Approach to Setting Operating Expenditure for Price Reviews

January 2018

This document is a summary of RIC's approach to setting operating expenditure for the Trinidad & Tobago Electricity Commission for the second regulatory control period.

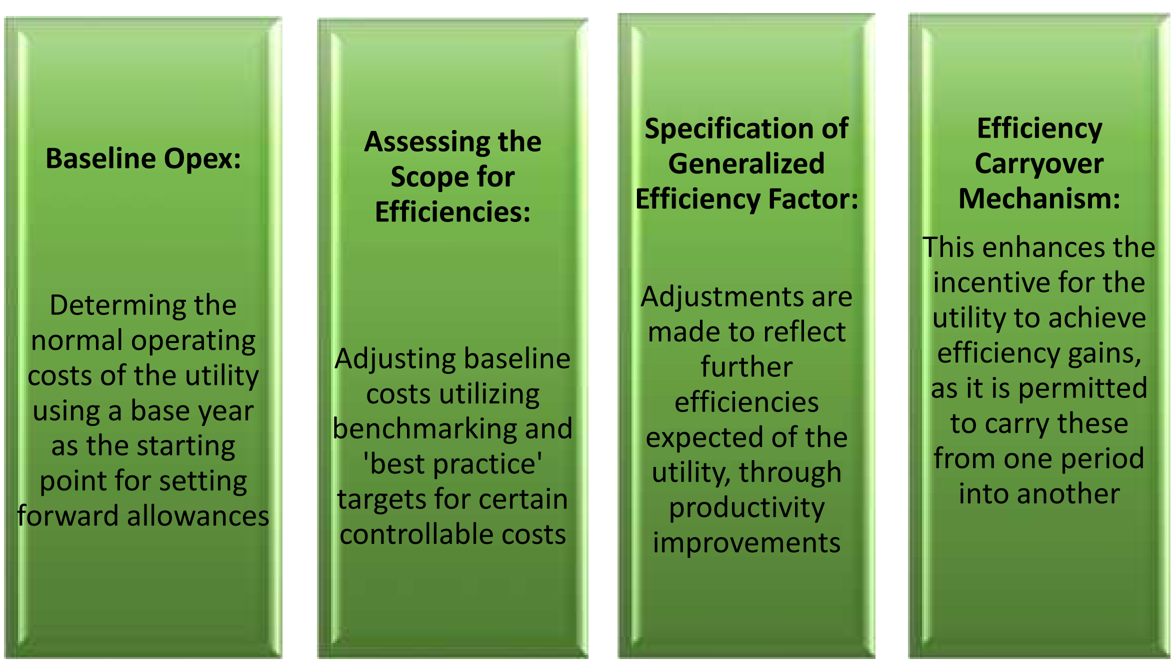
Summary Document

PURPOSE OF THE DOCUMENT

Operating expenses (Opex) are the day-to-day costs of running the utility and typically include cost for generation, fuel, repairs and maintenance, staffing, overhead costs, etc. Opex accounts for a very significant portion of a utility's total costs and are directly recovered from customers through tariffs. As a result, such costs can have notable impact on the final bills paid by customers. This paper examines the RIC's approach to assessing and setting operating expenditure (Opex) for the purpose of price reviews for regulated utilities. It reviews the actual Opex of the Trinidad and Tobago Electricity Commission (T&TEC) over the first regulatory period against what was approved by the RIC. The paper also discusses the RIC's proposed approach/measures for the second regulatory control period for the electricity transmission and distribution sector.

RIC'S APPROACH TO ASSESSING OPEX

The objective for the regulator is to understand what represents a reasonable allowance for the operating costs of the utility, that is, a level of costs that can realistically be expected to be incurred if the utility is run efficiently, within the constraints it faces. Most regulators utilize a broadly similar approach to setting Opex, based on reviewing historical expenditure and considering whether future activities justify an increase in expenditure. The RIC utilizes the following process/steps to determine its Opex allowance:



FURTHER CONSIDERATIONS AND RIC's PROPOSALS FOR THE SECOND CONTROL PERIOD

The RIC intends to continue to utilize the combination of approaches and techniques identified above for the second regulatory control period. The RIC is mindful that there remains certain elements of regulatory judgement in the process and is also cognizant of the following:

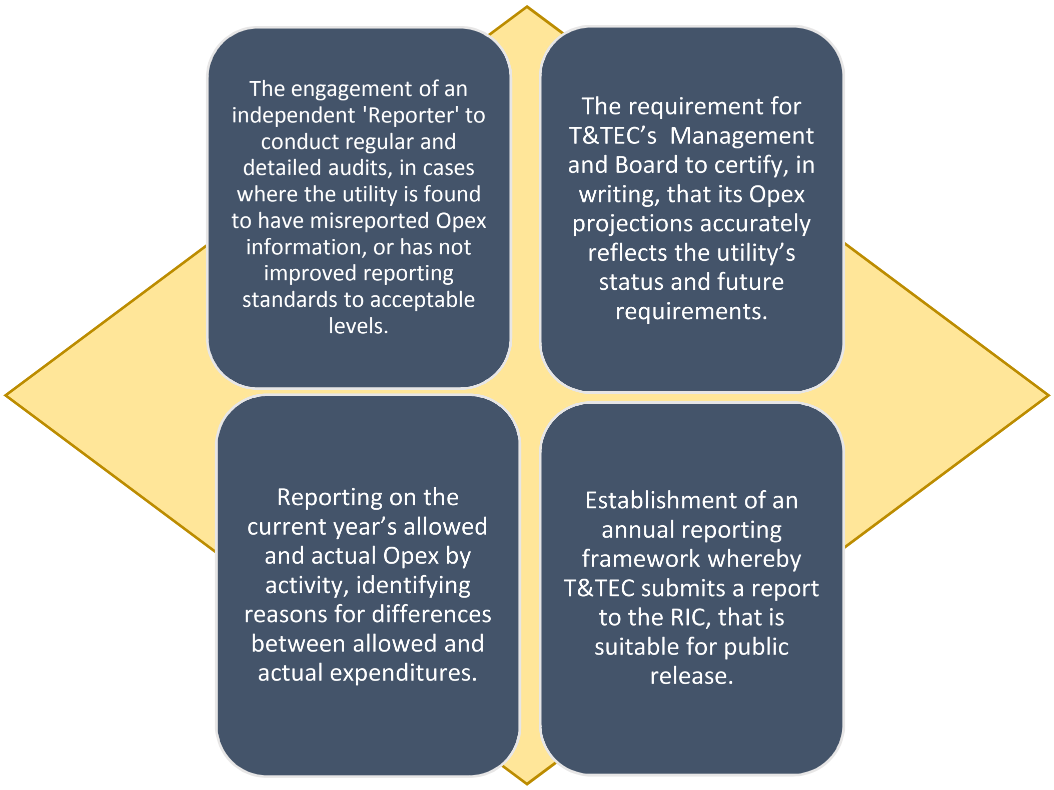
- Allowed revenue must offer a reasonable prospect for the utility to recover its efficient costs (including a reasonable rate of return). The risk of not doing so entails undermining incentives for efficient expenditure and investment
- The high proportion of costs that are uncontrollable limits the scope for cost reduction. However, the RIC has an obligation to ensure that costs that are inefficient or unnecessary are not allowed but, at the same time, to make an allowance for any additional costs arising out of new obligations.
- Estimating efficient costs purely on the basis of benchmarking is not recommended given the practical problems of finding good comparators, as utilities differ in size, structure and may face a variety of external operating environment factors.

The RIC proposes to align incentive-based regulation with utility management incentives. The RIC will therefore ensure that its focus on the achievement of certain outputs/outcomes continues and that the utility's management is subject to strong incentives for good performance. In this regard, some of the measures will include:

Options for incentivizing achievement of output in State-Owned Utilities

- Reputational incentives such as Naming and shaming (e.g. poor performance to be reported prominently in the media).
- Stricter cost management through analysis of actual cost savings against target levels.
- Regular publication of regulatory accounts in accordance with the regulatory accounting guidelines established by the RIC.
- Advocating for the implementation of Management Incentive Plans (MIP) which includes tying pay (and bonuses) to performance.
- Procedural incentives such as the inclusion of an incentive mechanism geared towards provision of high quality information by the utility.

In addition to the incentives discussed above, the RIC and T&TEC have already embarked on a collaborative data mapping exercise to increase the effectiveness of the regulatory data collection and reporting process that currently exists. In its continuing efforts to improve reporting compliance and reliability of data from T&TEC, the RIC will also give consideration to the following:



Finally, most regulators use different mechanisms and tools to address unforeseen costs and to mitigate risks, as some uncertainty will inevitably remain when setting price limits. Some of the mechanisms to address uncertainty include cost pass-through allowances for uncontrollable costs, reopeners (if revenue falls short by a specified minimum amount), logging up and down (inclusion of expenditure not previously allowed) and interim determinations. The RIC will continue to use these mechanisms when necessary and where appropriate.

Responding to the Document

All persons wishing to comment on the main document, which can be obtained from the RIC's website, 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.