

International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

27 May 2013
Mr. Thomas Possert, MBA

Dear Sirs

Response to Request for Information “Rate Regulation”

On the 28 March the IASB published a request inviting comment on price regulated activities for the representation of price regulation systems. As such we appreciate the opportunity of answering this request for information.

Question 1: For the types of rate regulation that you think would be useful for us to consider in the Discussion Paper, what types of goods or services are subject to the rate regulation being described?

To begin this response the regulatory systems concerned are briefly described, yet it should be noted that our remarks refer solely to the regulatory systems pertaining to the electricity and gas sector of the Austrian energy industry. The Austrian district heating sector, for example the district heating pricing in accordance with the Price Act of 1992, is not discussed.

We would like to point out that this response to your request for information was drafted by energy utilities that have drawn up their consolidated financial statements in accordance with IFRS for several years already.

In the electricity and gas sector the regulation described herein pertains solely to network tariffs. Pricing of the mere energy component for electricity and gas has been fully liberalized and as such is subject to free market forces (unbundling of electricity and gas transmission network and energy generation and sales operations).

Since the beginning of the liberalization of the electricity markets in 1997 (Directive 96/92/EG) and the natural gas markets in 1998 (Directive 98/30/EG) the energy networks in the EU have been subject to regulation. Since then this framework has been steadily developed further (Directive 2003/54/EG for electricity and Directive 2003/55/EG for gas; Directive 2009/72/EG for electricity and Directive 2009/73/EG for gas). With the Electricity

Industry and Organization Act (EIWOG) and the Natural Gas Act (GWG) the Austrian legislator implemented these EU directives into national law.

In general, network usage fees are calculated ex ante, whereby uniform tariffs for all customers are calculated, principally per federal state and per network level (collective determination of tariffs for all customers), based on actual costs and actual volumes of previous years. The effective costs of the latest financial year available as audited by the regulator (OPEX and CAPEX) form the basis for the regulation. The adequacy test for actual costs is carried out in accordance with the general principles of cost determination in accordance with the Electricity Industry and Organization Act (EIWOG) and the Natural Gas Act (GWG).

Since the Electricity Industry and Organization Act (EIWOG) of 2010 and the Natural Gas Act (GWG) of 2011, an ex-post revenue regulation is provided for by means of the so-called regulatory account. Shortfalls in actual results due to deviations in volumes or costs are accrued in the actual period, and lead to a corresponding increase in revenues via the network tariff $t+2$. Conversely, surplus actual results lead to a corresponding reduction of the actual results, and consequently to a reduction of the permitted network tariff, i.e. network revenues.

Electricity and gas distribution networks

In recent years, a long-term regulatory system was implemented for electricity and gas distribution networks. Following the original “cost-plus regulation” an “incentive regulation” has been implemented and legislated for the calculation of distribution network tariffs.

The audited costs are benchmarked with comparable energy utilities with the aim of bringing cost-inefficient companies in line with efficient companies within a certain regulatory period, whereby the mid-term costs caused by inefficiency are not accredited.

Key points of the incentive regulation for distribution networks:

- annual implementation by ordinance for system usage charges or by notice
- duration of the regulatory period
Gas: 10 years; divided in 2 x 5 years
Electricity : 13 years, divided in 2 x 4 plus 1 x 5 years
- conceded interest (CAPEX) as a pre-tax WACC
Gas: 1st Period 6.97%; 2nd Period 6.42%
Electricity: 1st Period 6.04%; 2nd Period 7.025%; 3rd Period 6.42%

- to provide appropriate incentives for investment and properly account for CAPEX development in the regulatory period, an investment factor has been implemented
- to account for changes in supply tasks in the regulatory period an operating-cost factor has been implemented

Transmission networks

For transmission networks the cost-plus regulation remains valid.

Key points of the cost-plus regulation for transmission networks:

- annual implementation by ordinance for system usage charges or by notice
- duration of the regulatory period: Electricity : 1 year
- conceded interest (CAPEX) as a pre-tax WACC: Electricity: 6.42%
- Ex-ante recognition of Ten-Year-Network-Development-Plan investments

Question 2: What are the objectives of the rate regulation and how do they influence the interaction between the rate regulator, the rate-regulated entity and customers?

Regulatory objectives:

- The primary objective of price regulation is the limitation of network utilization fees (efficient service provision)
- Non-discriminatory access to networks with the aim of fostering competition in the energy sector
- Compensation of reasonable costs, including appropriate compensation for network assets. This in turn should create incentives for necessary investments.
- Effective and efficient networks as part of general infrastructure
- Fulfillment of public service obligations through EU-wide organization to promote competition and non-discrimination

Tasks of the regulation:

- Unbundling
- Enforcement of non-discriminatory network access
- Cost based charging system
- Guaranteeing security of supply
- Monitoring and transparency

Influence on interaction:

The regulation of prices serves the protection of customers (prevention of arbitrary, inflated prices). Price regulation ensures equal access of suppliers to customers.

The positive aspects of competition, static and dynamic efficiency should be simulated by the regulation. Regulation also leads to investment protection and security for the network operator, which in turn establishes general market security.

„Incentive regulation“ ensures maximum efficiency in the usage of domestic electricity and gas networks. The regulated network operators are given incentives to reduce costs and increase efficiency. At the same time network customers benefit from reduced costs due to decreasing network tariffs. Moreover, the Austrian Regulatory Authority (E-Control) governs the provisions for network access.

Question 3: What sort of rights or obligations does the regulation create?

The duties of the network operators are regulated by the Electricity Industry and Organization Act (EIWOG) and Natural Gas Act (GWG) as well as by the related ordinances and are contractually stipulated in the network access contracts and general terms and conditions for distribution network with the customers.

On request, network operators receive a concession free of charge from the federal government (for electricity), i.e. the approval of the regulatory authority (for gas) which gives them the sole right and the obligation to connect all costumers within the concession area to their public network. This regional concession is based on the network area originally covered by a supply monopoly (pre-liberalisation).

Should a network operator no longer be able to fulfil his obligations according to the statutory requirements, the Authority may withdraw the concession and transfer the duties to another network operator.

Following are some examples concerning rights and duties:

Rights:

- Connection of all customers in the network area and receipt of the officially prescribed tariffs from the connected clients
- Access rights to meters

Obligations:

- Only officially prescribed tariffs without any additions or deductions may be charged to customers

- All customers must be treated equally (principle of non-discrimination)
- Principally, network access may not be refused
- Sensitive commercial information may not be divulged, particularly not to the sales operations within vertically integrated utilities
- Regular meter reading
- Data exchange, in particular concerning billing data, with other market participants
- The network is to be operated safely and reliably
- Applicable only to transmission networks: investment obligation for projects approved in the Ten-Year-Network-Development-Plan

Question 4: For the rights and obligations identified in response to Question 3, how does the rate-regulated entity enforce its rights, or how does the rate regulator enforce the settlement of the rate-regulated entity's obligations?

The regulatory authority, in the form of the executive board of the E-Control, officially determines the costs, the targets and the quantity structure of system operators periodically by notice. The "Social Partners" have the opportunity to make representations, the right to information and insight into the proceedings. The network operators have the right to lodge a complaint against such decisions with the Energy Regulatory Commission and subsequently to lodge a complaint with the Austrian Administrative Court.

The system usage fees are determined by regulatory commission ordinances, in which compensatory payments may be determined as necessary. Special interest groups have the opportunity of representation in this regulation enactment process.

Appeals against cost decisions may be submitted to the Regulatory Commission (REK), i.e. after 2014 to the Administrative Courts. Individual complaints pertaining to tariff regulation may be submitted to the Constitutional Court (VfGH). Complaints against decisions by the Regulatory Commission concerning the general terms and conditions for the network (First Instance) or in the context abuse proceedings (Second Instance) may be submitted to the Administrative Court (VwGH).

The ECA may demand the establishment of the legally required state of affairs by means of official notification within the context of abuse proceeding. The network operators have the right to appeal against the decision to the REK, i.e. after 2014, to the Administrative Courts. An appeal against this ruling to the Administrative Court (VwGH) is possible.

The regulation of the electricity and gas industry is carried out by a national regulatory authority (E-Control), a public-law institution made up of three bodies (Management Board, Regulatory Commission, Supervisory Board).

In general the procedural provisions apply to distribution networks and transmission networks equally.

Question 5: How does the rate regulation ensure the recovery or reversal of under- or over-recoveries of allowable costs (ie variance amounts)? Are these mechanisms effective in recovering or reversing those amounts within the targeted time frame?

As of the FY 2012, within the electricity and the gas network sectors, the appropriate remuneration is determined under consideration of a so-called regulatory account. This account counteracts the basic issue of setting network fees based on historical figures and the resulting differences in actual volumes and resulting revenues. In accordance with accrual-based accounting principles, differences between actual profits and profits due to stipulated tariffs are accrued by means of the regulatory account. Due to a special provision in the local accounting act (UGB) this accrual must be accounted for both on the asset and liability sides of the balance sheet.

→ Impacts on balance sheet/ income statement in FY 2012 (t)

→ Impacts on cash flow in FY 2014 (t+2)

The mechanism of the regulatory account ensures that the effects of calculated differences in revenues and not influenceable network costs (e.g. upstream network costs) on the balance sheet and income statement are considered directly in the current fiscal year (t). In the following audit process the regulatory authority calculates the regulatory account based on the actual figures of the FY, whereby the corresponding cash-flow regarding the calculated difference amount takes place in the FY (t+2).

Should you wish to discuss certain aspects of this response in more detail, please do not hesitate to contact us. Your contact person would be Mr. Thomas Possert, MBA (Energie Steiermark AG +43 316 9000 54130; thomas.possert@e-steiermark.com) who will gladly answer any further questions.

Yours faithfully