Establishing an Appropriate Form of Price Control

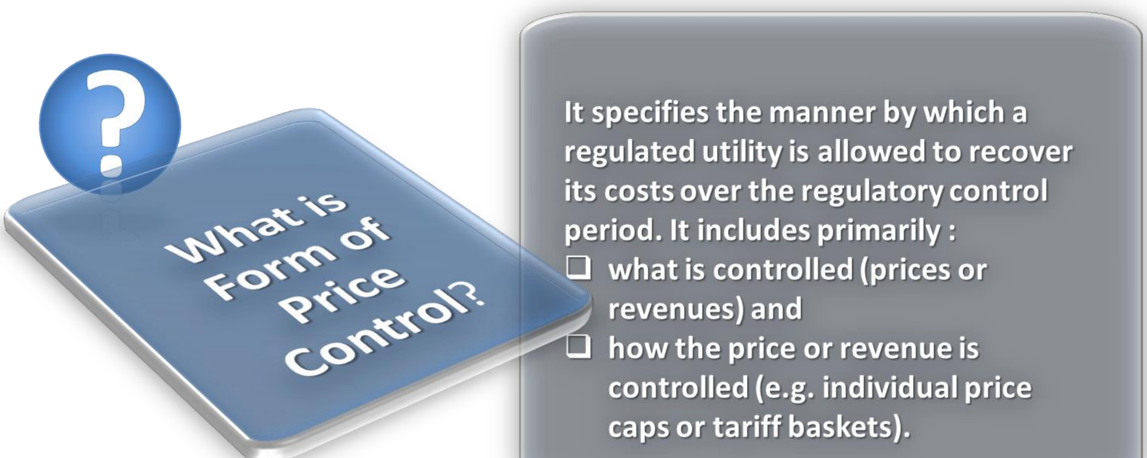
January 2021

As part of the second price control review for the electricity transmission and distribution sector, the RIC intends to revisit the forms of price control that are consistent with an incentive framework so that the RIC makes an informed decision regarding the most suitable approach going forward. The main document also highlights the key strengths and weaknesses of the alternative approaches.

Summary Document

ESTABLISHING AN APPROPRIATE FORM OF PRICE CONTROL

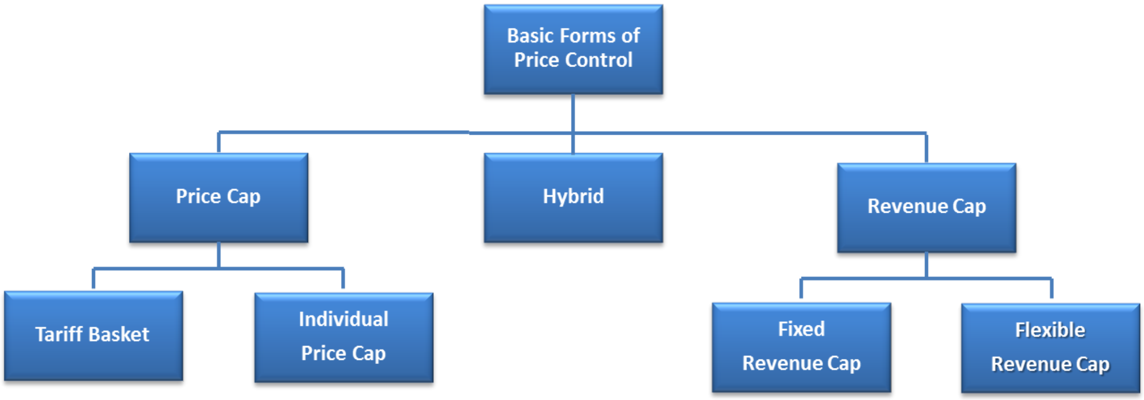
The Regulated Industries Commission (RIC) is required to establish principles for determining rates and charges of service providers under its purview. The RIC Act allows the RIC to utilize be some form of incentive regulation; however, the Act does not specify any particular form of price control.



There are three primary forms of price control under incentive regulation[1] that the RIC may utilize under the RIC Act: Price Cap, Revenue Cap or Hybrid.

[1] These forms of price control can also be classified as *ex-ante* price controls (these controls are built on forecasts). The rate of return price control can also be classified as an *ex-ante* price control, but does not fall under the incentive regulation approach.

These are depicted in the diagram below.



The following table outlines some of the key characteristics of different Forms of Price Control:

	Firm has incentive to price efficiently?	Firm has pricing Flexibility?	Regulated firm bears volume risks?	Information required for setting cap, given allowed revenue?	Information required for compliance?
Average Revenue Cap	Some incentive	Yes	Yes	Low	Low
Total Revenue Cap	No	Yes	No	Very Low	Very Low
Hybrid Revenue Cap	Some incentive	Yes	Some risk	Low	Low
Tariff Basket	Yes	Yes	Yes	Medium	Medium
Disaggregated Price Caps	Yes	No	Yes	High	Medium

In the first regulatory control period for the electricity transmission and distribution sector, the RIC utilized a fixed (total) revenue cap. A fixed or total cap was chosen because it provided distinct advantages, such as an appropriate balance of the allocation of risk between customers and the service provider, while concomitantly incentivising the service provider to reduce costs. It also provided T&TEC with the operational flexibility it needed to meet its service objectives and, at the same time, it exposed T&TEC to risks it could control.

On balance, the fixed (total) revenue cap performed well:

- It provided an appropriate basis for establishing efficient tariffs;
- It provided for stable household bills; and
- No undue risk had to be borne by any customer or T&TEC.

The RIC is acutely aware that the energy landscape is undergoing extensive changes and as part of the second review, will employ further measures to encourage greater conservation and energy efficiency among customers. In this regard, a fixed revenue cap encourages demand management on the part of a utility. At the same time the RIC is aware that over the longer term, the rollout of electric vehicles may provide new demand streams for T&TEC. Concomitantly, the growth of renewables and the possibility of greater self-generation can dampen demand. The revenue cap is best suited to enable T&TEC to manage these risks.

Comments are welcome on the RIC's proposal to continue with a fixed revenue cap for the 2018-2023 Price Control period for T&TEC.

All persons wishing to comment on the form of price control are invited to review the main document and submit their comments using any of the options provided.