

2. Scheme of Control Agreement

2.1. Introduction

HK Electric's business is regulated through a bilateral agreement - [Scheme of Control Agreement](#) (SCA) – entered with the HKSAR Government. The duration of the current SCA is from 1 January 2009 to 31 December 2018.

The activities of HK Electric are subject to the SCA, which provides for the Company a full recovery of its total operating costs from its gross tariff revenue, and earn every year a Permitted Return of 9.99% of average net fixed assets except for renewable energy (RE) fixed assets for which the Permitted Return is 11%. The SCA also contains certain adjustments to the Permitted Return in the form of performance-based financial incentives and penalties encouraging emissions reduction, energy efficiency, operational performance and service quality enhancements, etc.

The SCA is not a franchise nor does it provide exclusive rights for HK Electric. Rather, it sets out the obligations of the Company, the returns for shareholders and the arrangements by which the Government monitors the Company's financial affairs and operating performances as far as they are electricity-related.

The SCA regime has proven itself a simple, light-handed and cost-effective tool to accomplish in full the Government's energy policy objectives of providing a safe, reliable and environmentally friendly supply of electricity at a reasonable price. It provides HK Electric with the certainty much needed for making timely and sufficient long-term infrastructure investment, as well as the flexibility in managing and operating its power supply businesses efficiently.

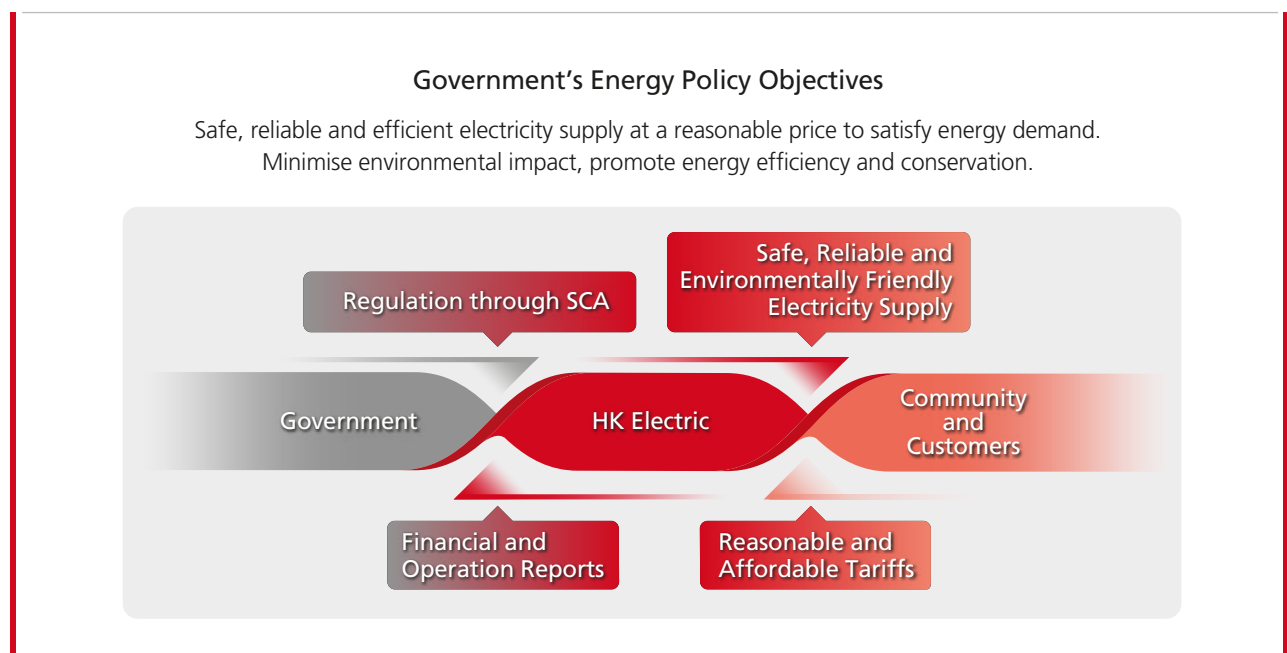
2.2. Regulatory Framework

Through the regulatory reviews, including Mid-term Review, Development Plan Review, Auditing Review and Tariff Review, the Government effectively monitors HK Electric's financial and operational performances.

2.3. Performance Incentives and Penalties

Under the SCA, various performance incentives and penalties are in place to encourage HK Electric to take proactive steps in reducing emissions, sustaining high standards of operational and customer service performances, promoting energy efficiency and harnessing RE in Hong Kong. Such incentives and penalties will impact on the Permitted Rate of Return.

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Regulatory Reviews under the SCA

Mid-term Review	Government and HK Electric jointly conduct review in the mid-term of the SCA, i.e. five years after it comes into effect, on all SCA-related matters; any modifications to be mutually agreed by both.
Development Plan (DP) Review	HK Electric submits at least every five years a DP to Government covering the projected basic tariff rate, projected sales, and projected operating and capital expenditures. The DP shall be vetted by Government and approved by the Executive Council. Financial Information of approved 2014-2018 Development Plan and 2014 Tariff Review
Auditing Review (AR)	HK Electric will make submission to the Government no later than end of March to initiate the AR process for reviewing HK Electric's financial, technical and environmental performances for the preceding financial year.
Tariff Review (TR)	Government and HK Electric jointly conduct TR in October to determine the tariff for the following year. Financial Information of 2018 Tariff Review

Performance Incentives and Penalties Mechanisms under the SCA

Category	Measurement for Each Year	Adjustment to the Permitted Rate of Return	
		Incentive for performance above the respective threshold	Penalty for performance below the respective threshold
Emissions Performance Linkage Mechanism	Emission levels of nitrogen oxide (NOx), respirable suspended particulates (RSP) and sulphur dioxide (SO ₂)	+0.05% to +0.1% (Overachievement of all the statutory caps on the three emissions)	-0.2% to -0.4% (Exceedance of any of statutory caps on the three emissions)
Operational and Customer Services	Supply reliability	+0.01%	-0.01%
	Connection and supply	+0.01%	-0.01%
	Appointment punctuality	+0.01%	-0.01%
Energy Efficiency	Energy audits	+0.01%	-
	Energy saving pursuant to the above energy audits	+0.01%	-
Renewable Energy	Percentage of electricity generated from HK Electric's renewable energy systems	+0.01% to +0.05%	-

2.4. Signing of New SCA

In April 2017, HK Electric entered into a new Scheme of Control Agreement with the Government, effective for 15 years from 1 January 2019 until 31 December 2033. Under the new SCA, HK Electric is entitled to a permitted return of 8% on average net fixed assets. The agreement also introduces a number of elements that will further encourage the use of renewable energy and promote energy efficiency, as well as encourage power companies to continue to enhance their customer performance standards and operational transparency.

