



# Main elements of tariffs subject to review by ERE

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# Rate of return on assets, components, assessment of the base asset, type of the used adjustment

## – Rate of return, element of capital cost

- Capital costs are equal to return on capital plus depreciation
- $C \text{ capital} = R + D$
- Return on capital is calculated as follows:

$$R = B \times r$$

**B** - base asset adjusted by the start of base year of rate review cycle

**r** - allowed rate of return on the adjusted base asset



# Rate of return – continued

- The allowed rate of return on base adjusted asset is calculated on an allowed rate of return on capital in the base year, and estimated average rate of interest on long-term debt during the base year and debt/equity ratio.
- These three values shall be announced in the regulator's decision on tariffs in order for the assumptions used to calculate the allowed rate of return to be clearly defined.

# Rate of return - continued



- Rate of return on equity is calculated as follows:

$$r = roe * (1-d) + i * d$$

- roe - return on equity, a target determined by the regulator
- d - debt ratio – as ratio of long-term debt to long-term assets – that is determined by the regulator and applied to the equity
- i - weighted average of interest rate (The weighted average of interest rate on long-term debt in the base year divided for the total principal of long-term debt (total owned amount) at the start of the base year or for the three year average.



# RAB definition

- The RAB value – rate of fixed assets owned by companies KPGJ, TSO, DK and used to provide electricity and capacity to the distribution companies and to meet their obligation to ensure stability and reliability of the electric system.
- Value of the adjusted base asset should be equal to the cost of substitution of the fixed assets, which are used to guarantee the distribution service, minus the amortization and minus the adjustment for the economic annualization.
- The payments on new connections to be made by the users that are not included in the RAB.
- The RAB value shall be defined by the start of the base year of the rate review by allocating the assets in use.



# The RAB definition (continued)

- The stable assets in use – the value left in the previous year's balance
  - generation, transmission, distribution and general plant facilities)
- The envisaged amortization (-)
- The proceedings (+)
- Additions to assets to be used in the future (+)



# The ROE definition

- ROE- the rate of return on equity after the taxes on capital – in the methodology is defined as the objective of the regulator. Relevant formulas have not been defined, they will be discussed in the future.
- **In the absence of the private shareholders, the earnings might be used to support the program of capital expenses of the transmission and distribution utility and to increase the accounting value of the capital – thus, ROE will be selected in order to give to the utilities a flow of money for capital expenses (review of sources and use of funds)**
- **Regarding the generation, there will be no return since it is a company that won't create new capacities and rehabilitations – it might be zero**



# Control of policies and procedures

- It is thought to be treated as the definition of - WACC- (structure of capital comprises 100 percent state shares, unallocated earnings and long-termed and short-term debts to an equal extent)
- The aforesaid structure of capital makes necessary the definition of risk as a direct determiner of the company's value.
  - Business risk ( stability of incomes, stability of cost)
  - Financial risk – non-coverage of the financial liabilities



# Control of policies and procedures (continued)



- **Business policies regarding**
  - The extension and wanted level of service
- **Policy of corporation concerning :**
  - Marketing related to consumers
  - Human resources policies
  - Operation policies (equipment; fuel)

## **Oversight and control of procedures concerning:**

- Having contractual obligations
- Realization of determined targets
- Realization of investment plans
- Reduction of operational costs and reduction of fixed costs as well as improvement of efficiency
- Human resources
- Improvement of measuring system/obligatory realization of collections
- Policies of tariffs' compilation – request for increase of capacity tariff

# Risk management as result of monopoly's unbundling



## ■ Continuous risk control in:

- **Generation – for energy non-supply of transmission and distribution company**
- **Transmission**
  - **Failure to transmit energy received by the generation**
  - **Need for additional investments in order to introduce new generation**
- **Distribution/Supply**
  - **Failure to supply all the consumers as result of the shortage of electricity**
  - **Wanted service level (frequency and time of cut offs)**
  - **Keeping obligations towards transmission and generation**
  - **Bad debt risk**
  - **Thefts by the consumers**
  - **Disconnection of qualified consumers**
  - **Third party suppliers pressure in the future**



# Adjusted rates

- **Generation - Adjusted rates ( cost + ROR)**
- **Transmission – adjusted rates**
  - **Components of capacity and energy cost including the ROR adjustment**
  - **Inclusion of performance components (reduction of the losses, reduction of the cost)**
  - **Bonus expectations with no increase in the average rate**
- **Distribution –**
  - **Capacity and energy components including ROR adjustment**
  - **Inclusion of performance components**



# Coverage of remained costs and bad debts

- **Costs that might be created by the dissolution of companies (no asset is considered let at the moment)**
  - **No more needed units**
  - **Equipment and lines that can not be used even though they are not amortized**
- **Coverage of bad debts**
  - **Based on laws in effect**
  - **This component's envisaging in the rates of end users**



(Continued)

- **Adjustment of rate of return as result of risk in the future**
  - It will create reliability of ratemaking system and continuation
  - Level of rate of return (ROR) will change periodically
  - *Envisagement of introduction of temporary tariffs to cover the risk of exceeding costs and bad debts*
  - *Competition encouragement –Third parties will try to reduce the cost*



# ERE procedures on handover of applications for price increase by the licensees

# Introduction



**Rate review will be conducted in compliance with the regulations defined in the relevant methodologies (generation, transmission, distribution)  
and in the regulations of ERE procedures and practices as well**

# Start of procedure



- Record of application for definition or review of the price with the supporting documentation at ERE
- Making of the decision on eligibility of the request by the board of commissioners within 12 days





## Continuation of procedure

- Public will be announced by KSH within 5 days from the submission of the proposal regarding:
  - - the proposed changes in the rate of tariffs
  - - % of the change for every consumer class

## Continuation of the procedure



**Review of the application from the Tariff and Price Department within six months and holding of meetings with representatives of the applicant for the completion of documentation and other clarifications**



## Continuation of procedure

**Before making the final decision, the Board plans hearings for all the interested parties, such as state institutions, consumer associations or other individuals.**



## Continuation of procedure

- After the examination of the applicant's documentation, the Department of Tariffs prepares an information in detail on the analysis of the price proposed by the utility and other calculations made by the Tariff and Price Department and comments of the interested parties and submits it to the Board of Commissioners.



## **Making the decision**

**The making of the decision by the Board of Commissioners is open to the public according to law no. 9072 dated 22.05.2003**



***Thank you for your attention!***