June 24, 2015

Wong Kam Sing, JP
Secretary for the Environment
Environment Bureau
15/F & 16/F, East Wing, Central Government Offices
2 Tim Mei Avenue, Tamar, Hong Kong

AmCham

The American Chamber of Commerce in Hong Kong
1904 Bank of America Tower
12 Harcourt Road, Hong Kong

Dear Secretary Wong,

RE: Public Consultation on the Future Development of the Electricity Market

- Electricity is critically important to our daily lives, whether it be in the home or in business. As the largest overseas Chamber in Hong Kong, the American Chamber would like to take this opportunity to provide comments on the current public consultation, which is likely to affect the way this market is structured for the next 10 – 15 years.

- The Hong Kong Government has four energy policy objectives of safety, reliability, affordability and environmental performance. These policy objectives are very important to business and the Chamber endorses their continued use to ensure the stable and sustainable future development of the electricity market. The consultation document acknowledges that the Scheme of Control has continually and successfully delivered these objectives for our community over many years.

- The Chamber supports Government's proposal to enter into a new 10 – 15 year asset-based Rate of Return (RoR) contract with the power companies, to support a stable and adequate return for investors in a way that ensures financing certainty, which is especially important in the light of the very long lifetime of electricity infrastructure assets. Enhancements to the existing contract structure to incent the opportunity for further environmental improvements through investment in Renewable Energy (RE), Energy Efficiency and Conservation (EEC) and Demand Response Mechanisms (DR) would be welcome, with the pace and nature of progress commensurate with the community's readiness to take on the extra costs involved.

- Maintaining Hong Kong's outstanding level of supply reliability is especially critical to our members and we are pleased that Government has noted the wishes of the Chamber (set out in our June 18, 2014 submission) and the wider community on the preference for a local generation-based fuel mix in Hong Kong. We therefore support the Government's plans to provide extra gas-fired local generation in time to deliver new lower carbon and air emissions objectives for Hong Kong by 2020, which the Chamber strongly supports.

- On the prospect of competition in electricity supply - the Chamber notes the Government's review and that overseas experience is decidedly mixed in terms of the impact on prices, reliability and customer satisfaction. We are not opposed to offering more energy choices for customers but note Government's view that more competition within the energy generation and supply market may not help with reliability and does not necessarily equate to lower prices. More important is to continue to deliver the current high level of reliability at competitive prices that the current approach provides. Rather than introducing competition within the energy sector per se, the Government should support the provision of extra choice in customer service options, tariff types and rates, new payment options and potentially the option to purchase greener energy *within* the existing regulatory regime.

- Currently, the power companies are able to pass through their fuel costs to ratepayers. Businesses should have the right for the full pass-through of business costs to customers when these are properly and prudently incurred. In the case of fuel costs for electricity generation, these are often determined by Government - as in the decision to benchmark Hong Kong's electricity fuel mix at 50% gas set out in the current consultation document. The Environment Bureau also dictates fuel quality through application of

Tel: (852) 2530.6900 Fax: (852) 2810.1289 amcham@amcham.org.hk www.amcham.org.hk

the Air Pollution Control Ordinance (emissions caps). The Chamber is supportive of more transparency to help the community understand the nature of these costs but is *not* supportive of their reduction or delay due to any additional approval process introduced by Government for a cost on which we understand the companies make no profit. According to the Scheme of Control, Government approval is already needed each year for the Basic Tariff (covering the company's investment, returns and operating costs), which already accounts for around three quarters of the total tariff.

- In summary, our members would like to see three important topics given additional focus in the next regulatory period – more support for customers and the energy companies to achieve greater energy efficiency & conservation, the encouragement of smaller distributed renewable energy projects where practicable and the progressive installation of Advanced Metering Infrastructure (AMI or smart metering) across Hong Kong. This will allow customers to better control their energy usage, helping to manage business costs and reduce Hong Kong's overall energy intensity and carbon footprint. However, we need to be cognisant of both community sentiment and the impact on tariffs when determining the speed and depth of these measures, given the additional costs for ratepayers. In light of the economies of scale and the well-established expertise in the development, construction, operation and maintenance of commercial renewable energy facilities, engaging local power companies to explore the feasibility of further developing commercial-scale renewable energy systems would be a pragmatic and cost-effective alternative option for Government's consideration.

- The Chamber's responses to each of the six questions in the consultation document are enclosed as an Annex to this letter. In general terms, we are supportive of the overall approach, providing that a stable and effective regulatory regime facilitates the effective financing of the power companies to ensure that they can continue to strongly deliver against the four energy policy objectives that underpin business success and the livelihood of the wider community in our city.

Yours sincerely,

Peter J. Levesque
Chairman 2015

Richard R. Vuylsteke
President

Enclosure: Submission on Future Development of the Electricity Market – Annex

The American Chamber of Commerce in Hong Kong is the largest international chamber in Hong Kong and represents a broad and diverse membership.

AmCham

THE AMERICAN CHAMBER OF COMMERCE IN HONG KONG

Submission in Response to the Public Consultation on the Future Development of the Electricity Market

June 24, 2015

ANNEX

Question one: *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?*

The Chamber believes that the provision of a safe, highly reliable, affordable and environmentally sound electricity supply is the over-riding objective for Hong Kong. Experience in the US, where the clear majority of states still adopt the successful vertically integrated rate of return approach currently used in Hong Kong, suggests that this model can deliver good outcomes for consumers. Whilst the Chamber is generally supportive of competition, when and how such changes should be made is critical and we all recall the disasterous rush into competition in California in 2000-2001, where consumers there are still paying off the debts incurred. As noted in our covering letter, we understand that 'choice' can in many ways be delivered within the current regulatory regime and just as the foreword to the consultation document points out, any market change to facilitate competition needs to be fully deliberated by the community.

Question two: *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?*

The Chamber supports Government's assessment that the current contractual arrangement of the Scheme of Control has enabled the very successful delivery of the four energy policy objectives. As noted above, US experience of other regulatory models is mixed and we need to consider the most appropriate design for Hong Kong, which has its own unique circumstances. The current approach seems to be sound, has served Hong Kong well for many years and can be adapted to meet the changing needs of our community. The Chamber sees no reason why further improvements cannot be made, whilst retaining the existing framework.

Question three: *What is your view on the following areas in the future contractual arrangement (if any) between the Government and the power companies:-*

(a) Duration
(b) Permitted rate of return;
(c) Tariff approval mechanism;
(d) Fuel cost arrangement; and
(e) Incentive and penalty scheme relating to the performance of the power companies

What other improvements would you suggest?

The Chamber's views on the specific mechanisms within the current contractual agreement between Government and the power companies are as follows:

(a) *Duration.*The proposed duration of 10 to 15 years is regarded as appropriate, given the nature of the electricity industry, which needs to invest in very-long lived and immobile assets with certainty. The Chamber supports the move to a cleaner fuel mix for electricity generation set out in the consultation document and notes that this will also need significant capital investments. Reliability is critical to Hong Kong and the Chamber notes that if regulatory and investment certainty cannot be provided, as currently in the UK, reliability may be at risk.

(b) *Permitted rate of return.* The permitted return needs to reflect the fact that the power companies have to continue to make large investments in electricity supply, when it may take many decades to recover invested funds. In this context, we note that the Government has highlighted "the longer term goal of competition", so if investors are to commit to new generation now to meet Government's 2020 environmental targets they will need some certainty that any new plant built can attract sufficient capital through a reasonably secure rate of permitted return.

The final level of permitted return agreed will need to take into account the overall terms of a new contract, including the obligations on the electricity sector (such as the contractual commitment to meet customer demand for electricity - which we wish to see continue), the level of regulatory certainty, the ability for the companies to successfully raise funds, risk levels and the overall economic circumstances at the time of renewal. The Chamber trusts that Government will work to negotiate an appropriate rate of return to balance the interests of investors and the wider community, when all of these factors are known.

(c) *Tariff approval mechanism.* In respect of the tariff approval mechanism, we understand that the tariff price path derived from the Development Plans submitted by the companies already has to be approved by the Executive Council. The existing arrangements seem rigourous enough to ensure that the power companies are not able to increase tariffs at will without the appropriate approvals being in place, so the Chamber recommends that the current arrangements continue.

(d) *Fuel cost arrangement.* On the matter of fuel costs, as we have stated elsewhere, the Chamber believes suppliers should have the ability to pass these through to customers as long as they have been properly and legitimately incurred, since they are already largely pre-determined through Government policy.

(e) *Incentive and penalty scheme relating to the performance of the power companies.*The current Scheme of Control already allows for some incentive and penalty arrangements to enhance the performance of the power companies. The Chamber supports to the further development of such mechanisms in a new contract but notes that the incentives and penalties must be proportionate and reasonable, that they should focus on an area of significant importance to the community and, in particular, for any proposed penalties, key drivers must be controllable by the companies.

For other improvements, in our covering letter the Chamber has identified a small number of important enhancements which it believes the Government should take forward in negotiating a new Scheme of Control.

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

The Chamber notes that the particular environmental constraints found in Hong Kong makes the local development of additional renewable energy generation more difficult and expensive than in many other locations, given the cost and availability of land and limited natural resources. However, we believe that Hong Kong should further promote small scale distributed renewable energy generation in our city wherever this is achievable at a reasonable cost. We understand that there will need to be higher tariffs to pay for such investment and suggest that a prudent approach is taken to ensure that the wider community is fully behind the cost implications of such a move. We believe that the power sector should be incented to more proactively support the development of smaller distributed renewable energy projects with their customers and connect these to the grid, in line with development costs that the community considers acceptable.

In light of the economies of scale and the well-established expertise in the development, construction, operation and maintenance of commercial renewable energy facilities, engaging local power companies to explore the feasibility of further developing commercial-scale renewable energy systems would be a pragmatic and cost-effective alternative option for Government's consideration.

Question five: *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 the promotion of DSM and RE by the power companies?*

In respect of the specific requirements to be included in a new contract for the promotion of demand side management (DSM), the Chamber recommends a carefully planned rollout of advanced metering infrastructure ("smart meters") across Hong Kong through both power companies, so that potential synergies to link changes in consumer behaviour and new technology to a reduced level of investment in new generation and network assets can be directly captured within the value chain. We understand that trials in Hong Kong have begun to replicate experience in the US by giving customers better control over their energy use through the provision of more timely data on energy consumption. Through smart meters behavioural change can be supported and system peak demand reduced, which in turn can reduce generation and network investment.

The Chamber would support Government in developing the opportunity for additional incentives and targets within the new contract to encourage the power sector to do more to assist customers in saving energy, subject to the appropriate measurement and validation of results. For renewable energy, the Chamber believes that similar incentives could be put in place to further promote the development and connection to grid of smaller distributed renewable energy systems. We would suggest, however, that the pace of improvement (and acceptance of the consequent costs for customers) needs to be considered when setting actual targets for the companies.

Question six: *Do you have any other comments and suggestions?*

Again, related to US experience, we would make one additional observation - the current Scheme of Control has proven to be simple, clear and effective. As the consultation document itself notes this is not easy, given the complexity of the issues in the electricity sector, and the profound impact that any major change could bring to our society.

Not only does this simple approach aid the community in understanding the regulation of what is a very technical and complex industry but it demonstrates good governance in ensuring that a pragmatic, light-handed and simple approach continues to show that Hong Kong is a good place in which to do business.