



Tariff policy positions

Workshop no 4 – Part vi

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Policy categories

- Social fairness
 - Responsibilities
 - Uniformity of tariffs
 - Customer groups
 - Lifeline tariffs
 - Fixed charges
- Service levels / standards
- Service expansion
 - Connection fees
 - Infrastructure development charges
- Environment
 - Demand management
 - Abstraction charging
 - Losses
 - Environmental protection
- Full cost recovery
 - Definition
 - Time based
 - Efficiency
 - Capital investment
 - Grants and gifted assets
- Capital structure
- Capital value and return on capital
 - Regulatory capital value
 - Return on capital
 - Tax
- Process
 - Review periods

Social fairness (1)

Social responsibility – who?

- Options
 - Government responsibility
 - Service provider responsibility
- Preferred position
 - Government responsibility
- Subject to:
 - Government policy (not a WRRO decision)

Social fairness (2)

Uniformity of tariffs

- Options
 - Uniform throughout area of supply
 - Tariffs can vary according to costs
- Preferred position
 - Medium term – uniform
 - Longer term – possibility of cost reflective tariffs by area
- Subject to:
 - Appropriateness
 - Adequate reporting systems

Social fairness (3)

Customer groups

- Options
 - Cost reflective (reduced tariffs for large customers)
 - Uniform regardless of customer categories
 - Different tariffs to reflect affordability
- Preferred position
 - Short term – affordability
 - Medium term – uniform
 - Longer term – possibility of cost reflective tariffs for large customers
- Subject to:
 - Social conditions
 - Adequate reporting systems

Social fairness (4)

Lifeline tariffs

- Options
 - Rising block structure with lifeline rate
 - Uniform irrespective of consumption
- Preferred position
 - Uniform irrespective of consumption
- Subject to:
 - Legal amendments

Social fairness (5)

Fixed monthly charges

- Options
 - Fixed charges to reflect proportion of fixed costs
 - No fixed charges
 - Customer choice
 - Fixed charge + low tariff , or
 - No fixed charge but higher tariff
- Preferred position
 - Short term – retain fixed charge
 - Medium term – encourage customer choice
- Subject to:
 - Adequate reporting systems
 - Good customer services systems
 - Enforcement mechanisms

Service levels / standards

Should charges reflect level of service?

- Options
 - Uniform tariff regardless of level of service
 - Reduced tariffs for lower levels of service
- Preferred position
 - Uniform tariffs regardless of level of service
- Subject to:
 - WWRO to employ enforcement powers to ensure compliance with minimum service levels

Service expansion (1)

New connections – how much?

- Options
 - Connection fees to cover costs of connection
 - Cross subsidy through tariff – reduced connection fees
 - Direct subsidies for the poor to give access to the service
- Preferred position
 - Connection fees to cover costs of connection
 - To allow for direct subsidies from government and/or donors
- Subject to
 - Availability of funding for subsidies

Service expansion (2)

Infrastructure development charges

- Options
 - Infrastructure development charges for new connections to include for upstream system expansion
 - No infrastructure development charges – expansion financed through the tariff
 - Infrastructure development charges for commercial customers only
- Preferred position
 - Short term – no infrastructure development charges
 - Medium term – consider charges for large and medium commercial customers
- Subject to
 - Adequate reporting systems
 - Detailed long run financial analysis

Environment (1)

Demand management tariffs (water use control)

- Options
 - High tariffs to restrict consumption
 - Excess consumption tariffs
 - No demand management tariffs
- Preferred position
 - Short term – no demand management tariffs
 - Medium to longer term – consider demand management tariffs
- Subject to
 - Research and analysis

Environment (2)

Abstraction charges

- Options
 - Raw water abstraction charging system
 - No charges
- Preferred position
 - Abstraction charges to be applied
- Subject to
 - Government policy decision (not WWRO)

Environment (3)

Direct environmental protection - timetable for compliance with standards

- Options
 - Full and immediate compliance
 - Time based targets for compliance
- Preferred position
 - Time based targets
- Subject to
 - Government policy decision (not WWRO)

Full cost recovery (1)

Definition

- Options
 - Accounting definition
 - Revenue requirements excluding return on capital
 - Revenue requirements including return on capital
- Preferred position
 - Short term – revenue requirement excluding return on capital
 - Medium to longer term - include fair return on capital
- Subject to
 - Regulatory accounting systems to be developed and applied

Full cost recovery (2)

Time based cost recovery

- Options
 - Short term cost recovery
 - Medium to longer term cost recovery (5 – 10 years)
- Preferred position
 - Short term – minimum revenue requirements to maintain base levels of service
 - Medium to longer term - full cost recovery required
- Subject to
 - Adequate cash revenues to meet minimum requirements

Full cost recovery (3)

Efficiency expectations – who to determine?

- Options
 - Set by WWRO
 - Set by utilities
- Preferred position
 - WWRO to set targets in consultation with utilities
- Subject to
 - Support from KTA and utility supervising boards / agencies

Full cost recovery (4)

Capital investment – how recovered?

- Options
 - Annually through historic cost depreciation
 - Annually through current cost depreciation
 - Long run cost recovery calculation, e.g. LRMC
 - Asset management for underground assets and CC depreciation for above ground assets
- Preferred position
 - Asset management and CC depreciation
- Subject to
 - Adequate reporting and regulatory accounting systems

Full cost recovery (5)

Grants and gifted assets

- Options
 - Treat all assets identically regardless of how financed
 - Adopt the asset management approach of not adding gifted assets and for above ground assets spread grant income over life of asset
- Preferred position
 - Asset management approach
- Subject to
 - Adequate reporting and regulatory accounting systems

Capital structure

How to consider capital structure?

- Options
 - WWRO to take capital structure into account in tariff determination process
 - Treat capital structure as a management issue of the utilities
- Preferred position
 - Short term – consider capital structure to maintain cash flow obligations
 - Medium to longer term – once cost recovery achieved leave capital structure and a utility management issue only
- Subject to
 - Adequate reporting and regulatory accounting systems

Capital value and return on capital (1)

Definition of capital value

- Options
 - Accounting book value of assets
 - Current cost accounting book value of assets
 - Determine an initial regulatory capital value and add new investment in accordance with the asset management concept
- Preferred position
 - Asset management approach
- Subject to
 - Analysis to determine an appropriate RCV for each utility

Capital value and return on capital (2)

What is an appropriate return on capital?

- Options
 - Do not allow for a return on capital
 - Employ CAPM or similar to determine a market expectation of return on capital
 - Return on capital limited to cash flow obligations of debt service
- Preferred position
 - Short term – return determined by cash flow demands
 - Medium to longer term – market driven returns
- Subject to
 - Attainment of full cost recovery and appropriate institutional structures for utilities

Capital value and return on capital (3)

Taxation?

- Options
 - ‘Post tax’ return on capital
 - ‘Pre tax’ return on capital
- Preferred position
 - Short term – not a regulatory concern until utilities are generating profits
 - Medium to longer term – further analysis required once full cost recovery achieved
- Subject to
 - Nil

Process

Review periods?

- Options
 - Tariffs determined annually
 - Major review (3 to 5 years) with interim inflation related adjustments
- Preferred position
 - Short term (2007 / 08) – annual determination
 - Medium to longer term (2008 / 09 onwards) – periodic major reviews
- Subject to
 - Adoption of a comprehensive methodology and appropriate reporting systems

Next steps

- Preparation of a draft policy statement Jun 07
- Circulation to stakeholders Jun 07
- Stakeholder comments received July07
- Review comments / final tariff policy Jul / Aug 07
- WWRO to seek appropriate approvals Sep 07
- Adoption of tariff policy Oct 07
- Implementation for 2008 / 11 tariff review Dec 07 – Jun 08
- Application of tariffs Jul 08