PROVISIONAL TARIFF APPLICATION GUIDE

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1. Purpose

This paper intends to provide the provisional guidelines to file a tariff application at the Utility Regulatory Authority and should be read along with the relevant provisions of the law governing the determination of electricity tariff and the URA Tariff Guidelines and Methodology.

2. Legislation

The URA draws its mandate to determine electricity tariffs from Section 6 (d) of the URA Act 2004 (as amended). The Authority is further mandated under Part IV of the Electricity Act 2005 to regulate tariffs within the electricity sector. The main elements of the Act that relates directly to the tariff regime are:

- The Act establishes some general principles for tariff determination that include the recovery of reasonable and necessary costs; a reasonable return on invested capital; incentives for improvements in efficiency and quality of service, and the reduction of cross-subsidies, notwithstanding any necessary subsidy for certain categories of customers, and;

- The requirement that the licensees keep separate accounts (no legal separation is required);

3. Scope

The process of separation of accounts and ring-fencing business units will require detailed studies on asset valuation and allocations and defining proforma account for the business units. The details may just be estimates until some time when actual data is generated from actual operations of the ring-fenced units. As such, the Central Electricity Board (CEB) may not be presently in a position to fully apply all the principles and framework as envisioned in the URA Tariff Guidelines and Methodology which are built around ringfenced business units.

This provisional guide has been put in place to facilitate the tariff application process based on the current vertically integrated structure of the CEB.

4. Overview of the tariff application and review process

Presented below is the overview of the tariff application and review process.

MAIN ACTIONS BY THE UTILITY COMPANY	Utility determines the need for a tariff change to meet its revenue requirement Prepares information and supporting documents in support of the new proposed tariff Submits a case to the Authority Presents to the Authority the rationale for a change in tariff and defends its proposal Adds any extra information as required Answers all questions from the relevant stakeholders and the public
MAIN ACTIONS BY THE REGULATOR	Reviews case for completeness, study and examine the proposal made by the Utility Company Holds hearing with relevant stakeholders Reviews all information Seeks any more information needed Prepares report & Publishes decision

Administrative Stakeholder Engagement on Tariff Application

This is a buy-in process where representatives of stakeholder institutions are given a chance to comment and give their views on the proposed tariff change and the justification through a participatory process. The representatives of the Utility company are given an opportunity to present their tariff proposal and respond to any question or observations made by the stakeholders.

5. Preparing a tariff adjustment proposal

The Utility calculates the revenue required to cover all fixed and variable costs and the desired profit margin on the basis of which an application for tariff increase is submitted to the regulator justifying the:

- ✓ total revenue required
- ✓ proportion of revenue to be collected from each customer class
- ✓ tariff designs for recovering revenues required from each class

The application for tariff review should contain justification of the proposed tariff adjustment and shall include among other things the following information to assist the Authority to arrive at a just and reasonable decision:

- ✓ Summary of reasons for the proposed tariff variation;
- ✓ Comprehensive statement on the reasons for the proposed tariff variation; with supporting technical, financial information.
- ✓ Excel Sheet/Financial model with accessible formulae

The summary tables should provide the following information:

- ✓ Current and proposed tariffs per customer category;
- ✓ Proposed changes in monetary and percentage terms for each tariff category;
- ✓ Audited and proposed revenues; and
- ✓ Audited and proposed net operating income
- ✓ The total number of current and projected customers by tariff category
- ✓ A statement on the impact of the proposed tariff variation on consumers and quality service delivery

6. Electricity tariff determination Process

To arrive at a tariff, the URA reviews and verifies all information related to the various components that make up the revenue requirement and all supporting schedules as outlines below.

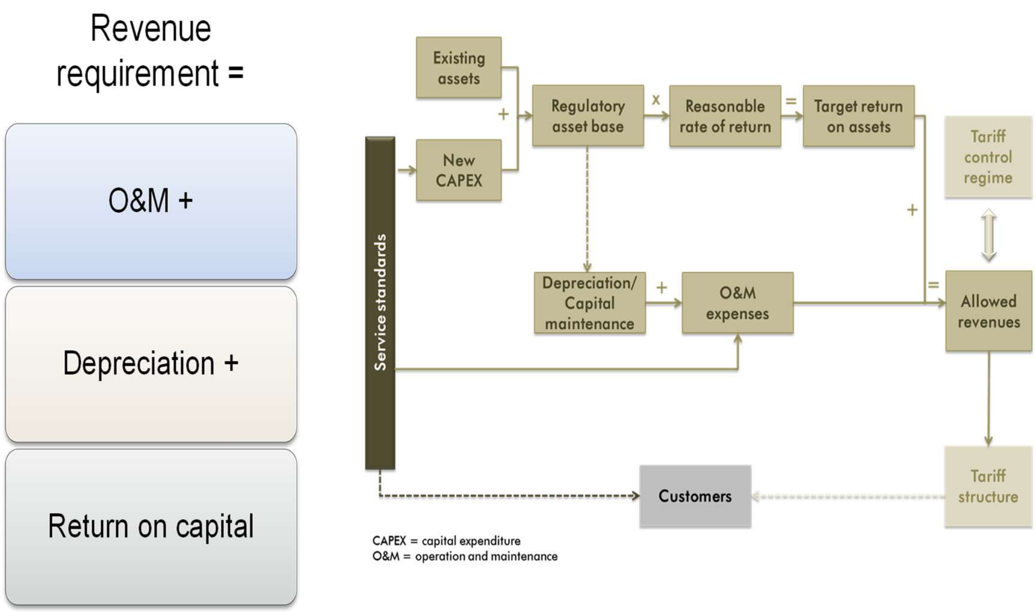

Table 1: Building Block for the Revenue Requirement

Revenue Requirement

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Electricity Production & Purchase costs

+ Operation & Maintenance costs

+ Customer Service Costs

+ Overhead Costs

+ Depreciation Costs

+ Rate of Return

+ Cost of Working Capital

(-) Income from other sources

Some key schedules needed for the revenue requirement assessment include but are not limited to the following;

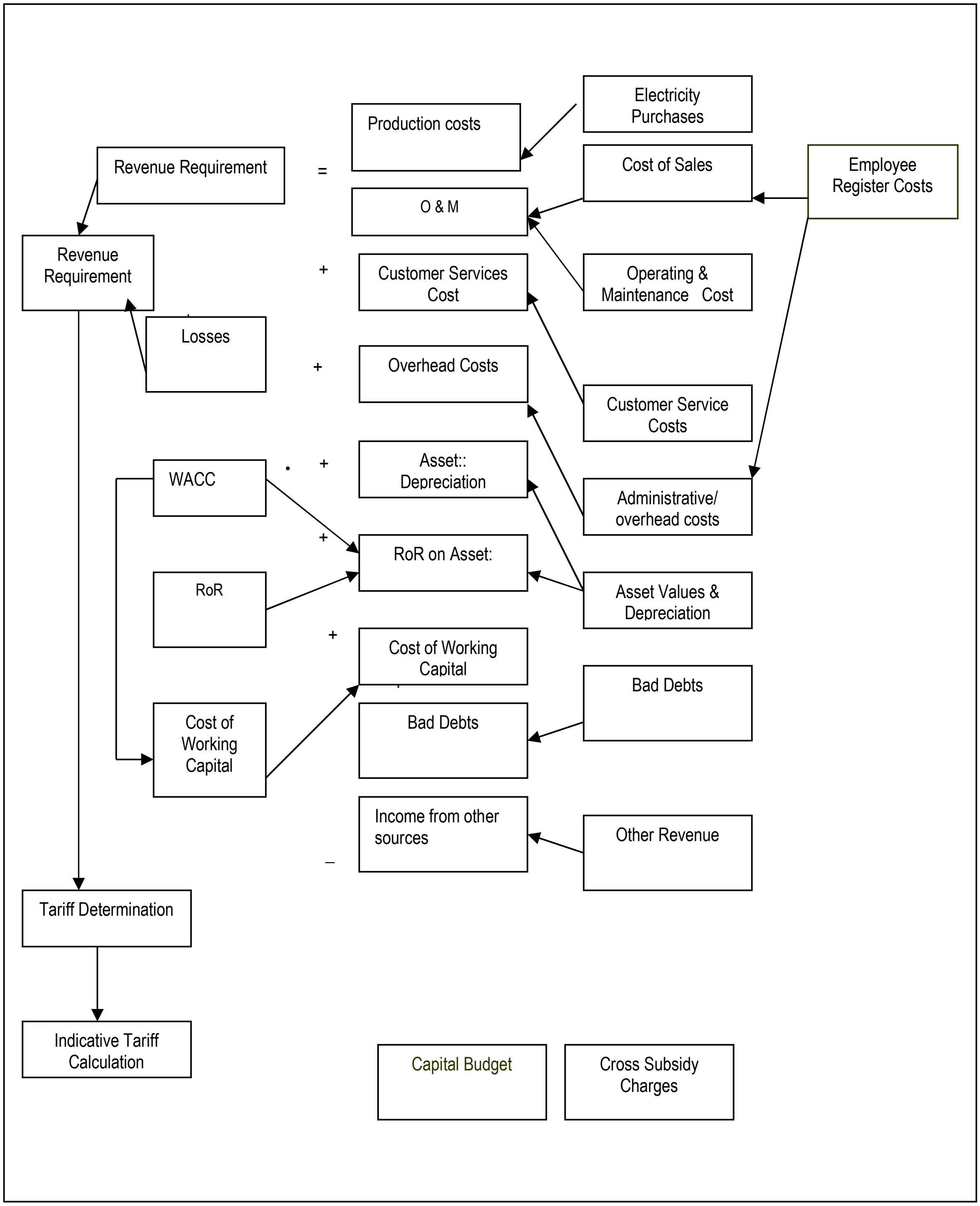

Table 2: Revenue Requirement Assessment

The principles underlying Revenue Requirement

- In determining tariffs for all customers, the URA will ensure that tariffs approved for each customer category reflect the cost each customer category imposes on the system;

- Recovery of prudently incurred costs by the Utility, that is, only just and reasonable costs incurred wholly and exclusively for the provision of electricity are allowed in the tariff determination process;

- Recognition of used and useful Utility assets, that is, only assets currently used by the utility to provide electricity to its customers are included in the electricity asset base;

- Financial sustainability of the Utility, that is, the applicable tariffs should enable the utility cover both capital and operational costs as well as earn a reasonable return.

- Delivery of quality service, that is, the determined tariff must be accompanied by noticeable improvements in the quality of services provided; and

- Social considerations for customers with low-income levels, that is, the tariff must remain accessible and affordable.

Allowable operating and maintenance expenses

- The Utility has to justify all the costs that must be incurred in order to efficiently operate, maintain and administer the provision of the regulated business

- Allowable operating expenses relates to all expenditure just and reasonable incurred wholly and exclusively for generation, transmission, distribution and supply of electricity. The costs include:
    a. Primary costs directly related to generation of electricity
    b. Electricity purchases (from Independent Power Producers IPPs)
    c. Wheeling charges;
    d. Staff costs;
    e. Maintenance costs;
    f. Financing costs;
    g. Operating costs;
    h. Overheads; etc.

- The qualifying criteria for allowable operating and maintenance costs are outlined below:
    a) Expenses must be incurred in an arm's length transactions;
    b) Expenses must be incurred in the normal operation of generation, transmission, distribution and supply of electricity, including a reasonable level of refurbishment, repairs and maintenance costs;
    c) Expenses must be prudently incurred after careful consideration of available options. Such consideration would entail a competitive bidding and transparency in the procurement process;

d) Limited expenses for research and development maybe included after the URA satisfies itself that they related to business operations.

- Besides the normal costs, the extraordinary costs corresponding to non-manageable costs by the Utility and the capital cost associated with working capital and deferred taxes must be presented and the Utility will have to justify the existence of such extraordinary costs.

- Operating expenses that do not conform to the above criteria may not be included in the revenue requirement. This includes unjustified expenses and unreasonable costs.

Allowable Depreciation expense

The depreciation component of the allowed revenue requirement should be computed as recommended in the Tariff Guidelines and Methodology. Consumers should not have to pay the costs of future consumers now.

Rate of Return

A real rate of return duly justified by the Utility shall be applied uniformly to all used and useful assets deployed by the Utility in generation, transmission, distribution and supply of electricity.

Rate Base or Regulatory Asset Base

The Rate Base or Regulatory Asset Base covers all assets employed by the regulated Utility in generation, transmission, distribution and supply of electricity. The following are conditions associated with determining whether assets may be included in the rate base.

a) Assets held by the Utility must be used and useful for the purpose of generating, transmission, distributing and supplying electricity and must be long-term in nature. Used and useful means that assets should be in a condition to supply demand in the short-term (i.e., within 12 months) and long-term in nature means that assets will remain used and useful for a period of more than 12 months. The URA will ensure that only property serving the public is eligible to earn a rate of return

b) Subsidized assets not financed by the Utility should not be included in the rate base. Partially financed assets may be included on a proportional basis. Provision for depreciation and Operation and maintenance costs be provided for the subsidized cost

c) Future assets are excluded from the rate base until they are useful and useful (enter into commercial operation).

d) Working capital determined as a proportion of the Utility's annual operating expenses

Tariff structure

Once the required revenue has been identified, the Utility will need to demonstrate and justify how these costs are allocated to the end-users and must show efficient allocation of the recognized costs in accordance with a responsibility criterion.

7. Sample of the Final Summary of presentation of the proposed tariff adjustment

		Test Yr.	Known & Measurable Changes	Adjusted Test Yr.
Utility plant-in-Service				
1	Generation	548	178	726
2	Transmission	110	59	169
3	Distribution	175	119	294
4	Buildings & Vehicles	77	89	166
5	**Subtotal, P-in-S**	**910**	**445**	**1355**
6	Rate of return	11.00	11.50%	11.50%
8	Return on Rate Base	**100.1**	**51.175**	**151.275**
9	**Accumulated Depreciation and Amortization**			
9.1	Depreciation	36	15	51
9.2	Amortization	8	5	13
10	**Subtotal, Depreciation and Amortization**	**44**	**20**	**64**
11	**Net Rate Base**	**866**	**425**	**1291**

		Test Yr.	Known& Measurable Changes	Adjusted Test Yr.
12	**Cost of Service**			
13	Powers Costs			
14	Owned Generation	349	16	375
15	Purchased Power	100	10	110
16	Transmission	96	5	101
17	**Subtotal Power Costs**	**545**	**31**	**576**
18	**Administration and General**			
19	Wages and Salaries	53	5	48
20	Benefits (including pensions & grat)	29	-3	26
21	Legal and Regulatory costs	6	-3	3
22	Other	53	8	61
23	**Subtotal, A&G**	**123**	**7**	**30**
24	**Taxes**			
24.1	Property	13	7	20
24.2	Income	32	45	77
25	Subtotal Taxes	**45**	**52**	**97**
26	**Total Cost of Service**	**668**		**706**

27 Revenue Increase (Decrease) ....

28 Revenues from Current Rates ....

29 Incremental Rev. Requirement ....

30 Percentage Change ....

		Test Yr Capital	Known & Cost of % change Adj. Capital	Adjusted Weighted Capital Measurable
31	**Capital Structure and Cost**	....	......	....
32	Long-term Debt	....	....	....
33	Short-term Debt	....	......	....
34	Preferred Stock	....	......	....
35	Common Stock	....	......	....
36	**Total**	**.......**	**.......**	**........**

8. Tariff Adjustment Decision Process

1) Establish the company's proposed revenue
2) Compare with the test year revenue
3) Establish Revenue deficiency
4) Translate revenue deficiency to the require percentage tariff change
5) Apply social tariff objectives
6) Review final tariff structure

9. Announcement of the Regulatory Decision

Taking into account the proceeding of the stakeholder engagement process and internal analysis done by the URA on the tariff application and decisions on the adjustments to be made, the Authority makes decision on:

- The final percentage tariff change to be implemented with or without conditions
- The effective date of implementation
- The date for official communication of the approved tariff to the Ministry responsible followed by communication to the Utility Company
- Publication of public notice in the Gazette and other media of approved tariffs (tariff schedule) and the reasons for the regulator's decisions.

10. Appeals Process

All tariff decisions made by the Authority are final but can be appealed against in competent courts by any party not satisfied with the decisions. The grounds can be on procedural matters and may call for a recalculation and reconsideration of the approved tariff.

11. Monitoring the Implementation of the Approved Tariffs

The utility company is responsible for the implementation of the approved tariffs and the Authority is responsible for monitoring the implementation to prevent slippages in implementation and is also responsible to evaluate the impact of new tariffs.

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