

# **Approach to Assessing Capital Expenditure for Price Reviews**

**May  
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This document presents a summary of the RIC's consultative paper on its approach to assessing capital expenditure (Capex) for price reviews for the Trinidad and Tobago Electricity Commission.

**Summary  
Document**

## RIC's Approach to Capex Assessment

The RIC's price review process is guided by the RIC Act. Capital expenditure (Capex) assessment forms an essential part of the price review process. The RIC engages in a thoroughgoing assessment of the service provider's proposed capital programme. This is to ensure that the approved Capex is prudent and that the programme consists of projects that are necessary to deliver a satisfactory and adequate level of service, at the most efficient cost. The assessment can essentially result in the regulator's acceptance, adjustment or disallowance of the service provider's proposals for capital expenditure.

Capex assessment is mainly two-fold; evaluating how the past capex programme was executed by the service provider, and assessing whether forecast capex is the best way to meet expected demand and to maintain and/or improve quality of the service, as necessary. The assessment involves the following:

### Part 1

Review of the actual or out-turn Capex of the previous control period (ex-post<sup>1</sup> assessment) to assess whether in the circumstances existing at the time, T&TEC's past decisions regarding capex investments were prudent, efficient and consistent with RIC approved projects.

### Part 2

Review of the forecast Capex for the forthcoming regulatory control period to establish the efficient and necessary level of Capex that will be required for the provision of adequate services to meet current demand and future requirements.

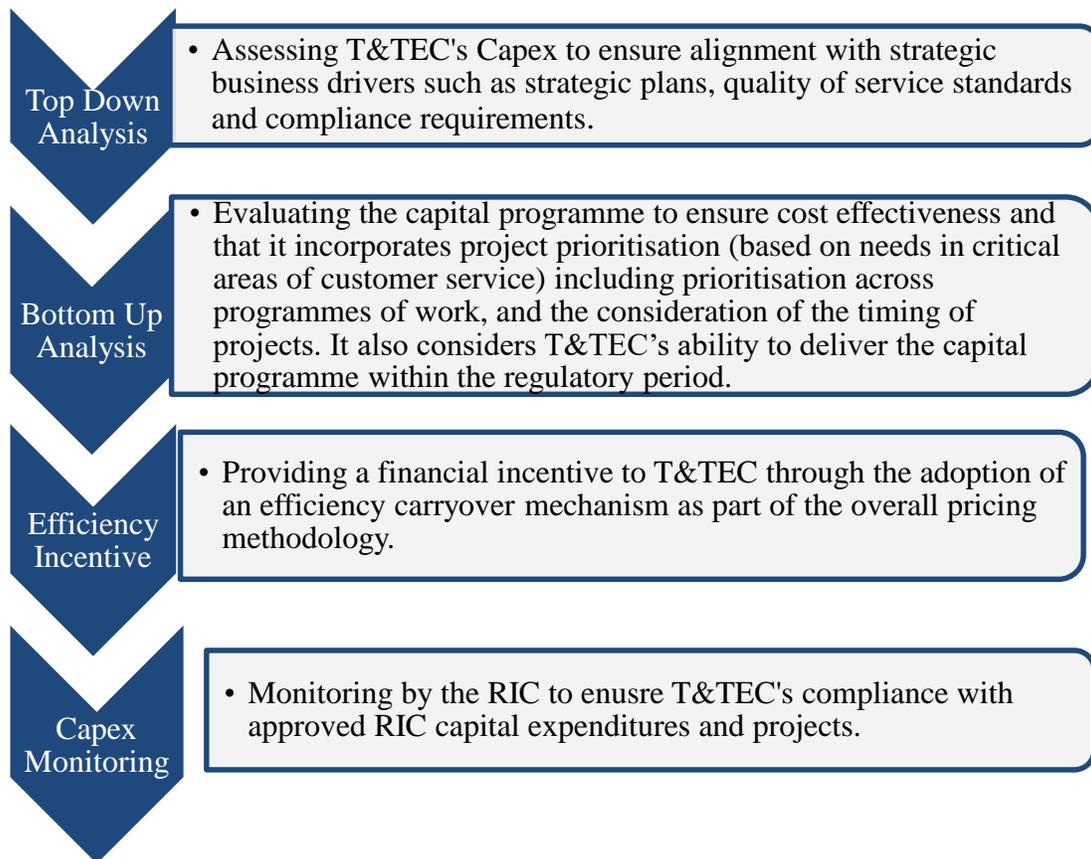
The assessment of Capex is initiated with the service provider's submission of its proposed Capex and involves some amount of testing of efficiency, prudence and "used and usefulness".

These tests are described as follows:

- i. **Efficiency Tests** – are used to determine whether the proposed Capex was representative of the best way to meet customers' needs for services.

- ii. **Prudency Tests** – are used to establish whether or not the decision to invest is prudent, given the particular and specific circumstances at the time.
- iii. **“Used and Useful” Tests** – are used to examine whether or not, the assets/equipment/plant to be installed are utilised in and contribute to, the provision of the service.

The RIC employs a combined top-down<sup>2</sup> and bottom-up<sup>3</sup> approach for the assessment of Capex. It is essential that comprehensive information is provided by T&TEC to support the assessment under these approaches. Some of the activities undertaken by the RIC to evaluate prudency, efficiency and “used and useful” and to incentivize compliance by T&TEC are as follows:



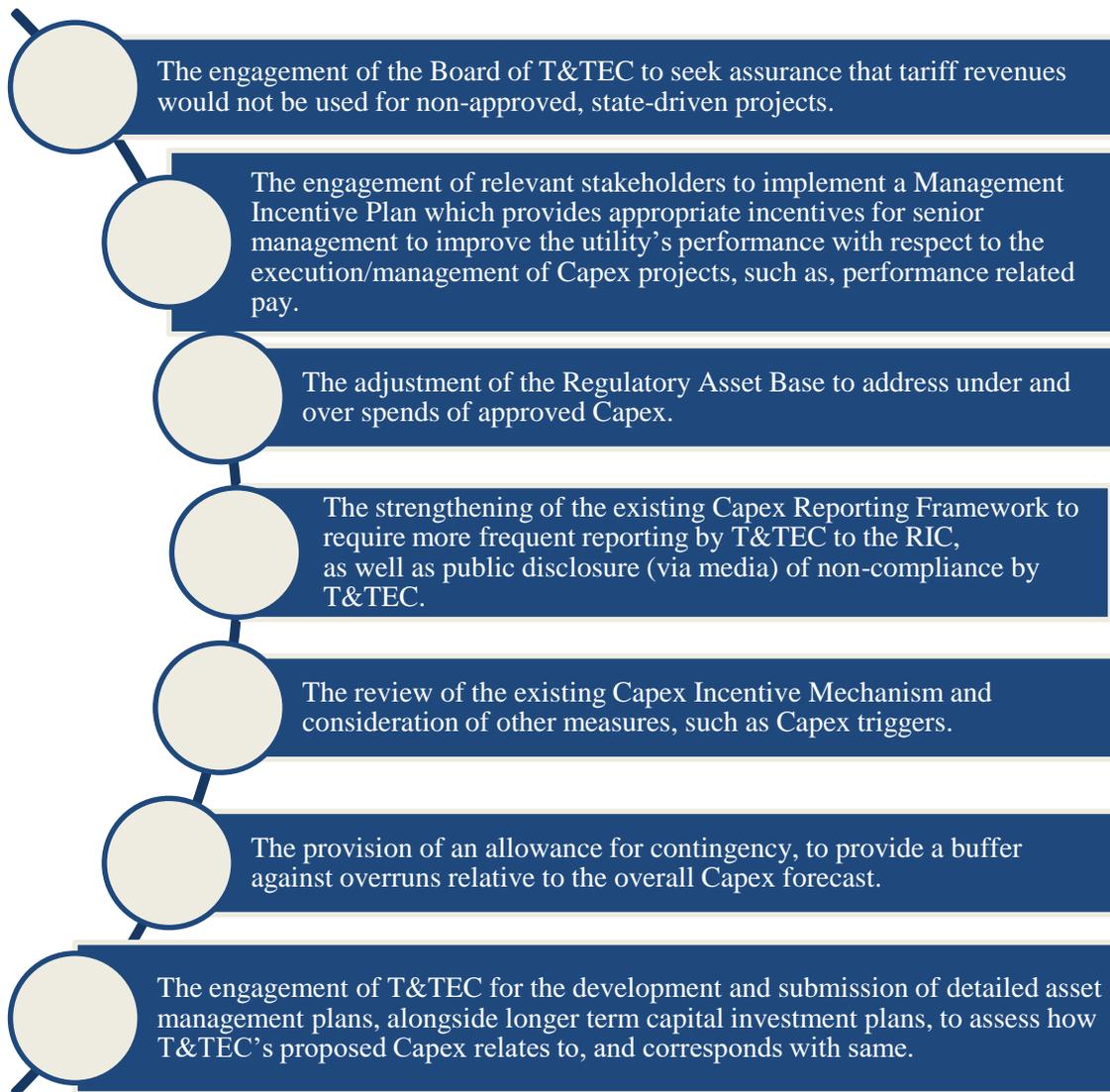
<sup>1</sup> Examination of results and events after they have occurred.

<sup>2</sup> Top-down analysis – high level review of strategic plan and the methodology used to determine Capex forecasts.

<sup>3</sup> Bottom-up analysis – detailed examination and assessment of particular investment projects.

## Further Considerations and Measures in the Treatment of Capex

The RIC's review of T&TEC's out-turn Capex for PRE 1, the first regulatory period (2006 -2011) highlighted the need for further measures to treat with undesirable outcomes such as cost overruns, project delays and poor project execution. To address specific issues arising out of these circumstances, the following measures are proposed:



**All persons wishing to comment on the document, “The Approach to assessing Capital Expenditures for Price Reviews” are invited to review the main document and submit comments using any of the options provided.**