

**For discussion on
16 December 2014**

Bills Committee on District Cooling Services Bill

Responses to follow-up questions arising from the previous meeting

Purpose

This paper sets out the Administration's response to the questions raised by Members at the meeting of 25 November 2014.

(a) In respect of the Administration's decision to provide the district cooling services through legislative means:

(i) Whether the Administration has considered any alternative means to provide district cooling services to potential users in the Kai Tak Development (KTD), such as by contractual means; if yes, details of the alternative means that were considered and the relevant legal justifications for not adopting the relevant means; if not, the considerations of not considering any alternative means before proposing the District Cooling Services Bill (the Bill);

(ii) The relevant legal justifications for deciding to provide district cooling services and to charge for the services concerned through legislative means, including an elaboration on the application of the authority which is stated in paragraph (iii) of the letter dated 21 November 2014 issued by the Administration and the legal justifications in addition to the said authority.

2. The Administration considered it not feasible to adopt means other than legislation for the Government to charge for the provision of district cooling services from non-Government users, to offset the operating costs from the revenue collected and to provide for the

necessary powers, duties and other matters in relation to the provision of the district cooling services in view of the considerations detailed below.

3. Firstly, as mentioned in the Administration's replies to the Legislative Council (LegCo) Panel on Environmental Affairs dated 25 July 2014 (CB(1)1903/13-14(01)) and to the LegCo Secretariat dated 21 November 2014 (CB(1)272/14-15(02)) respectively, the Administration has sought legal advice which indicates that there should be clear and explicit statutory authority based on which the Government may impose a charge or a fee. Further elaborations on the legal authority referred to in paragraph (iii) of the Administration's letter dated 21 November 2014 to the LegCo Secretariat are set out as follows.

4. The long established principle that statutory authority to charge is required was re-affirmed in the case of McCarthy & Stone (Developments) Ltd. v Richmond upon Thames London Borough Council [1992] 2 A.C. 48. In this case, the respondent local planning authority adopted a policy of charging a fee for consultations between developers and the authority's planning officers before a formal application for planning permission for speculative development or redevelopments was made. The applicant developers challenged the legality of the charge and applied for a judicial review of the authority's decision of not to revoke its policy to make such a charge. On appeal by the developers to the House of Lords, it was held that no charge could be made for pre-application advice in the absence of statutory authority, either express or arising by necessary implication. The giving of pre-application advice was not itself a function of the local planning authority within the meaning of section 111(1) of the Local Government Act 1972 and that to charge for such advice did not facilitate, nor was it conducive or incidental to, the authority's functions of considering and determining planning applications within the meaning of the subsection. Besides, the power to charge did not arise by necessary implication even though the authority had no obligation to provide the service which at its discretion it provided. Accordingly, the House of Lords held that the charge was unlawful.

5. The principle established in the McCarthy case is that there should be clear statutory authority based on which the Government may impose a charge or a fee. In the case of the District Cooling System (DCS), since the Government in effect will charge the users for the use of the district cooling services, there should be clear statutory basis for the Government to impose charges for the services.

6. Secondly, as explained in the Administration's paper to the LegCo Panel on Environmental Affairs in July 2014 (CB(1)1785/13-14(01)), section 3(1) of the Public Finance Ordinance (Cap. 2) provides that any charges received for the purposes of the Government shall form part of the general revenue, unless there are express statutory provisions to provide for alternative arrangements. In order to empower the Electrical and Mechanical Services Department (EMSD) to make use of the DCS charges and fees received by the Government to settle payment to the DCS contractor as well as utility costs arising from the operation of the DCS directly, the Administration will need to introduce the relevant statutory provisions to provide for this offsetting arrangement.

7. Moreover, it is necessary to provide for the necessary powers and duties in relation to the operation of the district cooling services such as access for inspection and maintenance, appeals, offences and evidential matters, which all require legislation.

8. On the basis of the above considerations, it would be necessary for the Administration to introduce a new piece of legislation to provide legal backing for the Government to collect charges from non-Government users of the district cooling services, and to use the revenue collected to offset the operating costs incurred by EMSD, as well as for other matters relating to the provision of the services for which legislation is required.

(b) In respect of district cooling services which have been provided by the Administration (or by any service provider together with the Administration), details of the arrangements, in particular, the services which are provided to the Kai Tak Cruise Terminal and the Ching Long Shopping Centre located in KTD, including the means of providing such services and the charging arrangement.

9. As mentioned in the LegCo brief on the Bill issued in September 2014, with the completion of the Phase I DCS project in early 2013, district cooling services to Kai Tak Cruise Terminal building and Ching Long Shopping Centre under the Hong Kong Housing Authority (HA) commenced in February 2013 and May 2013 respectively. Details of the service provision and charging arrangements are provided below.

10. EMSD, as the district cooling services provider in KTD, is responsible for the provision of district cooling services to all consumers through the operation of the DCS. EMSD has employed a design-build-operate (DBO) contractor through open tender to carry out the construction and day-to-day operation of the DCS as per the established procurement procedures and practices. The contractor is overseen and supervised by EMSD to ensure that proper and satisfactory service could be delivered to the consumers.

11. In respect of the district cooling services provided to Kai Tak Cruise Terminal, since the Tourism Commission is part of the Government, it is not subject to district cooling services charges under the Bill. EMSD recovers the utility cost arising from the provision of district cooling services from the Tourism Commission, which in turn recovers the charge from the operator. The payment of the utility cost is effected by an internal funding transfer through administrative arrangement.

12. Notwithstanding this, the notional “revenue” from Government departments (which could have been received by EMSD if Government departments, including the amount that would have been payable under the Bill had the Tourism Commission been a public consumer, were to

be charged for district cooling services in the same way as non-Government buildings using district cooling services at KTD) will be incorporated into the financial model for assessing the DCS's financial performance and for calculating the appropriate tariff that can achieve full cost recovery.

13. As for the charging arrangements with HA (which is a financially autonomous body), EMSD currently collects charges for the district cooling services from HA on the basis of a Memorandum of Administrative Arrangements entered between HA and the Government, which provides that HA is required to pay to the Government for services provided by the Government. The charges collected form part of the general revenue as provided in section 3(1) of the Public Finance Ordinance (Cap. 2). In this context, EMSD cannot directly utilize the district cooling services charges collected from HA to support the provision of DCS unless it is empowered by the law to do so. However, upon the passage of the Bill which provides for, among others, the offsetting arrangement, EMSD would be able to apply the charges collected from HA to settle the operation and maintenance fees for the DCS operator as well as utility charges for operating the DCS plants.

14. Regarding some of the members' enquiries on whether the operation of the DCS could be carried out by the Electrical and Mechanical Services Trading Fund (EMSTF) instead of the DBO contractor, we would like to clarify that this option is not feasible because under the "Electrical and Mechanical Services Trading Fund Regulation" (Cap. 430 sub. leg. G), the EMSTF was established to manage and account for the operation of certain government services of EMSD. In other words, EMSTF can only provide services to government users and public bodies. In the case of DCS, as many of the consumers are private non-residential developments, it would not be appropriate to apply the EMSTF for operation of the DCS.

(c) In respect of district cooling services which are proposed to be provided by the Bill:

(i) Details concerning how district cooling services will be provided in KTD, in particular whether any service providers will be involved besides the Administration and, if yes, the relevant arrangements including how the service provider is selected and the relationship between the Administration and the service provider.

15. EMSD as the district cooling services provider in KTD is responsible for the provision of district cooling services to all consumers through the operation of the DCS. The construction and day-to-day operation of the DCS is carried out by a DBO contractor employed by EMSD as per the established procurement procedures and practices. The contractor is overseen and supervised by EMSD which is responsible for ensuring that proper and satisfactory service could be delivered to the consumers.

(ii) Details of the arrangements for money that is receivable or received pursuant to the provision of district cooling services proposed by the Bill.

16. As mentioned in the LegCo brief on the Bill, the provision of DCS will incur substantial expenses on the part of EMSD for settling the operation and maintenance fees for the contractor as well as utility charges for operating the DCS plants. As mentioned above, EMSD cannot directly utilize the district cooling services charges collected to support the provision of DCS unless it is empowered by the law to do so.

17. Subject to the passage of the Bill, those parts of the charges and fees collected from consumers (i.e. non-government users) that are required for the purposes of settling payment to the DCS contractor or other expenses arising from the provision of district cooling services (including electricity and water consumption, operation, maintenance, management, repair, replacement and modification, etc.) will not form part of the general revenue and may be used to cover such operating expenses incurred by EMSD.

18. It is expected that in the initial years of operation, the number of completed developments in KTD is still relatively small, the revenue would not be able to cover all the operating costs incurred by EMSD for the district cooling services. However, as the number of completed developments increases in subsequent years, the project would be able to achieve a reasonably high subscription rate from the private non-domestic development in KTD given its competitiveness over other forms of air-conditioning. Should the charges collected exceed the operating costs incurred by EMSD for the district cooling services, the surplus will be transferred to the Government's General Revenue Account. The surplus, in context, represents the recoupment of the capital costs of the DCS project.

(d) Clarify whether option would be given to individual occupiers/tenants of a building to which district cooling services are provided to opt out for subscription to the services, and if so, how this could be effected in terms of legal and technical arrangements.

19. Since DCS provides chilled water to the heat exchanger(s) of user buildings for cooling purpose, one of the prerequisites for connection to DCS and subscription to district cooling services is that the building concerned has to be installed with a central air-conditioning system using chilled water.

20. The district cooling services tariff will be collected from the building owners of the central air-conditioning system or their authorized agents such as the building management offices (known as "approved consumers"¹ in the Bill) on a monthly basis. An approved consumer could apply for cessation of the approval as a consumer of the district

¹ Approved consumer, in relation to a building, means a person who is approved under clause 4 of the Bill as the consumer of district cooling services for the building.

As set out in clause 4(1) of the Bill, an owner or occupier of the building, or a person responsible for the management of the building, may apply to the Director of Electrical and Mechanical Services in a specified form for approval as the consumer of district cooling services for a building.

cooling services in accordance with clause 9 of the Bill². As for individual users within a building, as with the tenants or occupants of any other buildings using central air-conditioning systems, their use of air-conditioning services and the charging arrangements are to be decided and negotiated between them and the building owner or the management company.

Advice Sought

21. Members are invited to note the content of this paper.

Environment Bureau
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² The application must (a) state the intended date of the cessation; and (b) be made at least one month before that date.