

Approach to Assessing Capital Expenditure for Price Reviews

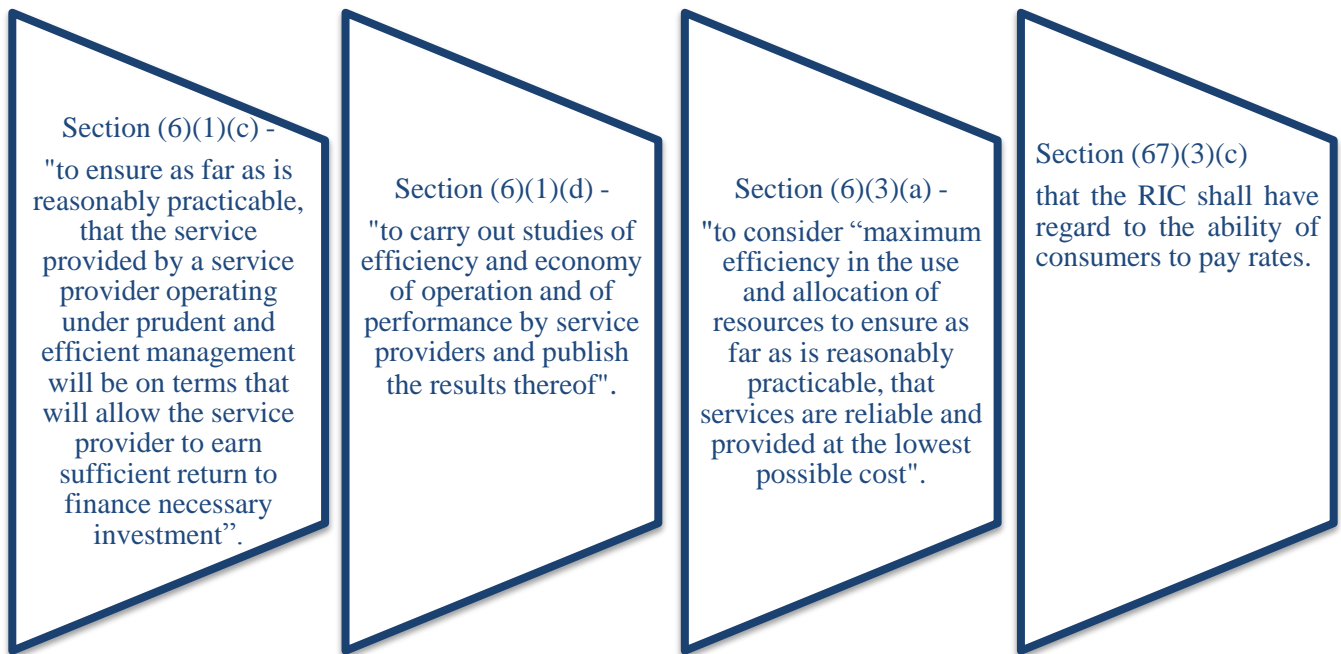
**January
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This document is a summary of the RIC's consultative paper on its approach to assessing capital expenditure (Capex) in price reviews for the electricity transmission and distribution sector.

**Summary
Document**

Why Assess Capital Expenditures for Price Reviews?

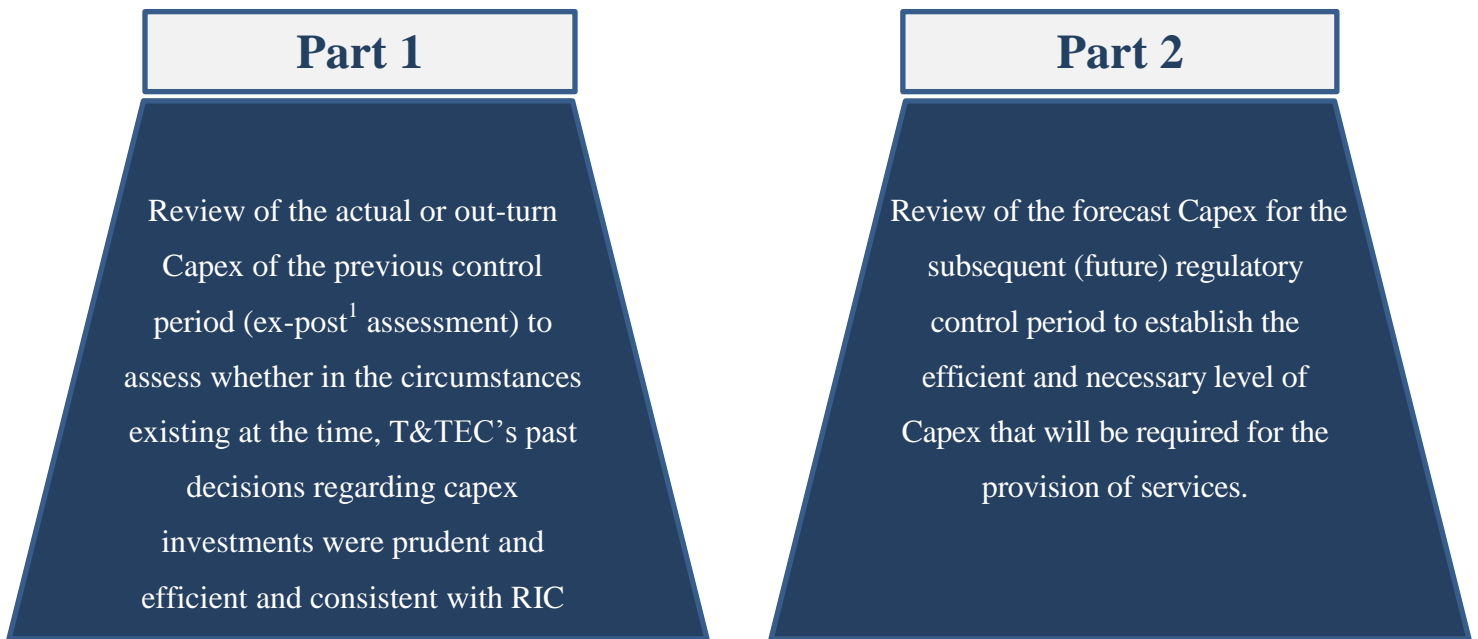
RIC's rate review process is guided by the RIC Act. Overall the process is designed to improve accountability and transparency and ensure that proposed rates are based on reasonable cost assumptions. **To meet these objectives and others articulated in the RIC Act, the interrogation/assessment of proposed (forecast) capital expenditures (Capex) of the utility is a critical activity in the rate review process.** The specific sections of the RIC Act which suggest the need for capital expenditure (Capex) assessment and/or guide the RIC's overall approach to the capital expenditure assessment are as follows:



Working within this legal framework, the RIC has established its approach to assessing expenditure, and the overall revenue requirement for service providers.

RIC's Approach to Capex Assessment

The RIC engages in the careful and thorough assessment of the service provider's proposed capital programme, 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, which is provided at the most efficient cost. The assessment can essentially result in the regulator's acceptance, adjustment or even disallowance of the service provider's proposals for capital expenditure. Broadly the assessment involves evaluating whether past and forecast future capex represent the best way of meeting customer needs for electricity services:



The assessment involves the testing of efficiency, prudence and used and usefulness of past and forecast Capex. These tests are defined as follows:

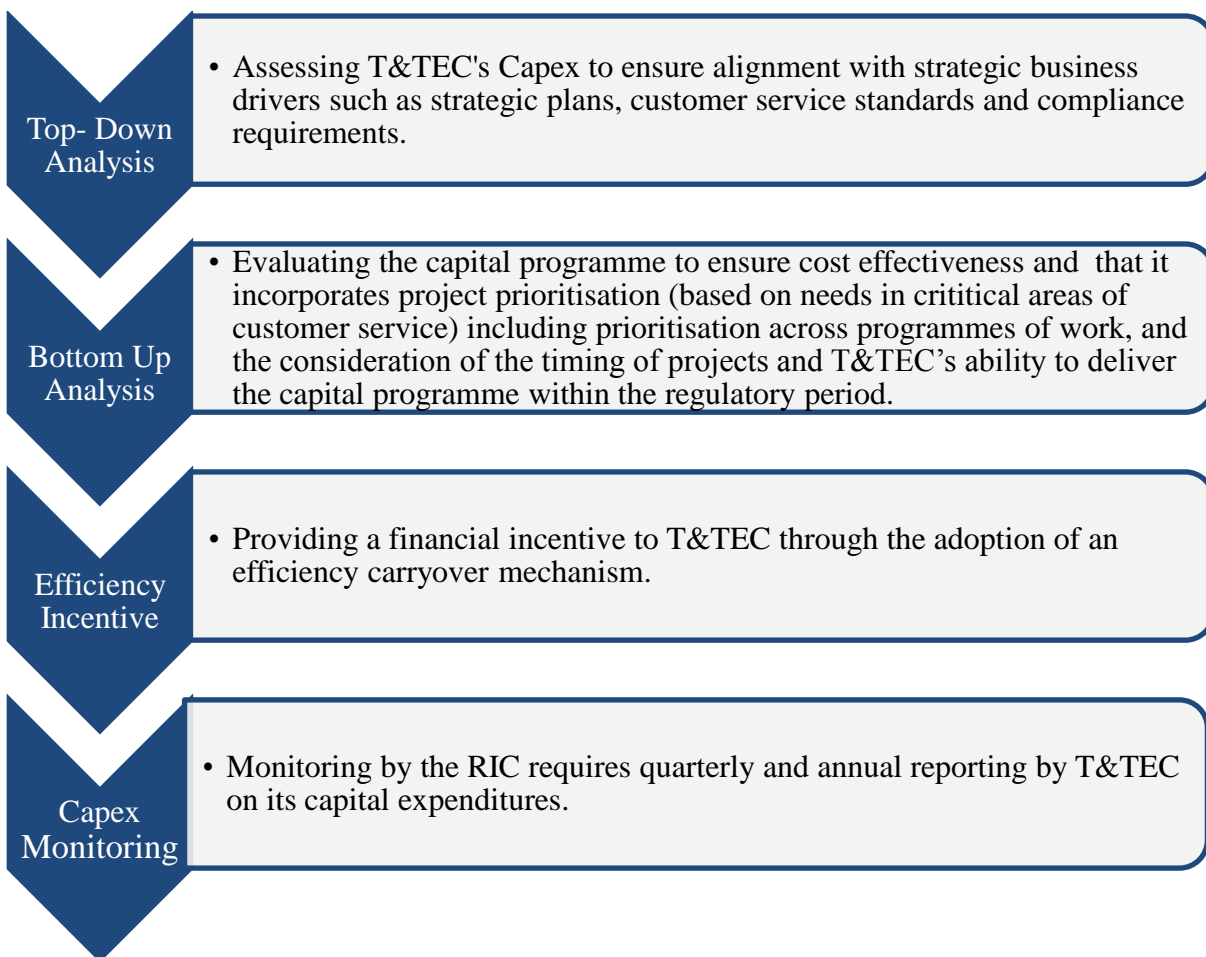
- i. **Efficiency Tests** – which determine whether the proposed Capex was representative of the best way to meet customers' needs for services.
- ii. **Prudence Tests** – which seek to establish whether or not the decision to invest is prudent, given the particular and specific circumstances at the time.

¹ Examination of results and events after they have occurred

- iii. **“Used and Useful” Tests** – which essentially examine whether or not the particular assets/equipment/plant are utilised in and contribute to, the provision of the particular service.

The RIC primarily employs a combined top-down² and bottom-up³ approach for the assessment of Capex. It is critical that comprehensive information is provided by T&TEC to support the assessment under these approaches.

Some of the activities undertaken by the RIC in its determination of Capex which meet the requirements of prudence, efficiency and “used and useful” are as follows:

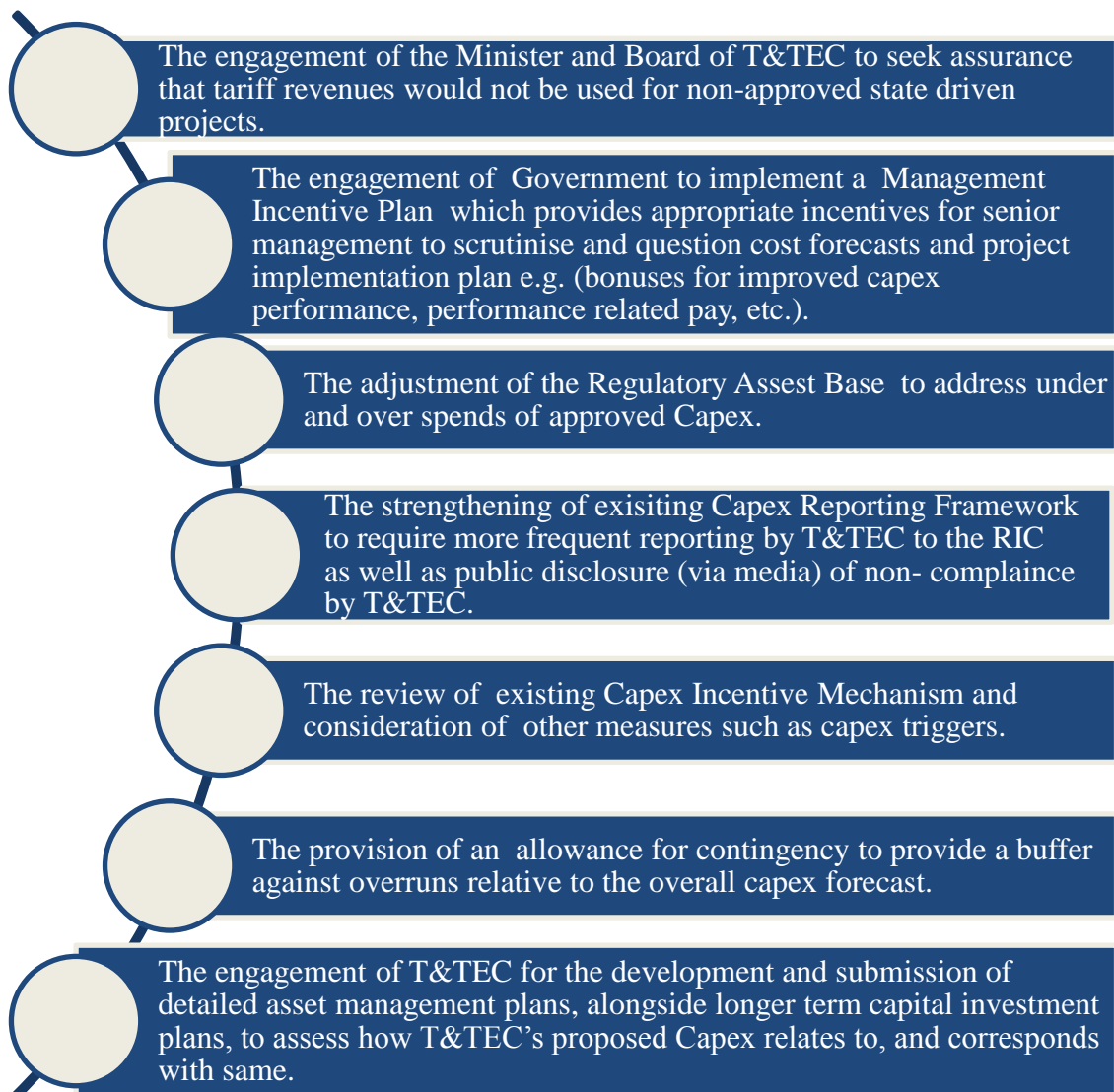


² Top down analysis – high level review of strategic plan and methodology used to determine capex forecasts

³ Bottom-up analysis – detailed examination and reassessment of particular investment projects plans.

Further Considerations and Measures in the Treatment of Capex

The RIC's review of T&TEC's out-turn Capex for 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. Further, challenges have arisen as a result of the governance arrangements for T&TEC due to state ownership. To address specific issues arising out of these circumstances, the following considerations and recommended measures are proposed.



Overall the RIC considers its approach to Capex assessment to be sufficiently robust and in keeping with established regulatory practice. The RIC believes the provision of incentives, the monitoring of Capex throughout the regulatory control period and the engagement of the Government and the Board of T&TEC on several matters will allow for continuous improvement in T&TEC's delivery of the approved Capex programme.

The RIC invites comments and views on all the ideas presented in this paper

Responding to the Document

All persons wishing to comment on the main document are invited to submit their comments by post, fax or e-mail to:

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All responses will normally be published on the RIC's website unless there are good reasons why they must remain confidential. Any requests for confidentiality must be indicated. A copy of this document is available from the RIC's website at **www.ric.org.tt**.