

# **立法會**

## ***Legislative Council***

LC Paper No. CB(1)1046/2023(05)

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### **Panel on Environmental Affairs**

**Meeting on 28 November 2023**

### **Background brief on the Scheme of Control Agreements with the two power companies**

#### **Purpose**

This paper provides background information on the Scheme of Control Agreements (“SCAs”) between the Government and the two power companies (i.e. The Hongkong Electric Company, Limited and HK Electric Investments Limited (collectively referred to as “HEC”) and CLP Power Hong Kong Limited and Castle Peak Power Company Limited (collectively referred to as “CLP”)). It also summarizes the major views and concerns expressed by Members during the discussions on the subject by the relevant committees of the Legislative Council (“LegCo”) in recent years.

#### **Background**

##### Regulation of electricity supply in Hong Kong

2. Electricity supply in Hong Kong is regulated through SCAs. SCAs set out the rights and obligations of the power companies and provide a framework for the Government to monitor their financial affairs and technical performance. As required under SCAs, the power companies have to submit to the Government their Development Plans relating to the provision and future expansion of their electricity supply systems. Development Plans are subject to the approval by the Executive Council.<sup>1</sup>

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<sup>1</sup> The full set of SCAs with the two power companies can be found in the [website](#) of the Environment and Ecology Bureau.

### Electric tariff components and adjustment mechanism

3. Electricity charges in Hong Kong have two major components, namely the Basic Tariff Rate and the Fuel Clause Charge (“FCC”), and they are known as the Net Tariff Rate collectively. The Basic Tariff Rate covers the operating expenses, standard fuel charges and return to a power company. FCC reflects the changing price of fuels and is borne by consumers and payable to a power company on a cost-pass-through basis. The difference between the standard cost of fuels and the actual cost of fuels is captured in the Fuel Clause Recovery Accounts (“FCAs”) and power companies can pass on to customers by adjusting their FCCs.<sup>2</sup> The Net Tariff Rates of any particular year may be reduced if the power companies offer special rebates, which are ad hoc in nature. A table showing the electricity tariffs in 2023 and previous years is in **Appendix 1**.

4. Pursuant to SCAs, the Government conducts tariff reviews with the two power companies respectively in October each year. As a gatekeeper, the Government seeks to eliminate unnecessary capital and operating expenditures of the power companies and contain tariff increases. To achieve this purpose, the Government examines factors such as the power companies’ operating and capital expenditures, fuel prices, cost control and productivity enhancement measures, balances of FCAs and the Tariff Stabilisation Funds,<sup>3</sup> and permitted rate of return.

5. The current SCAs with HEC and CLP commenced in January 2019 and October 2018 respectively, and are effective until 31 December 2033. Major terms include those relating to the permitted returns,<sup>4</sup> tariffs, the Tariff Stabilisation Funds, promotion of energy efficiency and conservation as well as renewable energy, the Customer Performance Incentive/Penalty Mechanism, the mechanism for treatment of excess generating capacity, information transparency, and five-year Development Plans.

6. A more frequent FCC adjustment mechanism has been adopted under the current SCAs, and it covers all types of fuel used by the two power companies for electricity generation. During the annual tariff review, an

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<sup>2</sup> FCAs are accounts maintained by the two power companies through which the differences between the standard fuel charges (included in the Basic Tariff Rates) and actual fuel prices incurred are returned to or recovered from consumers by means of a rebate or a surcharge each year.

<sup>3</sup> The purpose of Tariff Stabilisation Funds 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.

<sup>4</sup> Pursuant to the current SCAs, each power company was permitted to earn a return of 8% of the total value of its Average Net Fixed Assets for the year.

FCC rate will be determined with the power companies taking into account the projected fuel costs for the coming year and the use of FCA balances (e.g. utilizing surplus balance to lower the FCC or bearing deficit balance to defer the recovery of fuel costs). Starting from March each year, the power companies will largely adjust the FCC monthly based on the previous three-month average of actual prices or costs of fuel consumed (“monthly fuel cost adjustment”). This mechanism is intended to more timely reflect the actual cost of fuels and smoothen out short-term fluctuations in fuel prices.

### **Major views and concerns expressed by Members**

7. Issues relating to SCAs, annual tariff review and fuel mix for electricity generation were discussed by the relevant Panels.<sup>5</sup> Related issues were brought up during the examination of the Estimates of Expenditure in recent years. Members’ major views and concerns are summarized in the ensuing paragraphs.

#### Measures to contain tariff increase

8. Members took the view that the Government should play a more proactive role in containing tariff increase and alleviating the financial burden on the public. Some Members suggested that the Government and the power companies should:

- (a) introduce a new mechanism under SCAs such that annual adjustment to electricity tariffs would be capped at a certain rate (e.g. Hong Kong’s inflation rate for the year), and any excess chargeable by the two power companies as permitted by SCAs would be met by government subsidies;
- (b) take the opportunity of the interim review in 2023 to modify SCAs to enhance the profit control and/or the monthly fuel cost adjustment mechanism, so as to better contain tariff increase and better demonstrate the power companies’ commitment to corporate social responsibility. For instance, fuel price risks could be shared between the Government, power companies and electricity users;
- (c) regulation and transparency of the two power companies’ operating expenses should be enhanced to better ensure that the

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<sup>5</sup> Issues relating to energy supply and safety, including SCAs and annual tariff reviews, which were formerly within the purview of the Panel on Economic Development of LegCo, are now under the purview of the Panel on Environmental Affairs after the terms of reference of the two Panels were amended in October 2022.

companies would strictly control their costs in customers' best interest, and annual adjustment to the operating expenses component of the Basic Tariffs should be capped at a certain rate linked to market indices; and

- (d) consider introducing peak-valley electricity pricing, whereby tariff rates would vary depending on the time of the day.

9. The Administration advised that:

- (a) the current SCAs would remain effective until December 2033. All changes to the SCAs would have to be mutually agreed between the Government and the power companies. Any fundamental changes to the regulatory regime for the electricity market should be introduced in the next regulatory period. The Administration would examine the need to revise the regulatory regime to enhance competition in the run-up to 2033;
- (b) given the commercial nature of Hong Kong's electricity market and that the power companies were making profits each year, the Administration did not consider it appropriate to offer regular, large-scale subsidies to electricity tariffs;
- (c) Hong Kong's electricity supply was among the most stable in the world, and its electricity tariffs remained competitive among comparable economies, even during the energy crisis. In contrast, some electricity providers in other economies had faced operating difficulties, which had resulted in power supply interruptions or required government intervention. These reflected the merits of Hong Kong's regulatory framework for electricity supply. Under this framework, the Government critically examined capital expenditures of the power companies to avoid excessive or unnecessary investments. At the same time, as the power companies were entitled to reasonable returns on their investments, they were obliged to make sufficient investments to ensure service reliability and operational safety;
- (d) despite the above, the recent energy crisis had exposed a limitation of the monthly fuel cost adjustment mechanism, which allowed the power companies to fully pass the impact of global fuel price spikes onto consumers. To address the issue, the Government would explore with the two power companies a proposal to request the companies to shoulder more social

responsibility and absorb part of the fuel cost increases in case of extreme volatility of the global fuel market;

- (e) the feasibility of introducing peak-valley electricity pricing and potential implementation options would be explored; and
- (f) the Administration endeavoured to import more clean energy from the Mainland, which could help stabilize fuel costs for electricity generation. Connection with the Mainland's power network would be enhanced for the purpose. In addition, the Administration would continue to promote energy efficiency and conservation through public education and publicity efforts.

#### Fuel procurement by power companies

10. Members urged the Administration to ensure that the power companies procured natural gas and other fuels at the lowest prices possible. Members also suggested that the power companies put in place contingency plans to prevent fuel supply interruptions due to external factors. Some other Members queried as to whether the recent huge increases in FCCs were in line with the spirit of SCAs, which stipulated that the two power companies should assure the Government that their services were “provided at the lowest cost which is reasonable in the light of financial and other considerations”.

11. CLP advised that it had a diversified fuel mix, which included natural gas, coal, nuclear energy and renewable energy. Nuclear energy imported from Daya Bay Nuclear Power Station constituted about a third of its fuel mix. With a more stable price than that of coal or natural gas, nuclear energy had helped smooth out fuel cost increases. Currently, there were two major sources of natural gas supply to CLP, namely the gas fields in the South China Sea (through the China National Offshore Oil Corporation) and the Second West-East Gas Pipeline (through PetroChina International Company Limited). CLP had entered into long-term contracts with suppliers in order to ensure a stable supply of natural gas at reasonable prices. In addition, CLP purchased coal from the global market through tenders to ensure fuel price competitiveness.

12. HEC advised that currently, natural gas and coal each constituted about half of HEC's fuel mix, and its natural gas was mainly purchased from Australia and Qatar. HEC endeavoured to purchase fuels at reasonable prices, and had entered into long term contracts with fuel suppliers to reduce price fluctuations. As the prices of natural gas and coal had increased by over twofold and around fivefold respectively in the past two years according to international indices, HEC's fuel cost had inevitably been driven up.

Nevertheless, HEC was able to purchase fuels at very competitive prices. HEC would closely monitor the international situation and maintain communications with its fuel suppliers to ensure sufficient and reliable fuel supply. It also maintained a fuel reserve in Hong Kong to prepare for contingencies.

13. The Administration advised that before entering into long-term contracts with fuel suppliers, the two power companies would submit the terms of the proposed contracts to the Administration for its review. The Administration would engage a consultant to examine the contract terms, and would only approve the contracts if the terms were reasonable. Going forward, the two power companies would be requested to further diversify fuel procurement, with a view to obtaining fuels at more competitive prices. The Administration would also explore measures for enhancing the transparency of the two power companies' fuel procurement and fuel cost adjustment practices, accounting practices, etc.

#### Permitted returns

14. Some Members commented that the permitted rate of return at 8% of the total value of the power company's Average Net Fixed Assets ("ANFA") was too high, given that SCAs had significantly reduced the investment and operating risks faced by the two power companies. These Members requested that the calculation formula be reviewed to better safeguard public interest. It was also suggested that the two power companies should establish relief funds with a portion of their profits, and that such funds would be used to offset electricity tariff increases in case of surges of fuel prices.

15. Some other Members commented that the two power companies' service performance had been generally satisfactory. It was justifiable for power companies to obtain ANFA-based permitted returns as this arrangement could encourage the companies to make sufficient investments to ensure service reliability and meet environmental protection objectives. Moreover, compared with some other advanced economies, Hong Kong's electricity tariff pressure had been within a manageable range. Noting that shareholders of the two power companies would bear the interest on borrowed capital arranged for financing fixed assets up to 7% per annum through deduction from the companies' permitted returns, and interest above the cap would be charged to customers, Members sought explanation on this arrangement.

16. The Administration advised that:

- (a) ANFA covered capital expenditures on generation, transmission and distribution systems, as well as customer and corporate services development, in so far as they were electricity-related. If there was excess generating capacity, the cost of relevant equipment would be excluded from ANFA for calculating the permitted returns. During the SCA interim review, the Administration would examine the need to refine ANFA's coverage and relevant parameters; and
- (b) since the current SCAs had come into effect, the electricity customers of the two power companies had not been required to bear the interests on borrowed capital arranged for financing fixed assets. The Administration would review the current cap of interest rate on the borrowed capital undertaken by the two power companies, with a view to reducing the risks of financing of the power companies to be borne by electricity customers.

Motions passed by the Panel on Environmental Affairs

17. At its meeting on 22 November 2022, the Panel on Environmental Affairs ("EA Panel") passed a motion urging the Administration to suppress tariff increases and set aside part of the permitted returns to alleviate tariff increase pressure. The Administration was also requested to raise the subsidy amount under the Electricity Charges Subsidy Scheme to relieve the economic pressure on the grassroots,<sup>6</sup> while the two power companies should take the actual social and economic circumstances into consideration and adjust their profit margins.

18. On 22 May 2023, EA Panel passed a motion requesting the Administration to improve the contents of the SCAs with the two power companies in order to better meet the current needs of society.<sup>7</sup>

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<sup>6</sup> As one of the relief measures under the 2023-2024 Budget, each eligible residential electricity account is granted a subsidy of \$1,000. The current arrangement of distributing electricity charges relief of \$50 a month to each eligible residential electricity account is extended to the end of 2025.

<sup>7</sup> The Administration's written responses to the two motions are given in Appendix 2.

### **Council questions**

19. Members raised questions about electricity tariffs, fuel mix for electricity generation and SCAs at various Council meetings in recent years. The questions and the Administration's replies are hyperlinked in **Appendix 2**.

### **Latest development**

20. At the meeting on 28 November 2023, the Administration and the two power companies will discuss with EA Panel issues relating to SCAs.

### **Relevant papers**

21. A list of relevant papers is set out in **Appendix 2**.

Council Business Division 1 and Public Complaints Office  
Legislative Council Secretariat  
24 November 2023



## Appendix 1

### Electricity tariffs in 2023 and previous years

	CLP Power Hong Kong Limited (cents/kWh)				The Hongkong Electric Company, Limited (cents/kWh)			
	Basic Tariff Rate	Fuel Clause Charge	Rebates	Average Net Tariff Rate	Basic tariff	Fuel Clause Charge	Rebates	Average Net Tariff Rate
2013	84.0	22.4	-1.7	<b>104.7</b>	94.4	40.2	0	<b>134.6</b>
2014	88.4	22.4	0	<b>110.8</b>	101.8	33.1	0	<b>134.9</b>
2015	87.2	27.0	0	<b>114.2</b>	102.6	32.3	0	<b>134.9</b>
2016	88.9	24.3	0	<b>113.2</b>	105.5	27.9	0	<b>133.4</b>
2017	92.2	21.0	0	<b>113.2</b>	108.9	23.4	-21.9	<b>110.4</b>
2018 (Jan-Sep)	94.5	22.0	-1.1	<b>115.4</b>	109.1	23.4	-20.0	<b>112.5</b>
2018 (Oct-Dec)	91.0	27.8	-1.1	<b>117.7</b>				
2019	91.0	27.8	0	<b>118.8</b>	101.3	23.4	-4.6	<b>120.1</b>
2020	92.2	30.8	-1.2	<b>121.8</b>	102.0	24.8	-0.4	<b>126.4</b>
2021	93.7	28.1	0	<b>121.8</b>	109.0	17.4	0	<b>126.4</b>
2022	93.7	38.6	-3.4	<b>128.9</b>	109.0	27.3	-1.0	<b>135.3</b>
2023	93.7	62	-1.3	<b>154.4</b>	114.5	82.5	0	<b>197.0</b>

## Scheme of Control Agreements with the two power companies

### List of relevant papers

Committee	Date of Meeting	Paper
Panel on Economic Development (“EDEV Panel”) and Panel on Environmental Affairs (“EA Panel”)	29 April 2017	<a href="#">Agenda</a> Item II: New Scheme of Control Agreements with the two power companies  <a href="#">Minutes</a>
EDEV Panel	4 July 2018	<a href="#">Agenda</a> Item I: 2018-2023 Development Plans and 2019 Tariff Review of the two power companies  <a href="#">Minutes</a>
	10 November 2020	<a href="#">Agenda</a> Item I: Annual tariff reviews with the two power companies  <a href="#">Follow-up paper</a>  <a href="#">Minutes</a>
	10 December 2019	<a href="#">Agenda</a> Item V: 2020 electricity tariff review and electricity charges subsidy for non-residential customers  <a href="#">Minutes</a>
Panel on Financial Affairs	4 November 2019	<a href="#">Agenda</a> Item VI: Electricity charges subsidy  <a href="#">Minutes</a>

Committee	Date of Meeting	Paper
EA Panel	22 November 2022	<a href="#">Agenda</a> Item IV: Annual tariff reviews with the two power companies  <a href="#">Minutes</a>  <a href="#">Motion</a>  <a href="#">Administration's response to the motion</a>
	27 March 2023	<a href="#">Agenda</a> Item III: Update on Fuel Clause Charges under Monthly Fuel Cost Adjustment Mechanism by two power companies  <a href="#">Minutes</a>
	22 May 2023	<a href="#">Agenda</a> Item III: 2023 interim review of the Scheme of Control Agreements with the two power companies  <a href="#">Minutes</a>  <a href="#">List of follow-up actions</a>  <a href="#">Administration's response</a>  <a href="#">Motion</a>  <a href="#">Administration's response to the motion</a>
	26 June 2023	<a href="#">Agenda</a> Item III: Power supply incident in some areas on Hong Kong Island of The Hongkong Electric Company, Limited on 19 April 2023  <a href="#">Minutes</a>
Finance Committee	6 April 2020	<a href="#">Administration's written replies to Members' initial questions on the Estimates of Expenditure 2020-2021</a>  (Reply serial numbers: ENB159, 170 and 211)

Committee	Date of Meeting	Paper
	13 April 2021	<a href="#">Administration's written replies to Members' initial questions on the Estimates of Expenditure 2021-2022</a>  (Reply serial numbers: ENB067 and 188)
	13 April 2023	<a href="#">Administration's written replies to Members' initial questions on the Estimates of Expenditure 2023-2024</a>  (Reply serial numbers EEB(E):120, 122, 130 147, 148 and 173)

Council meeting	Paper
23 October 2019	<a href="#">Council question 6</a> : Future fuel mix for electricity generation
6 May 2020	<a href="#">Council question 1</a> : Fuel mix for electricity generation
2 November 2022	<a href="#">Council question 6</a> : Alleviating the burden of electricity tariffs on members of the public as well as small and medium enterprises
14 December 2022	<a href="#">Council question 12</a> : Adjustment of electricity tariff
8 February 2023	<a href="#">Council question 1</a> : Alleviating financial burden on members of the public
15 March 2023	<a href="#">Council question 4</a> : Use of clean energy for electricity generation
7 June 2023	<a href="#">Council question 6</a> : Scheme of Control Agreements signed between the Government and the two power companies
	<a href="#">Council question 20</a> : Power supply incidents of the two power companies