



Press Release
29 April 2005

Hongkong Electric Submission Urges Supply Reliability and Cautions against Experimentation on Electricity Market

The Government should proceed with Stage II of the public consultation on the future development of the electricity market on the basis that the current Scheme of Control Agreement (SCA) should be retained in its current form, Hongkong Electric recommended today. The Company also said that it is prepared to work with the authorities on ways to improve the existing regulatory regime to further deliver on the Government's policy objectives.

In its submission to the Government today in response to the first stage of the public consultation, the Hongkong Electric Company Ltd (HEC) explained that the SCA has worked extremely well in achieving Government objectives, maintaining safe and reliable supply of electricity at a reasonable cost while providing an effective framework for the implementation of environmental policy. Change must not be for the sake of change, it reasoned.

Drawing on the lessons from failed market reforms overseas costing tens of billions of dollars, e.g. in California, the submission concluded that none of the suggested changes have benefits that demonstrably outweigh both the costs of implementing them and the risks they introduce. Experimentation should be avoided, the submission stressed.

Hongkong Electric's Managing Director, Mr. Tso Kai-sum, said HEC has been communicating with various stakeholders since the release of the consultation document in January while carrying out extensive research on market reform in other jurisdictions.

"This submission is based on HEC's own hands-on operating experience in overseas power markets, feedback from various stakeholder groups, and findings from detailed research," he said.

Mr. Tso pointed out that Hong Kong ranked first in a survey on the number and index of high-rise buildings in the world, followed by New York City as a distant second. Though the lower planning criteria for HEC require a lower investment level than New York's, HEC has been able to maintain the same level of reliability, i.e. at 99.999%, thanks to good asset management skills, thorough planning, quality construction, and timely and sensible investments.

“Given the high-rise living and working environment, Hong Kong people are demanding and they expect the highest standards to be maintained at all times. The impact on supply reliability must be considered when contemplating any changes,” Mr. Tso said.

He maintained that the permitted return under the SCA is reasonable, and is sufficient to attract investment and provide electricity supply at reasonable tariff. He added that the return is not a guaranteed return, and that HEC’s profit attributable to shareholders had been below the permitted return levels over the past two years.

The Return on Asset Approach, he reasoned, is the most appropriate model for power companies in Hong Kong in that it is simple to monitor and provides incentives to ensure continued and adequate asset investment and efficient financing.

On the suggestion to link tariffs with the Consumer Price Index (CPI), Mr. Tso believes that it is understandable but not achievable. “Over 90% of HEC’s costs are not related to the local inflation. A CPI-following tariff would make tariffs unreflective of costs but increase risk,” he explained.

Mr. Tso described the benefits that could be brought about by increased interconnection as illusory, citing HEC’s analysis which indicates that the costs of any new interconnection would be higher than the benefits of deferring new generation facilities.

In addition, utilizing interconnection for regular electricity transfers would bring increased risks to supply reliability, as evident in overseas experience when the failure of a single piece of equipment could have a cascading effect on a highly interconnected network, leading to multiple failures and even total system blackout.

Mr. Tso went on to say that it would not be prudent to predicate the development of the local electricity market on supply from the Mainland, as the Mainland would not have any surplus electricity to supply to Hong Kong in the foreseeable future. “From an environmental perspective, all spare capacity in Guangdong should be used to phase out the existing highly-polluting, but low-efficiency small thermal plants to improve the regional air quality,” he said.

Opening grid access would blur accountability and responsibility, and in view of its potential impact on system reliability, has to be considered with utmost caution, Mr. Tso remarked, pointing to the relatively small size of the local electricity market; scarcity of land and lack of indigenous fuel supplies. “In the absence of any real prospects of competition in the near future, it would be premature to introduce an open access regime at this stage.”

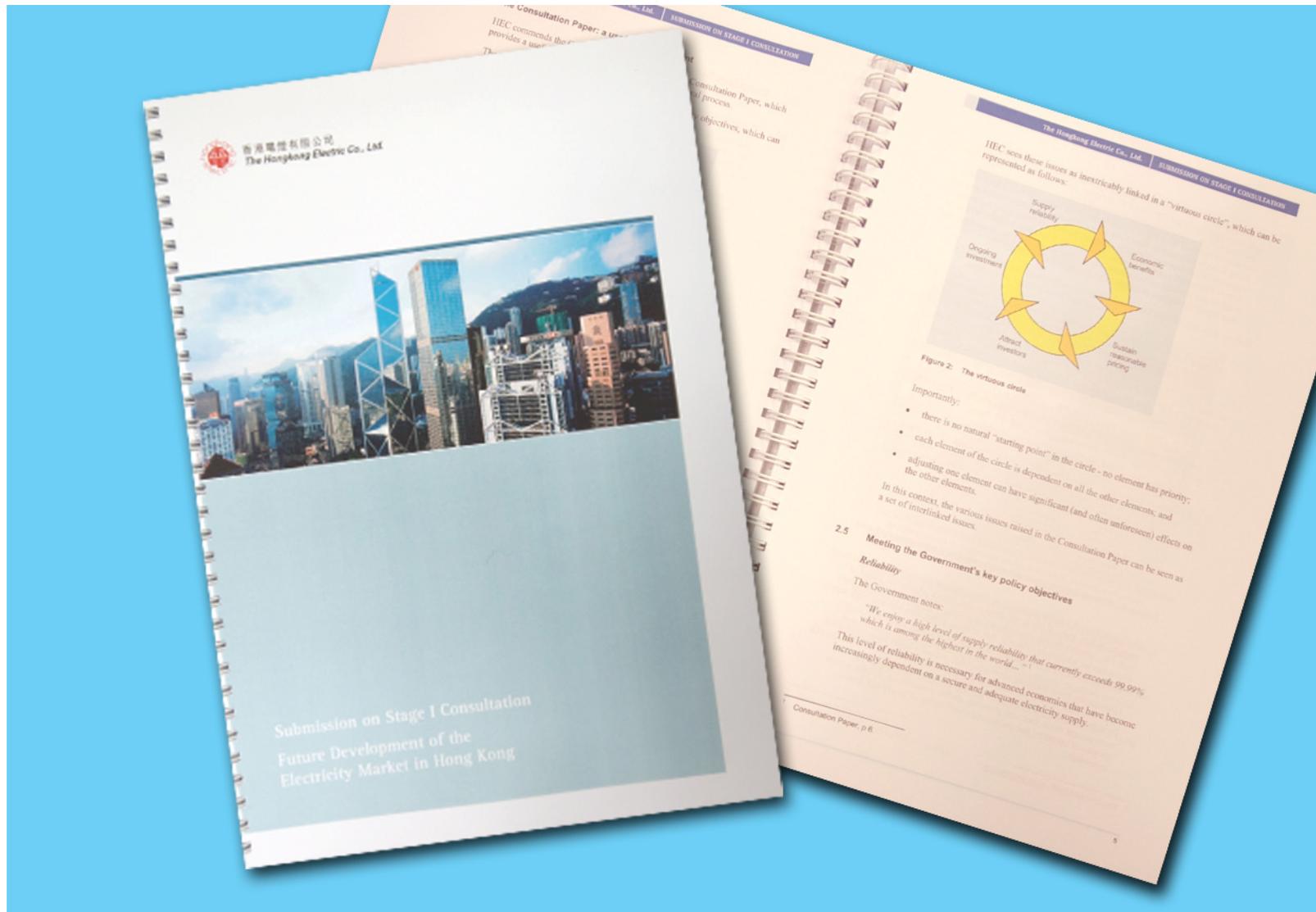
Moving forward, Mr. Tso called on the Government to proceed with Stage II of the public consultation by agreeing on the elements of the current SCA for the next term given that the existing balance in the SCA is appropriate. He also thought that refinement of the SCA through appropriate adjustments within the current framework should be done if it could enhance the existing regime and further deliver on the Government's objectives. "We look forward to working closely with the Government and all stakeholders in the months to come," Mr. Tso added.

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HEC's 120-page submission to the Government in response to Stage I consultation on future development of the electricity market in Hong Kong.