



Submission on
Public Consultation
on the Future Development
of the Electricity Market
(Executive Summary)

June 2015

Executive Summary

Introduction

The Government launched a public consultation on the future development of the electricity market in Hong Kong on 31 March 2015. HK Electric's submission is that the proposals contained in the Consultation Paper will only bring about uncertainties, but not benefits.

Hong Kong is a highly compact vertical city and depends heavily on electricity. Under the stability provided by the cost-effective Scheme of Control Agreement (SCA) regime, Hong Kong has been enjoying world-class electricity services and has achieved the Government's four energy policy objectives of safety, reliability, affordability and environmental protection.

At the same time, the SCA provides certainty for investors to make long-term investments necessary to maintain Hong Kong's electricity infrastructure, making it a very effective tool in balancing the interests of consumers and investors.

As we consider the future regulatory framework, our focus is the interests of Hong Kong going forward. Hong Kong people expect to continue enjoying quality and affordable electricity services with minimal environmental impact. We cannot afford to give away the success we have already achieved, and there is no room to experiment with change for the sake of change.

With the full achievements of the Government's four energy policy objectives and the excellence in electricity supply, HK Electric does not see any need to impose unnecessary changes to the current SCA regime. It remains our conviction that the current SCA regime, with its clear and proven track record, continues to be the best way forward for Hong Kong.

Question 1 **How important is choice to you in respect of the supply of electricity? What objectives do you consider should be achieved through introducing competition to the electricity market?**

HK Electric's Views

As far as the supply of electricity is concerned, choice and competition are not, of themselves, the goals Hong Kong aspires to but rather the means. Introducing them to Hong Kong may put the Government's energy policy objectives at risk.

Experiences from overseas deregulation are lessons to avoid – deregulation processes are complicated and protracted with many unexpected problems. Competition may not deliver any tariff reduction, and choices may not entail customer satisfaction.

The fundamental ingredients behind the success of the telecommunications market reform are simply absent for similar success to be repeated in the electricity sector. There can be no valid conclusion drawn as the two markets are totally different.

The electricity market in Hong Kong does not possess prerequisites for introducing effective competition:

- There is insufficient market size or growth potential to attract enough players to the market;
- There is no land resource for new generation companies;
- Introducing new supply from the Mainland removes rather than opens up choices; and
- Potential for distributed generation is too limited to become meaningful.

Question 2 To what extent do you think the current contractual arrangement by SCAs has allowed us to achieve the energy policy objectives of safety, reliability, affordability and environmental protection, and what problems do you see with this regulatory approach?

HK Electric's Views

Under the SCA regime, the Government's four energy policy objectives of safety, reliability, affordability and environmental protection have been fully achieved under light-handed and low-cost regulation. For HK Electric:

- Our world-class reliability of 99.9999% is ranked first or second and among the best in the world;
- Our tariff is reasonable and affordable, and far lower than those of other world cities;
- Our commitment to stringent cost control has been very successful. From 2008 to 2014 net tariff only increased by a nominal 5.9%, which is significantly lower than the cumulative inflation of 23% over the same period. Indeed, at end of 2013 we were able to announce the freezing of tariff for five years from 2014 to 2018, which is unprecedented in the world; and

- Our tremendous efforts to improve environmental performance have paid off with significant reduction in the three categories of emissions (sulphur dioxide, nitrogen oxides and respirable suspended particulates) by 40% to 90% from 2008 to 2014, far below the emission caps set by the Government.

The SCA is a well-proven and cost-effective regulatory regime that has delivered world-class electricity supply to Hong Kong customers. HK Electric does not see any need to impose unnecessary changes to the current SCA regime.

Question 3 What is your view on the following areas in the future contractual arrangement (if any) between the Government and the power companies?

HK Electric's Views

(a) Duration

The contract term should be sufficient to attract long-term investment in electricity infrastructure and allow long-term power system planning and fuel procurement. Overseas regulatory framework is either perpetual or very long term.

HK Electric strongly believes that a 15-year duration is most appropriate for regulating the electricity infrastructure in Hong Kong. A 10-year term is simply insufficient to allow for effective planning and the five year option, which may or may not be exercised by the Government, does not assist.

(b) Permitted rate of return

Electricity infrastructure is characterized by its unique investment profile which has assets that are capital intensive, illiquid, long-lived, and with depreciating value.

The rate of return (RoR) risk is asymmetrical. In Hong Kong tariff is very affordable, and electricity has never been a significant expenditure item. Electricity bills account for only 1.6% of the general household expenditure for residential consumers, and for many businesses less than 3% of their operating costs. If the RoR is too low to attract ongoing investments, new and replacement capital investment will be discouraged and significant outages and interruptions may occur, resulting in huge social and economic impacts.

There is no reason to change for the sake of change. For Hong Kong to continue to enjoy high quality electricity supply, the current level of permitted RoR needs to continue to create the right environment for power companies to make long-term investments in electricity infrastructure. This is the best way to balance the interests of consumers and investors.

(c) Tariff approval mechanism

The current tariff approval mechanism well balances the regulatory need for the Government to scrutinize and approve tariff adjustment and the flexibility provided for the power companies to adjust the basic tariff rate in accordance with the actual situation. It has proven to be effective in safeguarding consumer interest.

It is unfair and against global practice to ask the power companies to absorb part of the fuel costs. If fuel costs can no longer be passed through, a risk premium will be required to compensate investors for the increased business risk, which will ultimately be borne by consumers and hardly be in their interests.

(d) Fuel cost arrangement

Fuel cost pass-through is the norm in energy industry. The Fuel Clause Recovery Account is an effective cushion to buffer fuel cost impacts on consumers.

HK Electric always strives to minimize its fuel costs through prudent fuel operating and procurement policies and practices. The fuel component of electricity tariff is subject to rigorous scrutiny by the Government and close monitoring by the Legislative Council and the public at large.

HK Electric does not consider any fuel price speculation through financial instruments as a responsible and effective cost-stabilizing management tool. We firmly believe that it is only prudent and in the best interests of consumers not to carry out fuel hedging activities.

(e) Incentive and penalty scheme relating to the performance of the power companies

The existing incentive and penalty schemes under the SCA, namely the emissions performance linkage mechanism and the customer-related performance incentive and penalty mechanisms, are effective and appropriate to encourage out-performance in environmental protection and customer service. These mechanisms should be maintained.

Question 4 **Should Hong Kong promote renewable energy despite its higher tariff implications; and if so, about how much (in terms of percentage of your electricity bill) are you prepared to pay?**

HK Electric's Views

HK Electric recognizes the many difficulties and challenges in developing renewable energy (RE) in Hong Kong. These barriers and associated risks, including scarcity of suitable sites, limited potential for contribution, local geographical constraints, should be considered before introducing any local RE policy or project.

The SCA has established a standardized arrangement to encourage RE installations by customers. HK Electric welcomes and facilitates customers' initiatives for connection. Further success is highly uncertain, since potential for small-scale REs is heavily constrained.

Feed-in tariff scheme raises controversial cross-subsidy issues, whilst neither net-metering scheme nor RE certificate scheme is cost-effective.

Commercial scale RE system is the only pragmatic RE strategy for Hong Kong. In the case of the proposed off-shore wind farm under planning by HK Electric, the tariff impact is expected to be minimal considering the associated project cost will be spread evenly throughout its life span of about 25 years.

Question 5 **What specific requirements would you suggest to be set out in the future contractual arrangement (if any) between the Government and the power companies to encourage promotion of demand side management and renewable energy by the power companies?**

HK Electric's Views

The existing demand side management (DSM) measures being implemented by HK Electric under the current SCA are appropriate and effective in promoting energy efficiency and conservation (EE&C) to consumers:

- Free energy audits and interest-subsidized loans help businesses improve energy efficiency;

- Smart Power Fund helps aged residential buildings to implement EE&C measures; and
- Education Fund promotes energy efficiency to consumers and spreads green messages to students and the general public.

Question 6 Do you have any other comments and suggestions?

HK Electric's Views

As we submit at the outset, when assessing any proposed changes we must be pragmatic and be guided by three major principles – to ensure that the four energy policy objectives can continue to be achieved; that any change to be introduced must be cost-effective; and that there must be a reasonable return to ensure continuous investment.

The SCA regime is a light-handed and cost-effective regulatory approach with a clear and proven record of serving Hong Kong well, achieving all of the four Government's energy policy objectives of safety, reliability, affordability and environmental protection. HK Electric is proud to be part of these achievements and be able to offer to our consumers electricity supply of world-class reliability at affordable prices, as we continue to generate cleaner electricity in support of Hong Kong's initiatives to combat climate change.

These achievements should not be taken for granted. For these achievements to continue, Hong Kong must continue to have a steady and effective regulatory regime which strikes the correct balance between the interests of consumers and investors. HK Electric is convinced that the right balance has been maintained in the present SCA, and a longer term of 15 years would add further certainty to facilitate effective planning.

There is absolutely no case in making any rash changes which will upset the balance to favour one group at the expense of the other and will jeopardise the achievements we already have. The stakes are too high to lose with little or even nothing to gain.

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