



May 30th, 2013

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Request for Information: Rate Regulation

Dear Mr. Hoogervorst:

IBERDROLA is pleased to submit its comments concerning the International Accounting Standards Board's *Request for Information: Rate Regulation (RFI)* issued in March 2013. IBERDROLA, a corporation organized under the laws of the kingdom of Spain, is one of the largest energy companies in the world and one of the leading electricity groups with operations in more than 40 countries and over 28 million electricity customers and 3 million gas customers.

We appreciate the time and consideration the IASB has taken in developing its request for information (RFI) concerning rate regulation. We understand the RFI is a step in the development of a Discussion Paper that will identify and more clearly articulate: the common features of rate regulation; whether those common features create economic resources for, or claims against, a rate-regulated entity that should be recognized in International Financial Reporting Standards (IFRS) financial statements; and the information about the consequences of rate regulation that would be most useful for users of IFRS financial statements. We welcome the opportunity to respond to the RFI and address the questions posed by the Board. We agree that the eventual development of a proposed standard will be a significant step forward and would allow rate-regulated entities to prepare and present financial statements in a manner that better reflects the economic realities of their operations.

Overall Comments

Iberdrola is the parent company of a group of companies carrying out activities primarily in the electricity and gas industries, in Spain and other countries, with a significant presence in the United Kingdom, the United States, Brazil and Mexico. With the scope and under the conditions established in applicable regulations in each territory, the activities carried out in such industries may be classified into regulated activities and liberalised activities.

Our understanding of the aim of the RFI is to identify common features of rate regulation and as our group is affected by as many different rate regulated schemes as countries, or areas, we are based in our response comprises also different questionnaires.



Although not all the jurisdictions in which our group is present have adopted IFRS, our consolidated financial statements are prepared under IFRS.



Spain

The regulated industry and why it should be considered

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:

- (a) whether you are a rate-regulator, a financial statements preparer, auditor, user or other (please specify);
- (b) what jurisdiction the rate regulation that you are describing is in;
- (c) whether that jurisdiction is a recent adopter of IFRS; and
- (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.

If the jurisdiction has not adopted IFRS, your views are still useful to us. It would be helpful if you could include information about what local GAAP is applied and how the effects of the rate-regulatory scheme are reported in accordance with that local GAAP.

Response 1

In Spain the regulated activity we describe refers to the operation of electricity distribution network, and does not include the sale of electricity to customers.

- (a) The primary operating company of Iberdrola in the regulated business in Spain is Iberdrola Distribución Eléctrica, S.A. a wholly owned subsidiary which is a financial statement preparer.
- (b) The jurisdiction the rate regulation we are describing is Spain.
- (c) Although Spain has not adopted IFRS for statutory accounts we have been preparing our financial statements under IFRSs as adopted by the European Union since 2005 for consolidated purposes.
- (d) Iberdrola and its subsidiaries are private sector entities.



The objectives of the rate regulation

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
- (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);
 - (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);
 - (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
 - (iv) are there other aspects of the rate-setting mechanism that reflect any specific objectives not envisaged above?

Response 2

- (a) The high level objectives of rate-regulation are set by European legislation to protect the interests of consumers.
- (b) The system is intended to provide an adequate rate of return to the distribution system operators. Adequate means fair enough for the companies to make the necessary investments for the required service quality and to avoid inefficient investments.

The economic regulation of the distribution activities is based on regulatory periods that last four years. Basically, the remuneration of each distribution company is calculated considering: (i) remuneration for investments, (ii) remuneration for operating and maintenance and (iii) remuneration for all other costs necessary to exercise distribution activities, which will include commercial management, network planning and energy management costs.

- i. The focus is more on reducing the cost to customers (price-cap or revenue-cap scheme) than on cost-plus regulation. The latter scheme is considered as providing incentives to excessive investment.
- ii. Within each period, the annual remuneration is calculated by updating the base remuneration of the previous year, in line with the CPI (without energy products and unprocessed foods, and net of taxes) and IPRI, and adding the remuneration for the new



investments made. Annual incentives are also set for enhancing quality and reducing losses.

Quality incentive. In general terms, the quality incentive consists of comparing utilities' global quality indicators with target indicators, resulting in penalties or bonuses. The limits of the incentive/bonus are 3 per cent. of the remuneration.

Incentive for losses. This incentive is calculated as the sum of a) the difference between the actual loss percentage and a target, b) a loss price and c) the power flowing through the networks of distribution companies. The limits of the incentive/bonus are 2 per cent. of the remuneration.

- iii. The distribution activity is remunerated by means of access tariffs or tolls paid by electricity consumers and producers. Access tariffs are fixed by the rate-regulator per unit distributed through the electricity network. Access tariffs are the same for the whole country.
- iv. No, there are not.

The rights and obligations established by the rate regulation

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;**
- (b) if the entity's right to operate in the market is established by licence:**
 - (i) is there a cost to acquire the licence; and**
 - (ii) can the licence be revoked, renewed or transferred;**
- (c) how competition is excluded or encouraged;**
- (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**
- (e) whether the entity can choose to stop providing the goods or services that are subject to rate regulation and, if so:**
 - (i) how is this achieved; and**
 - (ii) what are the consequences for the entity?**

Response 3

- (a) The distribution system operators have been authorized to build and operate their networks. The distribution companies are natural monopolies in the areas in which they operate and are not subject to competition..
- (b) The ownership of the network does not entail an exclusive right for its utilization, third party access rights to the network are legally guaranteed..
 - i. Distribution system operators have to demonstrate their legal, technical and economic capacity. Authorizations have an unlimited time span.
 - ii. This authorization is under periodical inspection from the authorities and can be revoked as a result of very serious offences.
- (c) The distribution system is considered a natural monopoly and the regulator activity is focus on promoting economic and technical efficiency.
- (d) Access tariffs have to be sufficient to cover the remuneration for distribution operators. They are set as explained in response 2 b)..Distribution operators also collect fees for new connections, which are also regulated.
- (e) One of the features of electricity is that it is a universal service, consequently, the distribution operators cannot stop providing service.



The enforcement of rights and obligations

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);
- (b) are the rights and obligations separable from the business; and
- (c) what happens to the rights or obligations when the entity ceases to provide the rate-regulated goods or services?

Response 4

- (a) There are not recoveries or reversals of under-or-over allowable costs, except for minor adjustments. These minor adjustments results from calculation errors or calculation revisions, which are taken into account when fixing the access tariffs for the next year.
- (b) These calculation revisions are inseparable from the business.
- (c) If a distribution operator ceased to provide the service, he would still keep the right to receive the pending amounts.



The recovery or reversal of cost and income variances

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;
- (b) how does the rate-setting mechanism adjust for unexpected changes in demand for the rate-regulated goods or services;
- (c) has there been a recent trend whereby the balances of the variance amounts have been increasing? If so:
 - (i) is this caused by an increase or a decrease in the demand of the rate-regulated goods or services;
 - (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
 - (iii) what are the main components of the variance amounts (ie what are the main categories of cost or income variances)?

Response 5

There are not recoveries or reversals of under-or-over allowable costs. The remuneration taken into account for calculating annual access tariffs is regarded as provisional and may be adjusted after being revised to be regarded as definitive and the difference will be settled when fixing the next year access fees.



United Kingdom

The regulated industry and why it should be considered

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:

- (a) whether you are a rate-regulator, a financial statements preparer, auditor, user or other (please specify);
- (b) what jurisdiction the rate regulation that you are describing is in;
- (c) whether that jurisdiction is a recent adopter of IFRS; and
- (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.

If the jurisdiction has not adopted IFRS, your views are still useful to us. It would be helpful if you could include information about what local GAAP is applied and how the effects of the rate-regulatory scheme are reported in accordance with that local GAAP.

Response 1

The Iberdrola activity in UK is developed through Scottish Power and its subsidiaries. These answers are in respect of the operation of the Iberdrola UK Distribution (SPD, SPM) and Transmission (SPT) networks as regulated by OFGEM. The UK transmission and distribution companies are natural monopolies in the areas in which they operate and are not subject to competition (although there is competition in metering and connections).

The accounts of SPD, SPM and SPT are prepared under IFRS for both statutory subsidiary accounts (year ending 31 Dec) and Regulatory accounts (year ending 31 March).

They operate under a Price Control mechanism governed by OFGEM. Distribution companies are currently working to DPCR5 (until 31 March 2015) and Transmission companies to RIIO T1 (to 31 March 2021).



The objectives of the rate regulation

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
- (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);
 - (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);
 - (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
 - (iv) are there other aspects of the rate-setting mechanism that reflect any specific objectives not envisaged above?

Response 2

- (a) The high level objective of the regulation of these activities is to protect the interests of consumers, including future consumers. Although some aspects of distribution activity are susceptible to competition (such as connections and metering), the regional distribution networks are natural monopolies. OFGEM, as the industry regulator, administers a price control regime which ensures network operators (DNOs) can, through efficient operation, earn a fair return after capital and operating costs while limiting costs passed onto customers.
- (b) The mechanism under which the UK distribution and transmission companies operate is a Price Control mechanism and OFGEM developed the RIIO process in its recent price controls (Revenue = incentives + innovation + outputs). It is designed to
 - a. Put stakeholders at the heart of the decision making process
 - b. Invest efficiently to ensure continued safe and reliable services
 - c. Innovate to reduce network costs for current and future consumers
 - d. Play a full role in delivering a low carbon economy

Under RIIO companies are required to submit well justified business plans detailing how they will meet the RIIO framework.



There are incentives to efficiently deliver the outputs required (rewards and penalties) as well as rewards and penalties linked to network reliability, customer service, stakeholder engagement, environmental responsibility and innovation. Customer demand does not impact revenues earned and there are no incentives or penalties linked to this. The package is designed to support the growth of low carbon technologies.

The price control sets the “allowable revenue” with some pass through elements and timing adjustments.



The rights and obligations established by the rate regulation

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;
- (b) if the entity's right to operate in the market is established by licence:
 - (iii) is there a cost to acquire the licence; and
 - (iv) can the licence be revoked, renewed or transferred;
- (c) how competition is excluded or encouraged;
- (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
- (e) whether the entity can choose to stop providing the goods or services that are subject to rate regulation and, if so:
 - (iii) how is this achieved; and
 - (iv) what are the consequences for the entity?

Response 3

- (a) Transmission and distribution operators have the exclusive right to operate in their network areas (although there are small numbers of embedded networks in those areas that are not subject to the price controls).
- (b) Rights are established by license.
- (c) It is a monopoly with competition in some non price controlled activities e.g. connections.
- (d) Revenue is set via the RIIO methodology with the associated incentives and penalties.
- (e) Transmission and distribution entities cannot stop providing the "goods or services".



The enforcement of rights and obligations

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);
- (b) are the rights and obligations separable from the business; and
- (c) what happens to the rights or obligations when the entity ceases to provide the rate-regulated goods or services?

Response 4

- (a) Over or under recovery of revenues is adjusted in the revenue for future regulatory periods with agreement from OFGEM where OFGEM will look to protect the end customer from fluctuating prices.
- (b) The rights or obligations (taking it as any over or under recovery) are not separable from the underlying business.
- (c) This question is not applicable in our case.



The recovery or reversal of cost and income variances

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;
- (b) how does the rate-setting mechanism adjust for unexpected changes in demand for the rate-regulated goods or services;
- (c) has there been a recent trend whereby the balances of the variance amounts have been increasing? If so:
 - (i) is this caused by an increase or a decrease in the demand of the rate-regulated goods or services;
 - (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
 - (iii) what are the main components of the variance amounts (ie what are the main categories of cost or income variances)?

Response 5

- (a) Ofgem use the Revenue models to adjust for over and under recovery of revenues for prior periods and this information is collected via the annual RRP (regulatory reporting pack) submission. The roll forward RAV (regulatory asset value) is also used as a mechanism for updating any adjustments from price control to actual results. Again, this is updated annually as part of the annual reporting of RRP data.
- (b) Unexpected demand (which leads to an over recovery) is carried forward into the revenue calculation for the next year together with any other adjustments e.g. changes in the cost of pass through items such as Rates or changes in RPI assumptions.
- (c) There is no growing trend up or down. Demand has been higher in very recent years but this has been offset by other changes in costs and assumptions.



United States of America

The regulated industry and why it should be considered

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:

- (a) whether you are a rate-regulator, a financial statements preparer, auditor, user or other (please specify);
- (b) what jurisdiction the rate regulation that you are describing is in;
- (c) whether that jurisdiction is a recent adopter of IFRS; and
- (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.

If the jurisdiction has not adopted IFRS, your views are still useful to us. It would be helpful if you could include information about what local GAAP is applied and how the effects of the rate-regulatory scheme are reported in accordance with that local GAAP.

Response 1

Iberdrola USA, Inc. (IUSA), a wholly-owned subsidiary of Iberdrola, S.A. (Iberdrola), is a super-regional energy services and delivery company with operations in four states in the northeastern United States of America (U.S.): New York, Maine, Connecticut and New Hampshire.

IUSA was previously named Energy East Corporation (Energy East). Energy East changed its legal and operating name to Iberdrola USA, Inc. on December 1, 2009. Iberdrola purchased Energy East in September 2008, and as a result we have directly confronted the challenging decisions required in making the necessary conversions to comply with IFRS. The most financially significant conversion involved accounting for rate-regulated activities. At December 31, 2008, we had nearly \$3 billion of regulatory assets (or 20 percent of our total assets of approximately \$13 billion) and \$2 billion of regulatory liabilities recorded in accordance with accounting principles generally accepted in the U.S. (U.S. GAAP) that we did not reflect as such for purposes of IFRS financial reporting to Iberdrola. More importantly, the exclusion from our IFRS financial statements of the effects of regulation has led to results that do not reflect the economic substance of our operations.

Our wholly-owned subsidiaries, and their principal operating companies, include: CMP Group, Inc. – Central Maine Power Company (CMP), and RGS Energy Group, Inc. – New York State Electric & Gas Corporation (NYSEG) and Rochester Gas and Electric Corporation (RG&E). CMP conducts regulated electricity transmission and distribution operations in Maine, operates under the authority of the state of Maine Public Utility Commission (MPUC) and is also subject to regulation by the Federal Energy Regulatory Commission (FERC). NYSEG conducts regulated electricity transmission and distribution operations and regulated natural gas transportation, storage and distribution operations in upstate New York. NYSEG also generates electricity, primarily from its several hydroelectric stations. RG&E conducts



regulated electricity transmission, distribution and generation operations and regulated natural gas transportation and distribution operations in western New York. NYSEG and RG&E operate under the authority of the state of New York State Public Service Commission (NYPSC) and are also subject to regulation by the FERC.

- (a) IUSA and its subsidiaries are financial statements preparers, but are not registered as filers with the U.S. Securities and Exchange Commission (SEC).
- (b) The primary jurisdictions within the U.S. that the rate regulation described is in are: the states of New York and Maine.
- (c) The U.S. is not a recent adopter of IFRS. The SEC is still in deliberations concerning the adoption of IFRS for entities within the U.S.
- (d) The main suppliers of electricity and natural gas within the U.S. are private sector entities. IUSA and its subsidiaries are private sector entities.



The objectives of the rate regulation

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
- (b) how these objectives are reflected in the nature of the rate-setting mechanism? For example, to what extent:
 - (v) 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);
 - (vi) 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);
 - (vii) 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
 - (viii) are there other aspects of the rate-setting mechanism that reflect any specific objectives not envisaged above?

Response 2

The primary operating utility companies of IUSA are in New York and Maine and are subject to regulation by a federal commission (the FERC) and state regulatory commissions (the NYPSC and the MPUC).

- (a) The FERC is primarily concerned with the regulation of wholesale transactions (sales for resale of power and transmission services). The state commissions regulate retail electric and natural gas rates and services to ensure that customers enjoy safe, adequate and reliable services at prices that are just and reasonable for both consumers and utilities.
- (b) U.S. regulation is based on historic laws regarding monopoly utility service. Utility tariffs are reviewed and modified during proceedings before the regulatory authority including those that establish terms and conditions of service and rates. The companies are also required to file a broad spectrum of compliance filings that provide regulators insight into their operations and create a forum for evaluation of the companies' performance.
 - (i) Rate setting for the companies is designed to provide a fair return on investment for the equity shareholder and recovery of prudently incurred costs. The focus is to ensure rates are sufficient to provide safe and adequate service and a return for investment in the utility system. U.S. regulators use deferred cost mechanisms (which create regulatory assets and liabilities) to spread costs over a longer period of time (e.g. three to five years) to smooth the rate impacts on customers.



- (ii) Incentives such as earnings sharing provisions provide a company with an opportunity to exceed its allowed returns if it is able to create efficiencies during the term of a rate plan. Penalties also exist for underperformances against established service quality metrics.
- (iii) Energy costs are recovered from customers based on actual costs. Deferral accounting mechanisms (regulatory assets and liabilities) are used to track the differences between actual costs incurred and actual revenue collections. Since companies are allowed to collect actual costs, utilities are allowed to defer any cost differences from revenues in order not to influence their income statement either negatively or positively.
 - i. Rates are generally set on a price per unit. However, new mechanisms may be other than a price per unit, such as a revenue decoupling mechanism, which is based on total revenue for the company. Revenue decoupling is a mechanism designed to “decouple” sales usage from revenue collection. The mechanism creates a regulatory asset or liability and reconciles revenues with the levels assumed during the rate-making process, regardless of energy usage. The mechanism is designed to allow for the promotion of energy efficiency and lower usage by customers while protecting the utility from any revenue erosion.
- (iv) The companies true up certain expenses, such as storm and environmental costs to levels provided for in rates through the use of deferral accounting. Cost variances are deferred and ultimately recovered from or distributed to customers.



The rights and obligations established by the rate regulation

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;
- (b) if the entity's right to operate in the market is established by licence:
 - (v) is there a cost to acquire the licence; and
 - (vi) can the licence be revoked, renewed or transferred;
- (c) how competition is excluded or encouraged;
- (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
- (e) whether the entity can choose to stop providing the goods or services that are subject to rate regulation and, if so:
 - (v) how is this achieved; and
 - (vi) what are the consequences for the entity?

Response 3

In addition to the obligations outlined in Response 2, state regulatory commissions grant utilities the authority to engage in various forms of financing and control the delineation of service territories. The companies are granted exclusive rights and are obligated to serve customers in their franchised service territories.

- (a) The rate-regulated entities operating in Maine and New York are granted exclusive franchise rights to provide electric and natural gas service to customers living within the designated service territories.
- (b) The rate-regulated entities must apply for and receive a franchise to serve from the municipality and approval by the state regulatory commission to exercise its franchise before service can be provided to residents and businesses within the franchising municipality.
 - (i) Generally, there is no cost to acquire a license to serve customers.
 - (ii) The municipal franchise can expire and must be renewed from time to time. In New York, as a result of recently enacted legislation, a franchise can be revoked or modified if the rate-regulated entity is found to be in violation of the rules and regulations adopted by the NYPSC. In Maine, if a utility's action resulted in the inability to provide safe, adequate, reliable service at just and reasonable rates, then the MPUC could revoke the franchise.
- (c) Customers in Maine and New York have options to purchase their electricity and/or natural gas supply from entities other than the rate-regulated utility. Such entities are known as competitive energy suppliers or energy services companies. The state regulatory commissions support



policies that encourage competition in this sector. Customers also have the option to continue to purchase their electric or natural gas supply from the rate-regulated utility at market rates set in the competitive wholesale markets in New York or New England. No matter which entity a customer chooses to take supply service from, the regulated utility company has an obligation to provide safe and reliable delivery service per tariff rates.

- (d) The rate-regulated entities are subject to cost of service regulation. Remuneration is established by the regulator on the basis of substantiated costs including an opportunity to earn a fair rate of return on the invested capital. Costs, revenues, obligation to serve, quality of service requirements and consumer protections are factors in the rate-setting process. Regulators are legally required to allow utilities sufficient revenues to cover reasonable expenses and finance necessary investments as required in providing safe and reliable service.
- (e) The rate-regulated entity, as a condition of its authority to exercise its franchise, has an obligation to serve all customers that request service.



The enforcement of rights and obligations

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);**
- (b) are the rights and obligations separable from the business; and**
- (c) what happens to the rights or obligations when the entity ceases to provide the rate-regulated goods or services?**

Response 4

The rate-regulated entities in Maine and New York are subject to laws and regulations set forth by the state legislatures and approved by the state governors. Jurisdiction, powers and duties are given to state utility commissions, which are charged with ensuring safe, adequate and reliable service at just and reasonable rates. The rate-regulated entities set forth the rates, terms and conditions of service in commission-reviewed filings referred to as tariffs.

- (a) Generally speaking, retroactive rate-making is not allowed for the rate-regulated entities. However, certain cost components are forecast in the rate-setting process and subject to full reconciliation with customers. Any cost component subject to reconciliation is set forth in the rate-setting process of each state. Furthermore, in the state of New York, delivery revenues are reconciled annually in a revenue decoupling mechanism.
- (b) No. The rights and obligations of the rate-regulated entities are set forth for the entire business.
- (c) Not applicable. See response to 2(e).



The recovery or reversal of cost and income variances

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;
- (b) how does the rate-setting mechanism adjust for unexpected changes in demand for the rate-regulated goods or services;
- (c) has there been a recent trend whereby the balances of the variance amounts have been increasing? If so:
 - (i) is this caused by an increase or a decrease in the demand of the rate-regulated goods or services;
 - (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
 - (iii) what are the main components of the variance amounts (ie what are the main categories of cost or income variances)?

Response 5

The companies' rate plans provide for recovery or reversal of allowable costs for certain types of expense (i.e. storm, property tax, environmental) through deferral mechanisms. Such mechanisms provide for accrual of carrying costs on the deferred balances, until they are recovered from or returned to customers.

- (a) Deferral balances, which create regulatory assets and liabilities, are maintained within the company's accounting system, with monthly reconciliation. Rate surcharges or surcredits are used to collect or return the deferral balances. In certain instances, deferral balances can remain deferred until new fixed tariffs are set. In order to record a deferral balance the company must be assured of its recovery or return to customers. The assurance is provided through regulatory commission orders, regulations and laws.
- (b) The New York companies have revenue decoupling mechanisms that true up actual sales to levels assumed during the rate-making process. CMP has requested a similar mechanism in its recent 2014 rate case filing, submitted on May 1, 2013.
- (c) Yes, generally regulatory assets have been increasing due to the incurrence of costs greater than the embedded rate allowance. This is particularly true for the costs to restore service during major events such as storms. It is also true for other governmental mandates including tax decisions and laws.
 - (i) No, it is caused by an increase in costs greater than the rate allowance.
 - (ii) Under-recovery of costs, which have been deferred and will be recovered when rates are reset.

Generally operation and maintenance expenses such as storm restoration expenses (i.e. materials and supplies, overtime).



Brazil

The regulated industry and why it should be considered

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:

- (a) whether you are a rate-regulator, a financial statements preparer, auditor, user or other (please specify);
- (b) what jurisdiction the rate regulation that you are describing is in;
- (c) whether that jurisdiction is a recent adopter of IFRS; and
- (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.

If the jurisdiction has not adopted IFRS, your views are still useful to us. It would be helpful if you could include information about what local GAAP is applied and how the effects of the rate-regulatory scheme are reported in accordance with that local GAAP.

Response 1

- a) Iberdrola electricity distribution activities in Brazil are carried out by subsidiaries consolidated using proportional consolidation, being “Companhia de Eletricidade do Estado do Bahia, S.A.” (Coelba), “Companhia Energética do Rio Grande do Norte, S.A.” (Cosern) and “Companhia Energética do Pernambuco, S.A” (Celpe). On 27 April 2011, Iberdrola acquired ELEKTRO S.A., which is also a distribution company that operates in the states of Sao Paulo and Moto Grosso do Sul,
- b) The jurisdiction the rate regulation we are describing is Brazil.
- c) Brazil adopted IFRS in 2010. Regulatory assets and liabilities were fully written-off as the mainstream understanding indicated that their recognition was not in accordance with IFRS conceptual framework.
- d) Energy Distribution in Brazil is based on concession rights granted by the government both to private-sector and state-owned companies, mandatorily public traded companies and subject to the Securities Exchange Commission. The regulator (ANEEL) is an independent agency. Both private and state-owned companies have the same level of relationship with the regulator. In Brazil, there are 63 distribution companies. 67% of the market (consumers) in Brazil is served by private owned companies, while the other 33% is served by State Owned companies.



The objectives of the rate regulation

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**
- (b) how these objectives are reflected in the nature of the rate-setting mechanism? For example, to what extent:**
 - (ix) 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);**
 - (x) 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);**
 - (xi) 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**
 - (xii) are there other aspects of the rate-setting mechanism that reflect any specific objectives not envisaged above?**

Response 2

The Brazilian regulatory framework is based on regulatory periods that are revised every three, four or five years, depending on each company’s concession contract. Coelba, Celpe and Cosern have a five-year term and Elektro has a four-year term.

The tariffs are updated annually by the Brazilian National Energy Agency (ANEEL), through the annual adjustment process that considers inflation, an ex-ante efficiency factor and variations on the non-manageable costs components, such as energy and transmission. When a regulatory period ends, the mechanisms & conditions that applied may be subject to revision & change.

The costs necessary to run each concession are divided into two groups, Parcel A (non-manageable costs by the Distributor) and Parcel B (manageable costs by the Distributor), basically composed as follows:

PARCEL A	non-manageable costs	<ul style="list-style-type: none"> - electric energy purchased - transmission costs - sector charges
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PARCEL B	manageable costs	<ul style="list-style-type: none"> - operating expenses - asset depreciation - return on investment on assets
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Based on a given market level (in KWh) and the cost structure above, the regulator (ANEEL) establishes the required revenue and then divides this required revenue by the market level, fixing the price-cap per unit (\$/KWh).

Parcel A is a pass-through, if actual costs are over or under the costs included in the tariff, this over or under costs are considered in the next period (year) tariff and will be charged or reversed to the costumers of the next period. Here is where we believe a regulatory asset or liability would apply.

There are levels of quality that need to be met, otherwise there are penalties (fines). Investment in concession assets is subject to the regulator approval.



The rights and obligations established by the rate regulation

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;
- (b) if the entity's right to operate in the market is established by licence:
 - (vii) is there a cost to acquire the licence; and
 - (viii) can the licence be revoked, renewed or transferred;
- (c) how competition is excluded or encouraged;
- (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
- (e) whether the entity can choose to stop providing the goods or services that are subject to rate regulation and, if so:
 - (vii) how is this achieved; and
 - (viii) what are the consequences for the entity?

Response 3

The entity has exclusive right to operate in determined concession area, as established by a concession agreement which is usually obtained in an auction process. Concessions are usually for a 30 year period renewable for a second 30 year period, at the granting authority's discretion. The concession can only be revoked if the quality levels established by the regulator are not met.

Competition is forbidden within a concession area.

Parcel A (please see answer to question 2-b-i) is pass-through, the entity has the right to recover these costs without limit when incurred.

Parcel B is composed of 3 main elements, all of them are fixed. This parcel represents the risk of the business, if actual operating expense is lower than tariff level, or the actual market level is higher than the tariff market, the entity keeps the difference.

The entity must provide services to all customers within its concession area and is not entitled to choose to stop providing.



The enforcement of rights and obligations

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:

- (d) 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);
- (e) are the rights and obligations separable from the business; and
- (f) what happens to the rights or obligations when the entity ceases to provide the rate-regulated goods or services?

Response 4

Parcel A is fully recovered/reversed, actual over or under costs are included in the next period (year) tariff and charged/reversed to the costumers of this next period. This right/obligation is not separable from the business. When the entity ceases to provide the service (end of concession).



The recovery or reversal of cost and income variances

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:

- (d) what is the mechanism for tracking the recovery or reversal of such variance amounts;
- (e) how does the rate-setting mechanism adjust for unexpected changes in demand for the rate-regulated goods or services;
- (f) has there been a recent trend whereby the balances of the variance amounts have been increasing? If so:
 - (i) is this caused by an increase or a decrease in the demand of the rate-regulated goods or services;
 - (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
 - (iii) what are the main components of the variance amounts (ie what are the main categories of cost or income variances)?

Response 5

There is an off-balance account named "CVA" that records the actual over or under costs of the Parcel A. The CVA opened balance is remunerated by standard market interest rate, and is included in the next period (year) tariff.

Parcel A is fully recovered/reversed, in case of unexpected changes in market level the remaining balance will be included in the next period tariff. Parcel B represents the risk of the business, in case of unexpected changes in market the rate-regulated entity assumes the risk.

There has been a recent increase in the balance of the variance amount (may not be a trend) partially due to increase of the demand and mainly due to conjuncture factors that are leading to reduce the participation of hydroelectric energy (cheaper) and increasing the thermoelectric energy in the energy supply mix in Brazil. This overcost results in a net debit position. Since the mechanism of determining tariff is yearly an very dynamic, there are no elements to state that there is a trend whereby the balances increase, although balances can strongly be affected by high unexpected changes in conjunctures.



We appreciate your consideration of our responses to the above questions. We support the development of a standard that addresses accounting for and the reporting of Rate Regulated Activities.

Very truly yours,

A handwritten signature in purple ink, appearing to read 'J. Pastor', enclosed within a large, loopy purple scribble.

Javier Pastor
Accounting Standards Director