

Tel No : 2810 2538
Fax No : 2537 1002

29 March 2004

Mr Tso Kai-sum
Group Managing Director
The Hongkong Electric Co., Ltd
Hongkong Electric Centre
44 Kennedy Road
Hong Kong

Dear Mr Tso,

This letter sets out the agreement reached between The Government of the Hong Kong Special Administrative Region ("the Government"), The Hongkong Electric Company, Limited ("HEC") and Hongkong Electric Holdings Limited ("Holdings") as part of the interim review conducted during Year 2003 of the Scheme of Control Agreement ("SCA") dated 15th July 1993 as amended on 6th May 1999.

1) Definitions and Construction

The terms defined in the SCA shall have the same meanings herein unless the context otherwise requires.

The SCA and this letter shall be read and construed as a single document. Save as expressly amended by this letter, all the terms and conditions of the SCA shall remain in full force and effect.

Notwithstanding any provision to the contrary elsewhere in the SCA, if there is any ambiguity or discrepancy between this letter and the SCA, the content of this letter shall prevail.

2) Excess Capacity Adjustment

The Annex to the Supplemental Agreement dated 6th May 1999 shall be amended by :-

- (a) replacing “40%” with “Agreed Percentage” in paragraphs 2.2, 4.1(a) and note 2 to page 4 of the Annex to the Supplemental Agreement dated 6th May 1999; and
- (b) adding a new definition at the end of paragraph 2.2 of the Annex as follows :-

“Agreed Percentage means 40% for Additional Unit approved by the Government before 1st January 2004 or 50% for Additional Unit approved by the Government after 31st December 2003.”

3) Recitals

Paragraph (E) of the Recitals shall be amended by adding the following sentences at the end of the paragraph (E) :-

“HEC will make continuous efforts to improve its environmental performance and promote the efficient use of energy. To this end, HEC recognises the need for the Government to reduce emissions to improve regional air quality and to explore environmentally sustainable power sources, including but not limited to renewable energy, to supplement conventional power generation from fossil fuels and to promote public awareness of these alternative power sources and participation in the exploration. HEC will make continuous efforts to work closely with the Government in these endeavours.”

4) Development Fund and Rate Reduction Reserve

Clause 6 of the SCA shall be amended by adding the following new clause 6(4) :-

“Subject to any agreement to the contrary that may be entered into between the Government and HEC, HEC shall discharge its liability in respect of the balance in the Development Fund after the expiry of this Agreement. In the absence of any agreement (whether under Clause 11(3) hereof or otherwise), the Government and HEC will twelve months before the expiry of the current SCA (i.e. 31st December 2008) institute specific discussions regarding the way HEC shall discharge this liability.”

Clause 7 of the SCA shall be amended by adding the following new clause 7(7) :-

“Subject to any agreement to the contrary that may be entered into between the Government and HEC, HEC shall discharge its liability in respect of the balance in the Rate Reduction Reserve after the expiry of this Agreement.

In the absence of any agreement (whether under Clause 11(3) hereof or otherwise), the Government and HEC will twelve months before the expiry of the current SCA (i.e. 31st December 2008) institute specific discussions regarding the way HEC shall discharge this liability.”

5) Depreciation

Paragraph B(2) of Schedule 2 shall be deleted and replaced with the following paragraph :

“(2) (a) The net book value of all Fixed Assets acquired prior to 1st January 2004 shall continue to be written off uniformly over the remainder of the useful life of the said Fixed Assets in accordance with sub-paragraph (c) hereof; and

(b) the cost of all Fixed Assets acquired on or after 1st January 2004 shall, as from the first day of the month in which the said Fixed Assets are commissioned, be written off uniformly over the useful life of the said Fixed Assets in accordance with sub-paragraph (c) hereof.

(c) Type of Asset	Useful Life
Land	Unexpired terms of the leases
Cable tunnels	100 years
Ash lagoon	50 years
Gas pipeline	50 years
Buildings	35 years
Generation plant and machinery	35 years
Transmission and distribution equipment	35 years
Overhead lines (132kV and above)	35 years
Overhead lines (below 132kV)	30 years
Cables	30 years
Gas turbines and gas turbines combined cycle	30 years
Meters; microwave and optical fibre equipment and trunk radio system	15 years
Furniture and fixtures; sundry plant and equipment	10 years
Engineering and general purpose computers	10 years

Commercial motor vehicles and marine craft	6 years
Motor vehicles	5 years
Personal computers; office equipment; workshop tools	5 years
Refurbished or improved Fixed Assets	Remaining original life plus any life extension ”

6) Development Fund Cap

Paragraph B(1) of Schedule 3 shall be deleted and replaced with the following new paragraph B(1)(a) :-

“In November of each Year starting from 2004 a Tariff Review shall be conducted jointly by the Government and HEC. Such review shall be completed by the end of December of each year. The review shall revise, if necessary, the information (refer to Section A(3) hereof) contained in the last Preceding Financial Plan for the current Year and the Year next following :-

- (i) For each current Year, projections made in the Review will take into account an upper limit on the year-end Development Fund balance of 12.5% of the annual total revenues of HEC from sales of electricity to consumers in Hong Kong including fuel clause adjustment and excluding rebates or surcharges made during that Year. Excess above the upper limit for the current Year will be returned to consumers in the Year next following in the form of one-off rebate or tariff reduction.
- (ii) For the Year next following, to determine for that Year :
 1. the required Development Fund transfer; and
 2. the Projected Basic Tariff necessary to obtain such a Development Fund transfer.”

7) 3-year Rolling Forecast

Insert the following new paragraph B(1)(b) after the new paragraph B(1)(a) in Schedule 3 :-

“Following the submission by HEC of a Financial Plan for Financial Review covering the period up to and including 2008 and without prejudice

to the provisions of paragraph (1)(a) of Section B of Schedule 3, HEC will, in November of each Year starting from 2004, make available to the Government for the purpose of the Tariff Review their forecast on the following specific items in respect of the second Year following the then current Year (provided that this Year is covered by the Financial Plan up to 2008) :-

- (a) maximum demand for electricity,
- (b) electricity sales,
- (c) Basic Tariff Rate,
- (d) fuel clause charge or rebate,
- (e) Development Fund balance and Rate Reduction Reserve balance,
- (f) Fuel Clause Recovery Account balance,
- (g) Net Fixed Assets balance,
- (h) total operating and total capital expenditures,
- (i) Development Fund transfer, and
- (j) amount and cost of fuels to be consumed.

This forecast is made in addition to the existing 2-year rolling forecast made in accordance with the terms and conditions of the SCA. The forecast is made in good faith and is provided to the Government for its information only.”

8) Enhancing Transparency

Insert the following new paragraph A(6) after the paragraph A(5) of Schedule 3 :-

“HEC, as part of its continuing effort to increase transparency, will disclose to the Government for its information only, the segregated annual cost data which include capital and operating expenditure, and net fixed assets movement, pertaining to generation system, and T&D (transmission and distribution system) in, respectively, the Financial Review, the Tariff Review (Section B of Schedule 3 refers) and the Auditing Review (Section E of Schedule 3 refers).”

The agreement set out in this letter shall take effect on 1st January 2004.

IN WITNESS whereof the parties hereto have hereunto set their hands and affixed their seals on the date of this letter.

SIGNED and SEALED by

Secretary for Economic Development and)
Labour for and on behalf of The)
Government of the Hong Kong Special)
Administrative Region in the presence of :-)
)

The Common Seal of The Hongkong)
Electric Company, Limited was hereunto)
affixed by authority of the directors)
in the presence of :-)
)

The Common Seal of Hongkong Electric)
Holdings Limited was hereunto affixed by)
authority of the directors in the presence)
of :-)
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