

Ms Jane Pike
Senior Technical Manager
International Accounting Standards Board
1st Floor
30 Cannon Street
London EC4M 6XH
United Kingdom

May 30, 2013

Dear Ms Pike

IASB Request for Information – Rate Regulation – March 2013

The undersigned welcome the opportunity to respond to the Request for Information published by the International Accounting Standards Board in relation to Rate Regulation.

The information set out in the attached response has been prepared by – and reflects the views of – the following entities:

- Elia System Operator SA/NV (“Elia”)
- Fluxys Belgium SA/NV (“Fluxys”)
- Eandis CVBA (“Eandis”)
- Ores SCRL (“Ores”)

Should you require additional information on any of the matters addressed in our response, please do not hesitate to contact us.


Yours sincerely,

**Elia System Operator
SA/NV**



**Jan Gesquière
Chief Financial Officer**

Fluxys Belgium SA/NV




**Jean-Luc Vandebroek
Chief Financial Officer**

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IASB REQUEST FOR INFORMATION
RATE REGULATION
MARCH 2013

Question 1

For the types of rate regulation that you think would be useful for us to consider in the Discussion Paper (or would not be useful to consider, if applicable), what types of goods or services are subject to the rate regulation being described? In providing this information, please also tell us:

The regulation applies to the transmission and distribution of electricity and gas, and to gas storage and liquefied natural gas (LNG) terminalling activities in Belgium.

(a) whether you are a rate-regulator, a financial statements preparer, auditor, user or other (please specify);

Elia is a financial statements preparer. Elia is the sole transmission system operator (TSO) for the Belgian very high-voltage and high-voltage electricity networks, and for the offshore grid in the Belgian territorial waters of the North Sea. Elia also has a 60 % equity interest in 50Hertz transmission GmbH (“50Hertz”), one of Germany’s four TSO’s operating the very high-voltage transmission network in the northeast part of the country.

Fluxys is a financial statements preparer. Fluxys Belgium (a subsidiary of Fluxys) is the sole gas transmission operator (TSO) in Belgium and, in addition, offers storage and LNG terminalling services (through its subsidiary Fluxys LNG). Fluxys controls other subsidiaries active in gas transmission in Germany and in Switzerland and has, among other, stakes in companies linking the gas networks between England and Belgium, and between England and the Netherlands.

The Economic group Eandis and the Eandis group are financial statements preparers. The Economic group Eandis comprises 7 mixed Flemish Distribution System Operators (DSO), the operating company Eandis cvba, and its subsidiaries. The Distribution System Operators of electricity and natural gas in Flanders cover 78 % of the municipalities of the Flemish region.

The Economic group ORES (ORES) is a financial statements preparer. Ores (ORES) comprises 8 Walloon Distribution System Operators (DSO) and a limited liability partnership (ORES SCRL), the operating company of the DSO’s. It is the largest distribution system operator (DSO) of electricity and natural gas in Wallonia, covering 80 % of the regional market.

(b) what jurisdiction the rate regulation that you are describing is in;

Elia: Belgium (for Elia’s interest in 50Hertz located in Germany, see the separate response issued by 50Hertz)

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Elia – Fluxys – Eandis - ORES

Regulation and supervision of the transmission of electricity over the very high-voltage network in Belgium rests with the Commission for the Regulation of Electricity and Gas (CREG). CREG is an agency of the federal government. Regulation and supervision over the high- and low- voltage networks falls within the jurisdiction of the respective regional regulators: the Flemish Regulator for the Electricity and Gas Markets (VREG) for the Flemish region, the Walloon Commission for Energy (CWaPE) for the Walloon region, and the Brussels Commission for Energy (Brugel) for the Brussels Capital region. Currently the regional regulators have no authority with regard to rate setting, which falls under the sole jurisdiction of the CREG.

Fluxys Belgium: Belgium

Regulation and supervision of the transmission and storage of gas and LNG terminalling services, including rate setting, rests with the federal regulator (CREG).

Eandis and Ores: Belgium

Distribution of electricity and gas falls under the supervision and regulatory authority of the Flemish regulator (VREG) and Walloon regulator (CWaPE), respectively, except for matters of rate approval, which until December 31, 2014 remain the responsibility of the federal regulator (CREG). As part of the package of decisions taken recently by the federal government to devolve powers to the regions, rate approval for the distribution of electricity and gas will be transferred from the CREG to the VREG and CWaPE, respectively, from 2015 onwards.

(c) whether that jurisdiction is a recent adopter of IFRS; and

Elia, Fluxys Belgium and Eandis have presented their consolidated financial statements under IFRS for a number of years (Elia and Fluxys Belgium since 2005; Eandis since 2008). All three entities present their separate financial statements under Belgian accounting law. Ores is in the process of converting its financial statements to IFRS at a date yet to be set.

Belgian accounting law is applicable to the measurement of the Regulated Asset Base (RAB) and to the recognition and measurement of the revenue and costs for rate setting purposes in all four entities.

(d) whether the main suppliers of the rate-regulated goods or services (ie the rate-regulated entities), including your company if applicable, are predominantly private-sector entities, government entities or closely related to the rate regulator.

Elia is a limited liability company 48 %-owned by two holding companies representing the interests of Belgian municipalities. The free float of 52 % consists of shares traded on the Brussels stock exchange of which 9 % are owned by two major investors.

Fluxys Belgium is a limited liability company 89,97 % -controlled by a holding company (Fluxys) which is 77,7%-owned by Publigas, 20 % by the Caisse de dépôt et placement du Québec (CDPQ), and 2,1 % by the Federal Holding and Investment Company. Publigas is a Belgian communal holding company owned by Belgian intercommunal energy companies. CDPQ is a Canadian institutional investment fund. The

remaining 10,03 % of the shares of Fluxys Belgium are traded on the Brussels stock exchange. The Belgian State owns one share in Fluxys Belgium to which a number of protective rights attach.

Eandis is a limited liability partnership owned by 7 Flemish Distribution System Operators (DSO). The DSO's are 70 %-owned by 234 Flemish municipalities and 30 % by Electrabel (GDF Suez group). Electrabel holds 25 % of Eandis' voting rights (plus one share). Under European and Belgian legislation dealing with the unbundling of the production, transmission and distribution of electricity and gas, Electrabel will have to dispose of its interest in the DSO's by 2018. Eandis is the operating entity of the DSO's.

Ores is a limited liability partnership owned by 8 Walloon Distribution System Operators (DSO). The DSO's are 75 %-owned by Walloon municipalities and 25 % by Electrabel. Under European and Belgian legislation dealing with the unbundling of the production, transmission and distribution of electricity and gas, Electrabel has a put option on its shares that can be exercised to its public partner between January 1 and June 30, 2019. Ores is the operating entity of the DSO's.

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?
In providing this information, please tell us:**

(a) what are the high-level objectives of the rate regulation (for example, to restrict prices or to influence the levels of supply and demand or to restrict or encourage competition); and

The high-level objectives of rate regulation in Belgium are to secure the most appropriate prices for the services provided by the TSO's and the DSO's whilst enabling them to cover their costs of operating, maintaining, replacing, and extending the networks for the transmission and the distribution of electricity and gas (and storage and LNG terminalling for Fluxys Belgium), and to earn a fair return on the Regulated Asset Base. The regulation also aims to develop access to the networks, and to prevent abuse of monopoly power.

In addition, the regulators may impose on certain operators a number of public service obligations, for example, the promotion of renewable energy, the reduction of primary energy use, and the supply of a minimum quantity of electricity and gas to every household. These obligations may in certain cases be reflected in differentiated rates or may be subject to the recovery mechanism described in the response to questions 4 and 5 below.

(b) how these objectives are reflected in the nature of the rate-setting mechanism? For example, to what extent:

(i) is the rate-setting mechanism designed to give the rate-regulated entity a 'fair rate of return' (for example, a cost-plus mechanism) or is the focus more on reducing the cost to customers (for example, a price-cap or other incentive-based mechanism);

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The rate-setting system generally applicable in Belgium to the TSO's and DSO's, as described in the following paragraphs, is a hybrid of a cost-plus mechanism and features designed to achieve productivity, efficiency and reliability targets. The system applies equally to all TSO's and DSO's with slight differences in the regime applicable to each operator, which are discussed where significant.

Six months prior to the inception of every four year-regulatory period the TSO's and DSO's submit to the CREG for approval a multi-annual rate proposal, including a budget of total revenues which cover:

- the recovery of operational and financial costs deemed reasonable, including depreciation and pension costs
- a fair return on the Regulated Asset Base
- the cost of discharging public service obligations, if any and where applicable.

Once approved by the CREG, the rates embedded in the rate proposal are published and are not negotiable by individual customers. During any four year- regulatory period requests for changes to reflect the provision of new services, changes to existing services, or exceptional circumstances not within the control of the operator, may be submitted to the CREG. Rates are fixed during the regulatory period.

Operators are required to submit to the CREG half-yearly and yearly reports on actual vs budgeted revenues and costs. The CREG is empowered to reject costs deemed unreasonable. The treatment of variances between actual and budgeted revenues is addressed in question 5 (a) below.

Details of the components of total revenues are as follows:

Operational and financial costs

Operational and financial costs comprise controllable and non-controllable costs.

Non-controllable costs are those over which the operator has no direct control and include the depreciation of fixed assets, actual borrowing costs (irrespective of whether the debt to equity ratio meets the regulatory objective of 67/33 – see below), certain operational costs, ancillary services and costs, variances between actual and budgeted costs, less revenue from non-tariff activities, if any.

Controllable costs are those over which the operator has direct control and are subject to an incentive mechanism set by the CREG to improve productivity and efficiency through the application of a mandatory percentage of reduction of controllable costs fixed at the beginning of the regulatory period.

Regulated Asset Base (RAB)

The RAB comprises the depreciated replacement cost of the operator's fixed assets, as it was set originally by the regulator, or as it was estimated when the license to operate was awarded, plus or minus its net working capital.

The RAB changes every period for the acquisition or extension and replacement of assets, depreciation, disposals, capital grants, recoveries from third parties, and changes in net working capital.

Fair return on the Regulated Asset Base (RAB)

The fair return on the RAB is calculated annually based on the average annual value of the RAB, taking into account new investments, divestments, decommissioning of assets, depreciation, and changes in working capital requirements, using the following generic formula based on the Capital Asset Pricing Model (CAPM):

$$r = \text{Average RAB} \times (\text{OLOn} + (\text{beta} \times \text{equity risk premium}))$$

where

r = the fair return on the RAB.

OLOn = the average rate of return of the Belgian ten-year linear bond for the year in question.

beta = the systematic risk factor of the share of the entity (or a proxy thereof) calculated over a historical seven year period. It is a constant factor for the DSO's, which may be different for electricity distribution and gas distribution.

The equity risk premium is set at 3,50 %, except for Fluxys Belgium's gas storage and LNG terminalling services, where the equity risk premium is 4,30 %.

The value of the beta factor multiplied times the equity risk factor cannot be less than 70 base points.

The regulations aim at achieving a debt to equity ratio of 67/33. To the extent that equity exceeds 33 % of the Regulated Asset Base, the equity risk premium weighted by the beta factor (beta x equity risk premium) is set at 70 base points.

r is increased by an illiquidity premium of 20 % (1,20) at Eandis and Ores to reflect their status as non-listed operators.

(ii) are there incentives to meet targets that are not directly related to the cost-rate relationship (for example, efficiency, service levels, infrastructure investment, increased supply capacity or reliability, use of alternative resources or reduction in customer demand or usage);

The regulation system aims to provide a fair return on the amounts invested by the operators. However, without prejudice and to promote efficiency, the return can be increased or decreased when the objectives set by the regulator, for example, cost reduction targets, are met or, conversely, are not achieved.

Incentives currently in force pertain to cost efficiency. Other incentives may be introduced in the future.

(iii) does the rate regulation fix the price per unit or does it provide some flexibility for the entity to set prices (for example, through price ranges or caps, based on either unit prices or total revenue or total profitability); and

Rates are regulated through the approval by the CREG of the rate proposal, including budgeted total revenues and budgeted total volumes, i.e. prices per unit, prior to the inception of every four-year regulatory period. These prices per unit cannot be changed or otherwise amended by the TSO's or DSO's.

(iv) are there other aspects of the rate-setting mechanism that reflect

any specific objectives not envisaged above?

No.

Question 3

What sort of rights or obligations does the regulation create?

In providing this information, please consider:

(a) whether the rate-regulated entity has an exclusive right to operate in the market;

Elia was designated in September 2002 as the sole TSO in Belgium for the transmission of electricity for a period of 20 years and was certified in December 2012 as fully complying with the “full unbundling ownership rules” (and as a distribution system operator in the Flemish region for a 12 year period ending September 5, 2014, the local transmission system operator in the Walloon region for a 20 year period ending September 17, 2022, and the regional transmission system operator in the Brussels-Capital region for a 20 year period ending November 26, 2021).

Fluxys Belgium is the sole TSO in Belgium for the transmission of natural gas and was certified in September 2012 as complying with the “full ownership unbundling” model, which mandates the separation between production, transport and distribution activities. In February 2010 Fluxys Belgium was designated as the operator of the gas transmission network and the operator of the gas storage installation, while Fluxys LNG (a wholly-owned subsidiary of Fluxys Belgium) was designated as the operator of the Zeebrugge LNG terminal, each of these designations being made for a period of 20 years.

The 7 mixed Flemish DSO’s that are shareholders of Eandis were granted a 12 year license in September 2002 for electricity and in October 2003 for gas. Eandis was recognized as the DSO’s operating company in October 2009.

The 8 mixed Walloon DSO’s that are shareholders of Ores were appointed on January 9, 2003 by a decision of the Walloon Government for a period of 20 years, except for I.G.H. SCRL, which was appointed on October 14 2004 for a period ending January 1, 2023.

(b) if the entity’s right to operate in the market is established by licence:

Yes.

As regards Fluxys Belgium, the right to operate the gas transmission network, the gas storage installation, and the Zeebrugge LNG terminal is subject to the prior designation as operator of the respective infrastructure by the Belgian federal minister (or secretary of state) in charge of energy.

In addition, the operation of the gas transmission network is subject to prior certification by the CREG following an opinion of the European Commission. Belgian law also provides for the certification of the operator of the gas storage installation and of the operator of the Zeebrugge LNG terminal, although this is not required under European law and does not entail an opinion of the European Commission.

While the designation procedure covers all aspects of the operation, the certification procedure is designed only to ensure compliance with the rules establishing a structural separation between transmission activities and energy production and/or supply activities (“ownership unbundling”).

(i) is there a cost to acquire the licence; and

No (all four entities).

(ii) can the licence be revoked, renewed or transferred;

All four entities can petition the regulatory authorities for the renewal of their designation/license for the same duration. The designation/license may be revoked under certain circumstances, including bankruptcy, winding-up, merger or demerger, serious breach of the obligations under the designation/license, withdrawal of the certification as a fully owned unbundled system operator (only for Fluxys Belgium and Elia), or significant changes in the shareholding structure of the DSO's (Eandis and Ores) that could jeopardize independence in the management of the distribution network, in which cases the licenses would be transferred by the regulator to another operator. To be granted a license, the new operator would have to comply with some key requirements such as legal ownership of – or the right to use – the network, financial means and technical capabilities, professional reliability and managerial and legal independence towards energy suppliers.

The designations/licenses are *intuitu personae* and may not be transferred to third parties.

(c) how competition is excluded or encouraged;

Elia

All Belgian very high-voltage electricity network assets are fully owned by Elia. Elia also owns or has the right to use 94 % of the Belgian high-voltage electricity network assets.

Elia currently has a factual monopoly for operating the very high-voltage network at the federal level and the high-voltage network at the regional levels.

Belgian law entrusts the operation of the national very high-voltage electricity network to a single TSO, provided that it owns alone or jointly that portion of the network that covers at least three fourths of the national territory and at least two thirds of the territory of each region. Elia is the only company that fulfills the conditions provided by law to obtain the federal and regional licenses.

In addition to the requirement of being licensed by the federal (very high-voltage) or regional (high-voltage) regulatory authorities, any competitor in both segments of the market for the transmission of electricity would need to enter into contractual arrangements with the incumbent TSO to be able to operate the network owned by Elia.

Fluxys Belgium

Belgian law entrusts the operation of each of the gas transmission network, the gas storage installation, and the Zeebrugge LNG terminal to a single TSO (in total, 3 single TSO's whose activities may be combined in one single legal entity).

The operator of the gas transmission network must hold, alone or jointly, gas transmission permits for that portion of the network that covers at least three fourths of the national territory, which condition can be fulfilled only by Fluxys Belgium. Indeed, Fluxys Belgium owns the network and holds the gas transmission permits issued for the network.

In addition to the requirement of being designated and certified by the authorities, any competitor for the transmission of natural gas would, therefore, need to enter into contractual arrangements with the incumbent TSO to be able to operate the gas transmission network.

Transit of natural gas, storage of natural gas and LNG terminalling services face competition from providers in neighboring countries.

Eandis and Ores

The DSO's have a legal regional monopoly for the distribution of electricity and gas to residential customers and SME's in the area covered by their network.

(d) how the rights and obligations are expressed, for example, as a cap on the rate of return, as the right to recover entity-specific costs, as a right to recover an allowed level of costs (whether or not incurred by the entity), or as a right to recover specific types of costs without limit if and when incurred; and

The rights and obligations of the operators pertain to the right to recover the shortfall of – or the obligation to refund the excess of – revenues from/to the operators' customers in future regulatory periods. See question 5 (a) below.

(e) whether the entity can choose to stop providing the goods or services that are subject to rate regulation and, if so:

No. Certain operators are subject to public service obligations. In addition, certain customers have entered into long-term contracts (20 years or more) with certain operators.

(i) how is this achieved; and

(ii) what are the consequences for the entity?

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?

In providing this information, please tell us:

(a) does the rate regulation provide for retrospective recovery or reversal of under- or over-recoveries of allowable costs? If so, how is this achieved, for example through cash payments or other asset transfers to or from

parties outside the rate-regulated entity (such as individual customers or groups of customers, the rate regulator or the government);

No. Under- or over-allowable costs are recovered/reversed prospectively through an adjustment to the rates in the following regulatory period, i.e. not retrospectively. See question 5 (a) below.

(b) are the rights and obligations separable from the business; and

No.

(c) what happens to the rights or obligations when the entity ceases to provide the rate-regulated goods or services?

Those rights or obligations would be transferred to the new operator, since the excess or shortfall of allowable costs is recovered or reversed prospectively, not retrospectively. See question 5 (a) below.

Question 5

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

In providing this information, please tell us:

(a) what is the mechanism for tracking the recovery or reversal of such variance amounts;

During any four-year regulatory period actual revenues may differ from the budgeted revenues approved by the CREG. Deviations may arise because of an excess or shortfall of controllable and non- controllable costs, differences in the volume of electricity and gas transmitted or distributed, changes in the Regulated Asset Base, movements in the rate of return on the ten-year OLO bond, a change in the beta factor (for the TSO's only; the shares of the DSO's are not publicly traded), or a change in the debt to equity ratio.

Subject to the CREG's approval, variances of controllable costs are for the account of the operator (up to a cap for certain operators) and, therefore, increase or decrease its return on equity. Hence, these variances do not impact current or future revenue.

Variances of non-controllable costs, differences between actual and budgeted volumes of transmission and distribution of electricity and gas, and changes during the period in the Regulated Asset Base, or in the rate of return on the ten-year OLO bond, or in the beta factor (for the TSO's only; the shares of the DSO's are not publicly traded), or in the debt to equity ratio are reported in the balance sheet as amounts receivable from customers (with a corresponding credit to deferred revenue) or amounts due to customers (with a corresponding debit to deferred revenue) during the regulatory period. The regulatory system requires that the assets and liabilities arising from variances be readily determinable. At the end of the third year of the four-year regulatory period, the CREG reviews the amounts with a view to deciding whether they should lead to a prospective increase or decrease, as the case may be, of rates during the following regulatory period.

(b) how does the rate-setting mechanism adjust for unexpected changes in demand for the rate-regulated goods or services;

Unexpected changes in the demand for gas and electricity, i.e. differences between actual and budgeted quantities, are normally reported in the balance sheet of the operator as they occur, and, after approval of the CREG, are carried forward to the following regulatory period as adjustments to future revenue.

A request for change in the rates can be submitted to the regulator for unexpected developments during the regulatory period, for example changes in the demand for electricity or gas. After approval by the regulator, the rates applicable during the regulatory period are amended.

(c) has there been a recent trend whereby the balances of the variance amounts have been increasing? If so:

Variance amounts have been affected by the decline in the return of the ten year OLO bonds, savings on non-controllable costs, volume changes, and the costs incurred by the DSO's in complying with a number of public service obligations, e.g. green certificates and subsidies for the rational use of energy.

(i) is this caused by an increase or a decrease in the demand of the rate-regulated goods or services;

See (ii) below.

(ii) has the trend resulted in a net debit position (ie under-recovery of costs) or a net credit position (ie over-recovery of costs); and

A number of operators report balances of regulatory liabilities arising from a combination of savings on non-controllable costs and the reduction of the fair return on the Regulated Asset Base following the decline in the return on the ten year OLO bond. Others report balances of regulatory assets arising from higher than budgeted costs of complying with public service obligations and decreases in the volume of transmission and distribution of electricity.

(iii) what are the main components of the variance amounts (ie what are the main categories of cost or income variances)?

The main components of the variance amounts are differences in non-controllable costs, volume changes, and the change in the fair return on the Regulated Asset Base (caused by changes in the risk-free rate).