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Ms Debbie Yau
Clerk to Panel (Economic Development)
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Ms Yau,

**The Hong Kong and China Gas Company Ltd. (Towngas)
Basic Tariff Adjustment**

Thank you for your letter of 15 July. Regarding the questions from Hon. Tang Ka-piu on Towngas' basic tariff adjustment, we provide our reply below.

Justifications for tariff adjustment

Towngas advised that they would carefully consider impact on the public whenever they adjust tariff. They would also consider the competition from other alternative energy sources in the market, such as electricity and liquefied petroleum gas, to maintain price competitiveness.

Towngas does not adjust its basic tariff frequently. Prior to the present adjustment, Towngas has only raised its basic tariff four times in the last 18 years, i.e. since 1997. The accumulated increase was 14.3%, which was much lower than the accumulated inflation rate of 25.2% in the same period. The current adjustment to raise the basic tariff by 1 cent per megajoule (MJ) is equivalent to a 4.4% increase in basic tariff, or a 3.5% increase in the 2014 effective tariff (inclusive of both basic tariff and fuel cost variation charge (FCVC)). Such adjustment is lower than the cumulative inflation rate of about 9% since the last adjustment two years ago in April 2013.

As the price of naphtha (which is part of the feedstock) dropped in the past 2 years following the trend of crude oil price, the fuel cost variation charge decreased by around 50%. The effective town gas price in the first half of 2015 was 11% lower than the average in 2013. Thus, even after the current round of tariff adjustment, the effective town gas price for customers would still be about 7% lower than that in 2013.

Towngas estimates that the impact of the current tariff adjustment on customers is mild. Almost 80% of its residential customers would pay not more than \$10 extra for their gas supply each month. The monthly average increase is \$7.3.

Some 90,000 customers under the concession schemes for the elderly, people with disabilities, low income and single parent families would not be affected by the current tariff adjustment. Towngas has also committed to freeze the basic tariff in the coming two years after the current round of tariff adjustment.

Towngas explains that the upward adjustment is to cope with the inflationary increase in operating costs and to maintain high quality customer services. The last tariff adjustment was made in April 2013, which is more than two years from now. Due to the inflationary pressure (cumulative increase of about 9% in the last two years), manpower cost increased by over 10%, rental expenses raised by over 20% and Government rent and rate as well as depreciation were up over 5%. Although Towngas has exercised cost savings and process improvement measures to increase productivity and control costs, it is still unable to cope with the cost increases. In addition, in order to cope with the development of Hong Kong and enhance the safety and supply reliability of gas supply system, Towngas needs to continue to invest in its infrastructure. Just for the past two years alone, Towngas has already invested over \$2 billion in this regard.

Pursuant to the Information and Consultation Agreement (ICA), Towngas needs to consult the Government in advance of a tariff adjustment, and shall provide the Government with detailed information of the adjustment. The Government would request Towngas to provide strong justifications for the adjustment, such as reasons for the rise in operating costs, details of continuous

investment in infrastructure for the urban development and in maintaining safe and reliable services, etc.

Also, Towngas currently publishes an annual Corporate Information Booklet disclosing the financial, operational, environmental and safety information of the previous year in accordance with the ICA. The Government has been monitoring the overall energy market to ensure the normal functioning of the market mechanism and maintain competition. Our objectives are to ensure safety, reliability, environmental-friendliness and reasonable prices in energy supply.

Tariff charging mechanism

Regarding the tariff charging mechanism, Towngas' tariff is composed of two parts. The first part is basic tariff while the second part is FCVC.

For the first part on basic tariff, it is calculated based on the consumption times the unit rate per MJ at that consumption tier. For the second part on FCVC, since the prices of naphtha and natural gas for town gas production follow the trend of crude oil price changes, Towngas would reflect the fuel cost changes in the gas bill through the FCVC.

Towngas would report the change in FCVC to the Government monthly. In addition, in view of the rising price of naphtha, Towngas introduced natural gas to replace part of the naphtha as feedstock to produce town gas from October 2006. This has brought down the actual fuel costs and Towngas has fully passed on the fuel cost savings to customers in their gas bills through the FCVC mechanism. Towngas said that the fuel cost savings has amounted to some \$14 billion over the years.

Yours sincerely,



(Ms Esther Wang)

for Secretary for the Environment