary, to ameliorate the impacts of tariff increases on consumers.

Tariff adjustments since 2004

6. The Government conducted tariff reviews with the two power companies annually and the average net tariffs charged by HEC and CLP since 2004 are set out below –

Year	HEC (cents/kWh)	CLP (cents/kWh)
2004	103.3	87.2
2005	110.0 (+6.5%)	87.3
2006	117.4 (+6.7%)	87.1
2007	120.2 (+2.4%)	87.2
2008	127.4 (+6.0%)	91.1 [a] (+4.5%)
2009	119.9 (-5.9%)	88.4 [b] (-3%)/89.2 [b]
2010	119.9	91.5 (+2.6%)
2011	123.3 (+2.8%)	94.1 (+2.8%)
2012	131.1 (+6.3%)	98.7 (+4.9%)

Note: [a] from January to September 2008
[b] from October 2008 to December 2009 during which the Rate Reduction Reserve rebate of 0.8 cents/kWh ceased from 6 May 2009 with the depletion of the Rate Reduction Reserve.

Council deliberations

7. On 18 January 2012, the Council passed a motion urging the Government to, among others, take the following actions so as to create a sustainable and open electricity market –

(a) establish an energy management authority to explore Hong Kong's long-term energy demand, formulate and execute an energy policy, as well as monitor power companies, gas companies, liquefied petroleum gas companies and fuel supply companies;

(b) review the permitted returns of the two power companies;

(c) immediately activate the mechanism for interim reviews, and make public the relevant information and accounts, so as to facilitate public participation;

(d) study the computation mode based on linking permitted returns to fixed assets;

(e) raise the transparency of the processes for the formulation of SCAs and tariff adjustments, so as to facilitate public monitoring and ensure fair and reasonable tariff adjustment rates; and

(f) launch a review of the two power companies' development plans in accordance with the provisions of SCAs, increase the transparency of the development plans, and require the two power companies to revise their investment plans, revalue their assets, compress costs and rationalize their accounts.

Views expressed by the Panel on Economic Development

8. Electricity tariff has all along been a matter of contention and members of the Panel on Economic Development ("the Panel") have expressed views and concerns over a range of issues at the annual briefings on tariff reviews, including the following –

(a) disappointment at decisions of HEC and CLP to raise tariff despite the companies' substantial earnings;

(b) HEC's customers were paying tariff at a much higher rate than those of CLP;

(c) suggestion of setting up a tariff determination mechanism;

(d) introduction of electricity suppliers from the Mainland to enhance competition and lower the tariff;

(e) implementation of increased interconnection between the two power companies to minimize investment on new generating units;

(f) the Government should enhance monitoring of the power companies' investment on generation facilities, treatment of excessive generating capacity, and sales of surplus electricity to the Mainland;

(g) the Government should enhance transparency by urging the two power companies to disclose financial information related to the tariff reviews;

(h) separation of power production and transmission to facilitate market entry;

(i) the power companies should exercise greater versatility in handling the coal procurement contracts in the interests of customers;

(j) the Government should monitor the timing of the adjustment of fuel clause charges made by the power companies;

(k) the need to strike a balance between commitment to environmental protection and cost control; and

(l) the power companies should use the reserve in TSF to offset the fuel cost increase, or opt not to achieve a maximum rate of return.

Contentions with the 2012 tariff review

Reduction of the rates of tariff increase

9. The 2012 tariff review was controversial. Not only did the issue entailed deliberations at five Panel meetings but it was also the first time that the Government could not come to terms with the two power companies on the extent of tariff increase. The matter also attracted grave concerns of the Legislative Council and the general public. The two power companies subsequently revised their original tariff proposals by reducing the tariff increase and improving the tariff structure. Details of the relevant deliberations are elaborated in the ensuing paragraphs.

10. At the Panel meeting on 13 December 2011, HEC and CLP announced a tariff increase for 2012 of 6.3% and 9.2% respectively. Members expressed great discontent with the tariff increase which exceeded the inflation rate and requested both HEC and CLP to lower their increase. In particular, members considered it undesirable that the two power companies should, after making huge profits over the years, still seek to earn the maximum annual permitted rate of return of 9.99% under their current SCAs despite the chain effect of tariff increase on people's livelihood. The majority of members also considered that they had not been given sufficient information to assess whether the tariff increase proposals were justified. Members therefore questioned whether the Administration had properly played its gate-keeping role in vetting the rationale provided by the two companies for their tariff increase proposals.

11. The Administration advised that it had already urged the two

companies to reduce their rates of increase, particularly with regard to CLP over the following aspects –

(a) calculation of the Basic Tariff, in particular the increase in the operating expenditure, which was significantly higher than inflation, and the inclusion of a capital expenditure item which the Administration considered pre-mature, namely, the inclusion of capital investments in preparatory and early stage of works for additional generation capacity projects;

(b) the level of balances in FCA and TSF respectively; and

(c) the Government rent and rates anticipated to be refunded to the two companies as a result of relevant court cases ("the rent and rates refund").

12. Following the Panel discussion on 13 December 2011, HEC announced on 16 December 2011 improvement to its progressive tariff structure and the reduction of the rate of tariff increase to 4.97% or less for 90% of its domestic consumers. On 21 December 2011, the Council held an adjournment debate on the impact of electricity tariff increase on the general public and enterprises, as well as the Government's corresponding measures. On the same date, CLP revised downwards its tariff increase to 7.4%.

13. In view of the grave public concern about the tariff increases, the Panel held a further meeting on 23 December 2011 to discuss the issue with the Administration and the two power companies. At the meeting, the Panel passed a motion opposing to the tariff increase, and another motion urging the two companies to defer the tariff increase by two months, as well as demanding the Government and the two companies to submit to the Panel before 1 January 2012 the financial information relating to the capital investment of the two companies in the coming five years as well as their operating expenditures. CLP was also urged to lower the tariff increase by reducing the operating costs, taking out the capital investment projects not agreed by the Administration and making use of TSF, and to lower the tariff immediately upon receipt of the rent and rates refund. Hon Fred LI and Hon Emily LAU also jointly moved a motion requesting that the Panel be authorized to exercise the powers conferred by the Legislative Council (Powers and Privileges) Ordinance (Cap. 382) to order the Government to produce information. The motion was negatived.

14. CLP subsequently announced on 30 December 2011 a further reduction of the tariff increase from 7.4% to 4.9%. According to CLP, the reduction had been achieved by reducing operating costs, taking out

premature capital investment for increasing generation capacity, reducing the projected TSF balance and providing a one-off Rent and Rates Rebate by returning the rent and rates refund to customers.

Measures to keep costs down

15. Concerned about the likely tariff increase in future due to escalating fuel prices, some members urged the Administration to begin the negotiation process of the 2013 tariff review early. They also called on the Administration and the two power companies to explore measures and practices in operations which could keep costs down. Other members considered the reserve margins of the generation capacity of the two companies way too excessive, and opined that the Administration should more stringently vet the capital investments in generation capacity in the two companies' five-year development plans. There were also views that to contain tariffs, other sources of electricity should be explored, and that efforts should be made to encourage energy saving to contain electricity demand and obviate the need to make further capital investments in this regard.

16. The Administration undertook to listen to the views of members and the public in formulating the five-year development plans and reviewing tariff adjustments, and to ensure that the electricity supply in Hong Kong could achieve the policy objective of striking a balance amongst reliability, safety, environmental protection and affordability.

Enhancing the transparency of tariff adjustment

17. When the Panel discussed the 2012 tariff review, members repeatedly requested the Administration and the two power companies to provide detailed financial information relating to the capital investment of the two companies in the coming five years as well as their operating expenditures with a view to ascertaining whether the rates of tariff increase for 2012 were justified. Two special Panel meetings were subsequently scheduled for 3 and 7 February 2012 to examine the requested information. The two power companies, however, insisted that the requested information should be provided to the Panel on a confidential basis on grounds that disclosure of information related to contract requirements and projections of future business (e.g. capital expenditure and electricity sales) would enable suppliers to easily assess the budget estimates of certain projects, or know in advance the two companies' demand for services, and increase their bargaining power. This might cause an increase in the capital expenditure or costs of the two companies, affecting future tariff increases, and jeopardizing the interests of the public. The two companies further argued that if the information was not kept confidential, there might be a violation of

the Hong Kong Listing Rules requirements and detriment to the interests of small shareholders, or a breach of the Securities and Futures Ordinance (Cap. 571).

18. Many members, however, considered it difficult to clearly explain to the public the basis of their views on the 2012 tariff adjustments if the requested information could not be quoted at Panel meetings which were held in the public. After further discussion at the special meeting on 3 February 2012, the two companies agreed to provide marked-up copies of their business-related confidential information, with the details that had to be kept strictly confidential duly highlighted to facilitate open discussion without worrying about inadvertent disclosure of confidential information. Consequently, at the Panel meeting on 7 February 2012, members discussed, with closed-door and relevant confidentiality arrangements in place, the requested supplementary information provided in the form of confidential documents.

Views and concerns expressed at the Panel discussion on the interim review of the Scheme of Control agreements

19. When the Administration consulted the Panel on the interim review of the SCAs in 2013 at the meeting on 26 November 2012, members urged the Administration to consider taking the following actions –

(a) further reduce the permitted rate of return for the two power companies;

(b) urge the power companies to give incentives customers to save energy as under the existing tariff system, customers using more electricity paid at a lower rate of charge than those who consumed less;

(c) urge the power companies to consider imposing different rates of tariff which tie in with the electricity consumption during different periods of the day;

(d) review the level of the reserve capacity of the two power companies;

(e) enhance the transparency of the emission control systems of the two power companies, and assigning a third party to assess the emission performance of the two companies;

(f) conduct a review on the policy to use electricity generated by nuclear energy;

(g) explore the possibility of using cheaper type(s) of natural gas for power generation purpose;

(h) prepare early if the Administration intends to introduce competition in the electricity market in 2018, in particular in respect of the arrangement to allow the power companies to recoup the costs for the assets that would become stranded after the opening of the market; and

(i) consult the public on any changes to policies relating to electricity supply.

Latest developments

20. The Administration and the two power companies will brief the Panel on the tariff review for 2013 at the meeting on 11 December 2012.

References

21. A list of the relevant papers is in **Appendix I**.

Council Business Division 1
<u>Legislative Council Secretariat</u>
7 December 2012

Appendix I

Annual tariff review of the power companies

List of relevant papers

Administration's paper on The Hong Kong Electric Company Limited 2009 to 2013 Development Plan issued by Environment Bureau (Legislative Council Brief)
http://www.legco.gov.hk/yr08-09/english/panels/edev/papers/edev1216-enbcr2457608pt4-e.pdf

Administration's paper on CLP Power Hong Kong Limited and Castle Peak Power Company Limited 2008 Development Plan issued by Environment Bureau (Legislative Council Brief)
http://www.legco.gov.hk/yr08-09/english/panels/edev/papers/edev1124-enbcr1457608pt6-e.pdf

Administration's paper on New Scheme of Control Agreements with the two power companies
http://www.legco.gov.hk/yr07-08/english/panels/es/papers/edevcb1-546-1-e.pdf

LegCo question at the Council meeting on 10 June 2009: Fuel clause charge (Page 8798)
http://www.legco.gov.hk/yr08-09/english/counmtg/hansard/cm0610-translate-e.pdf

LegCo question at the Council meeting on 28 October 2009: Electricity tariffs of the two power companies (Page 415)
http://www.legco.gov.hk/yr09-10/english/counmtg/hansard/cm1028-translate-e.pdf

LegCo question at the Council meeting on 13 January 2010: Impact of the use of natural gas and wind power in electricity generation on electricity tariff (Page 4050)
http://www.legco.gov.hk/yr09-10/english/counmtg/hansard/cm0113-translate-e.pdf

Motion debate at the Council meeting on 8 February 2012: Seeking papers, books, records or documents in relation to the 2012 tariff adjustments by CLP Power Hong Kong Limited and The Hongkong Electric Company Limited (Page 5395)
http://www.legco.gov.hk/yr11-12/english/counmtg/hansard/cm0208-translate-e.pdf

Papers for the Panel meetings on 13 December 2011, 23 December 2011, 3 February 2012, 7 February 2012 and 27 February 2012
http://www.legco.gov.hk/yr11-12/english/panels/edev/agenda/edev20111213.htm
http://www.legco.gov.hk/yr11-12/english/panels/edev/agenda/edev20111223.htm
http://www.legco.gov.hk/yr11-12/english/panels/edev/agenda/edev20120203.htm
http://www.legco.gov.hk/yr11-12/english/panels/edev/agenda/edev20120207.htm
http://www.legco.gov.hk/yr11-12/english/panels/edev/agenda/edev20120227.htm

Minutes of the Panel meetings on 19 December 2000, 21 December 2001, 10 December 2002, 16 December 2003, 16 December 2004, 23 December 2005, 21 December 2006, 21 December 2007, 24 November 2008, 16 December 2008, 8 December 2009, 14 December 2010, 13 December 2011, 23 December 2011, 3 February 2012, 7 February 2012 and 27 February 2012
http://www.legco.gov.hk/yr00-01/english/panels/es/minutes/es191200.pdf
http://www.legco.gov.hk/yr01-02/english/panels/es/minutes/es011221.pdf
http://www.legco.gov.hk/yr02-03/english/panels/es/minutes/es021210.pdf
http://www.legco.gov.hk/yr03-04/english/panels/es/minutes/es031216.pdf
http://www.legco.gov.hk/yr04-05/english/panels/es/minutes/es041216.pdf
http://www.legco.gov.hk/yr05-06/english/panels/es/minutes/es051223.pdf
http://www.legco.gov.hk/yr06-07/english/panels/es/minutes/es061221.pdf
http://www.legco.gov.hk/yr07-08/english/panels/es/minutes/ev071221.pdf
http://www.legco.gov.hk/yr08-09/english/panels/edev/minutes/edev20081124.pdf
(briefed by CLP)
http://www.legco.gov.hk/yr08-09/english/panels/edev/minutes/edev20081216a.pdf
(briefed by HEC)
http://www.legco.gov.hk/yr09-10/english/panels/edev/minutes/edev20091208.pdf
http://www.legco.gov.hk/yr10-11/english/panels/edev/minutes/edev20101214.pdf
http://www.legco.gov.hk/yr11-12/english/panels/edev/minutes/edev20111213.pdf
http://www.legco.gov.hk/yr11-12/english/panels/edev/minutes/edev20111223.pdf
http://www.legco.gov.hk/yr11-12/english/panels/edev/minutes/edev20120203.pdf
http://www.legco.gov.hk/yr11-12/english/panels/edev/minutes/edev20120207.pdf
http://www.legco.gov.hk/yr11-12/english/panels/edev/minutes/edev20120227.pdf

Council Business Division 1
Legislative Council Secretariat
7 December 2012