

The background of the slide is a dark blue image of a globe with glowing blue energy lines and arcs connecting various points across the continents, symbolizing a global energy network.

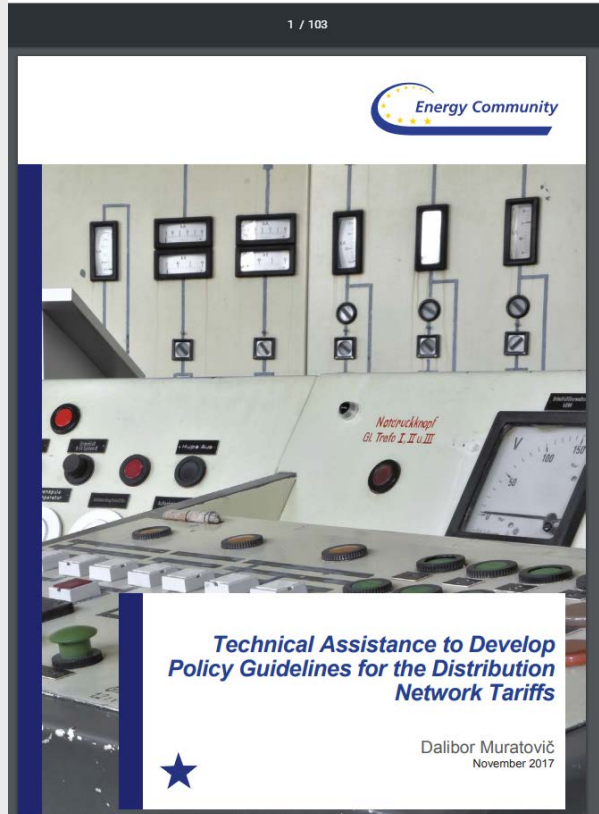
Policy guidelines for distribution network tariffs

Energy Transparency Week – Network Tarification

Kyiv, 10 October 2018

- 1. *Development of Policy guidelines [ECDSO-E]***
- 2. *Selection of the appropriate tariff methodology***
- 3. *Cost recognition: principles, criteria and procedure***
- 4. *Connection and use of network – allocation problem***
- 5. *Costs allocation and tariff setting***
- 6. *Monitoring***

1. ECDSO-E: <http://ecdsoe.org/>



- ***Need to work on coordinated approach and common position***
- ***ECDSO-E task force on network tariffs***
- ***The Study and Report***
- ***Developing Policy Guidelines***
 - Wider Consultations (ECS, ECDSO-E, ECDSO-G, ECRB)
 - Publication



POLICY GUIDELINES
by the Energy Community Secretariat

on the distribution network tariffs

PG 02/2018 / 3 April 2018

Policy Guidelines released in April 2018

https://energy-community.org/dam/jcr:a6882c6d-923f-4d6a-83d3-395773804984/PG_02_2018_ECS_tariffs_DS.pdf

- Principles***
- Methodology to determine justified costs/ approved revenues from regulated activity***
- Incentive regulation***
- Allocation of costs and tariff design***

2. Appropriate tariff methodology



Appropriateness, considering:

- *Legal framework*
- *Policy objectives*
- *Inherited practices*
- *Records and access to information*
- *Control of the processes*

Assessment (example): https://energy-community.org/dam/jcr:49de09fa-632a-4e1d-9feb-f93d95b1610d/ECS_UE_tariffs_052018.pdf

What defines a methodology



- *Principles*
- *Criteria*
- *Procedure*
- *Objectives*

Principles

- *Predictability*
- *Transparency*
- *Fairness and non-discrimination*
- *Respecting the economic environment*

(cost effectiveness, cost recovery, cost reflectivity...)

Regulation method

An optimal price regulation model is a coherent mix of the most appropriate regulation tools under the existing circumstances with the view to achieve the desired development

Incentive-based regulation is the best tool to achieve cost efficiency and to maintain and improve the quality, under the condition that the required or guaranteed level of quality of service has been established.

Methods

- **Cost plus / rate of return**
- **Revenue-cap / price-cap**
- **Yardstick / benchmarking**
- **Incentive / performance based**
- **Combination**

Conflicting objectives: Reconciliation and prioritization

3. Costs recognition



Principles and criteria must be known and communicated sufficiently in advance and applied consistently

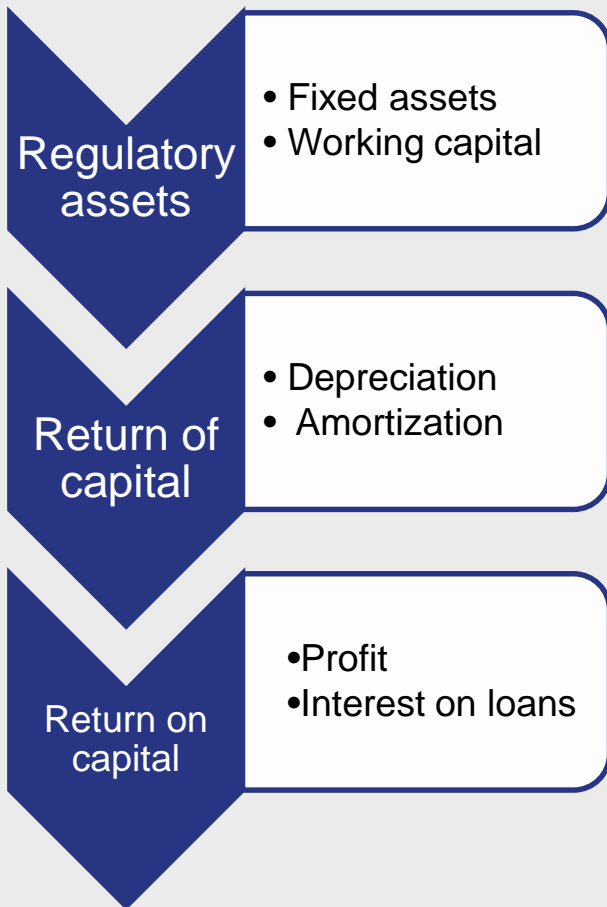
General premise:

- Overall social welfare
- Long term perspective

Specific criteria for cost assessment:

- **Prudence**
- **Reasonableness**
- **Usefulness and usability**
- **Non-economic criteria (quality, contribution to overall welfare)**
- **Respect of legally binding objectives**
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Regulatory Assets Base:

If the assets records are reliable and there is no indication of impairment, the Historic Cost method is recommended to determine fair value of assets. Replacement cost method is an optimal solution when missing evidence of fair value of assets is reported as a result of poor records, currency exchange rate volatility and inflation. Regulator should have wide competences with regard to the initiation and approval of the revaluation of fixed assets.

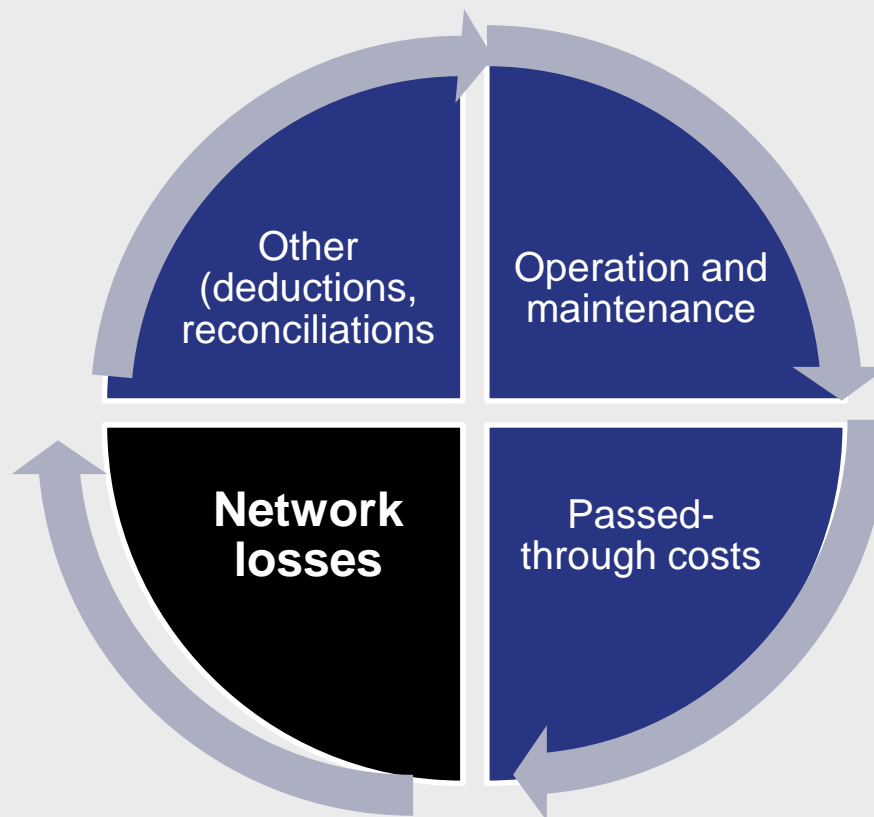
Depreciation policy:

Regulatory depreciation periods should be aligned with the accounting practice and/or the technical life time of network assets to the extent possible

Rate of return:

The reasonable level reflecting the prevailing conditions at the broader market in the EnC and CP, with gradual changes, if necessary, is assumed to bring more predictability and investor's confidence.

Operating expenditures



4. Connection costs

In technical terms, it is clear and well defined.

In commercial terms - inherited differences.

Deep connection – in addition to cost of the physical connection, the customers pays a charge/ fee for reinforcement of the existing network

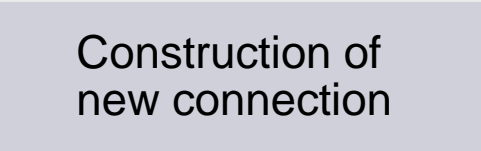
Shallow connection – only physical connection to the existing grid

Guiding principle: fairness

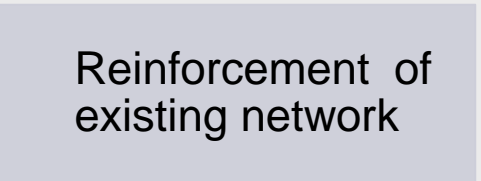
- ✓ Criteria for recognition of reasonable costs
- ✓ Transparent and competitive **procurement procedure** by DSO
- ✓ Installation by a competent installer (DSO own department or outsourced contractor)
- ✓ Consistency over long time



Purpose



Construction of new connection



Reinforcement of existing network



Connection costs vs connection charges

(position paper of ECDSO-E)

When is reinforcement necessary?

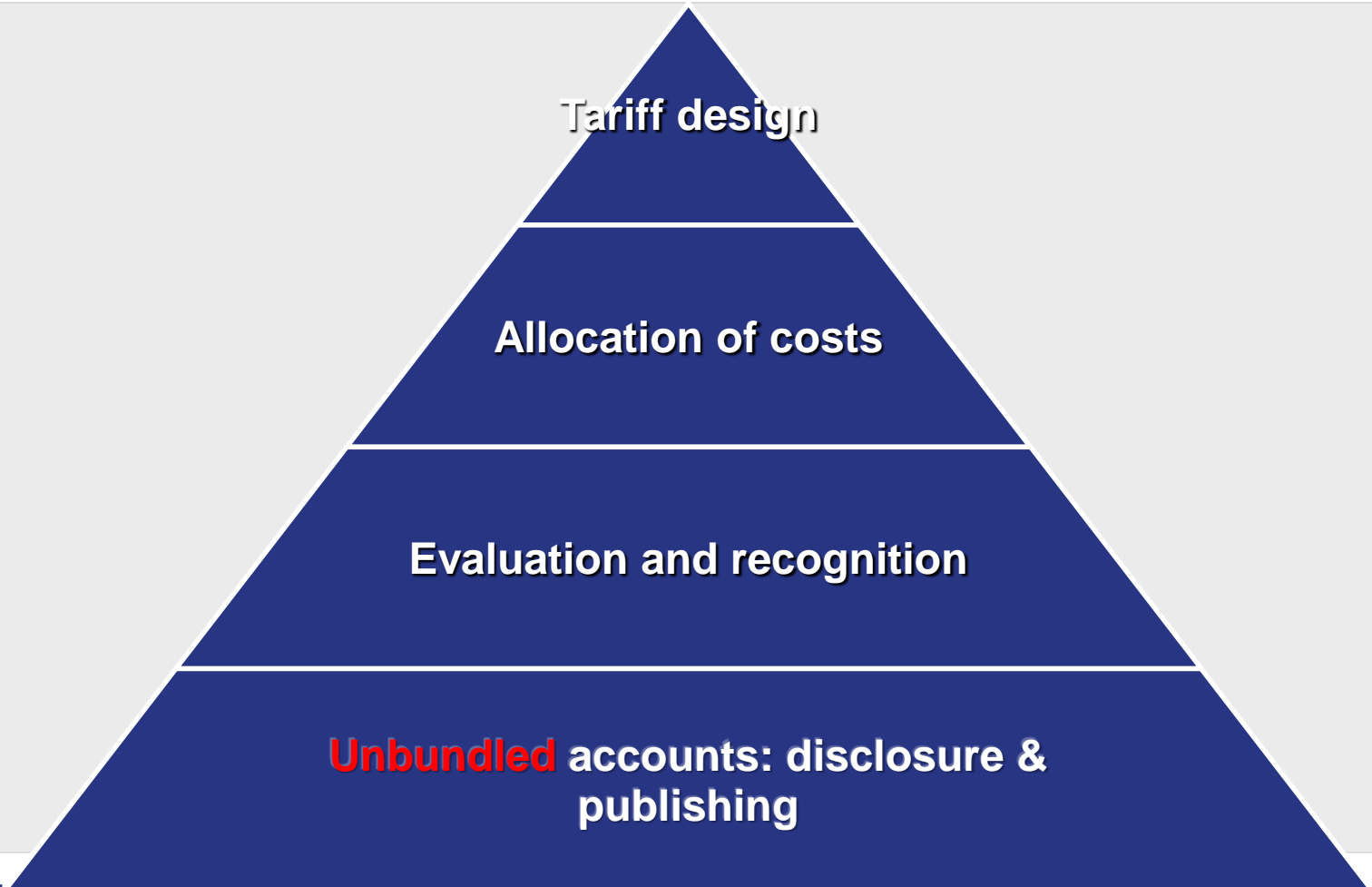
Should the costs be paid by customer only when reinforcement is necessary?

How to determine the costs of reinforcement?

How to share the reinforcement costs equitably?

What to charge to customer: reimbursement of actual costs, the lump sum contribution, fee per unit?

5. Cost allocation and tariff setting



Cost recognition

Principle of cost recovery:

Determination of revenues required to cover all reasonable and prudently incurred costs, taking into account network development needs.

Cost allocation

Principle of cost reflectivity:

Recognized costs shall be attributed to cost drivers and to customer groups reflecting the costs associated with the use of network with the view to give signal for more efficient use of network.

1) Primary allocation:

Costs allocated on observed activity (segment: **cost centers** / **profit centers**),

Secondary allocation: Costs of internal products and services and common services (**transfer charging & allocation keys**)

Deductible items (other revenues from use of licensed assets allocated to the observed activity)

2) Allocation of costs on tariff elements [COST DRIVERS]
- Definition of cost drivers: **capacity, energy, customer,**

3) Allocation of costs on CUSTOMER CLASSES
- Definition of customer classes

4) Reallocation: Tariff system should be understandable to the targeted customer group to react to price signal

Demand –
capacity
charge
(€/kW)

Volumetric
(or energy-
based)
variable
charge
(€/kWh)

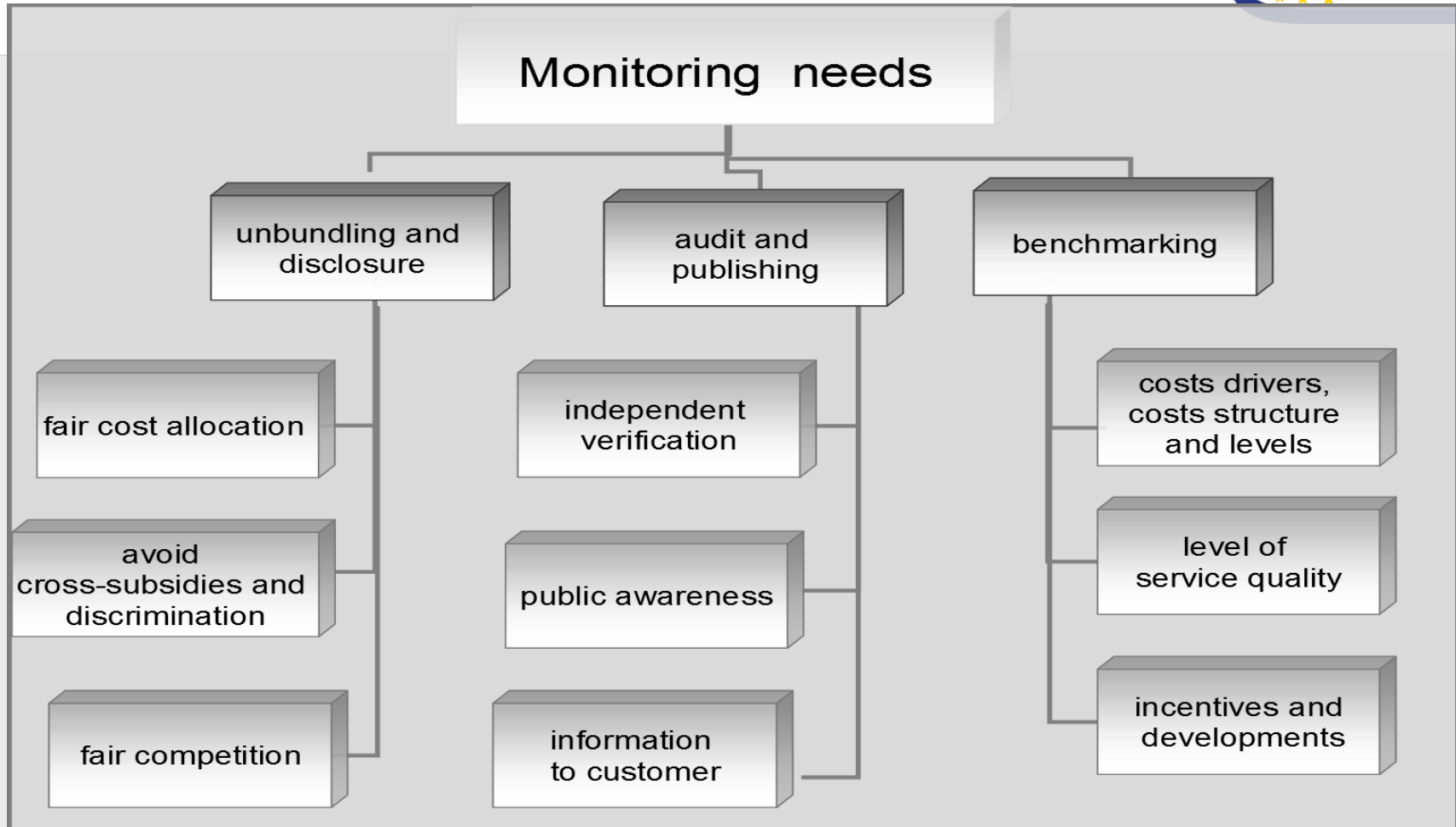
Fixed
charge
(€/metering
point per
period)

Reactive
energy
charge
(€/kVArh)

6. Monitoring

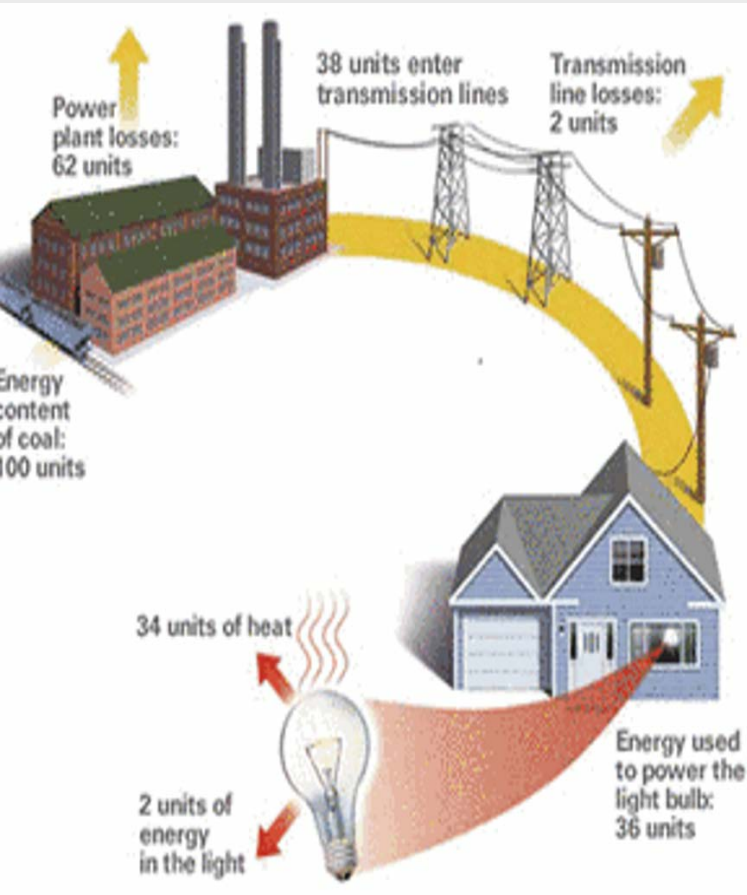


- § Regulator should have enough information about regulated company's operation.
- § Information must be true, clear and complete.
- § Complete information enables Regulator to bring fair and just decision in the best interest of customers and regulated companies.



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- ✓ **Technical and financial operational data in prescribed forms (for tariff application or compliance with license condition);**
 - ✓ **Investment plans and reports on realization;**
 - ✓ **Quality of service reports;**
 - ✓ **Plans of measures and activities related to network security, operational efficiency, restructuring or quality related commitments;**
 - ✓ **Documentation prepared by company according to laws and other regulation;**
 - ✓ **Report upon important events that may have effect on company's business;**

Incentives based regulation



- **Operational efficiency** (incentivizing operating cost effectiveness)
- **Allocative efficiency** (incentivizing cost effective investments)
- **Quality of service** (in parallel with operational efficiency)

Preconditions:

- **Stability and predictability of regulatory framework**
- **Achievability of objectives at pre-set rate of return**
- **Fair sharing of gains**



Questions?

www.energy-community.org