**Question 1:** What are the objectives of rate regulation? (i.e. restrict prices, influence the level of supply or demand or restrict and encourage competition)

(a) The objectives are to encourage competition, restrict prices, and influence the level of supply or demand. (b) The objectives reflect the nature of the regulated service (i.e., investment in service levels), and there is flexibility for the entity to set prices or are there other aspects of the rate setting mechanism that are relevant?

**Question 2:** What rights or obligations does the regulation create?

(a) The rights include the right to operate, set price, and acquire a license. (b) The rights are more limited, such as the right to operate, set price, or acquire a license. (c) The rights are limited to the right to operate, set price, or acquire a license.

**Question 3:** How does the rate-regulated entity enforce its rights?

The entity has the ability to appeal against a regulator's decision.

**Question 4:** How does the rate regulation ensure recovery or reversal of costs?

(a) In the UK, where actual costs are different to those forecast, there is no automatic 'true up' to revenue. Instead, to the extent agreed upon outputs are achieved at lower cost, the entity keeps the benefit for a period of time. To the extent that exact costs exceed forecast, a claim can be made in certain circumstances to the regulator, but the success of a claim is not automatic. Otherwise, forecasts are reviewed for the full 5-year period.

<table>
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<tr>
<th>Country</th>
<th>Rate setting mechanism</th>
<th>Rights to operate</th>
<th>Flexibility to set prices</th>
<th>Recovery of costs</th>
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<tbody>
<tr>
<td>United Kingdom</td>
<td>Price or revenue cap with revenue caps being set every 5 years based on forecast operating and capital expenditure. Revenue is normally linked to inflation. The aim of the rate setting mechanism is for an entity to over- perform on customer service targets and outperform both the operating and capital expenditure targets (i.e., ‘incentive based’).</td>
<td>Entity’s right to operate, set by license with the regulator having powers to enforce compliance with the license and legislation. The regulator generally can terminate a license but with a 25-year notice.</td>
<td>There are circumstances to the regulator, but the success of the claim is not automatic.</td>
<td>In the UK, where actual costs are different to those forecast, there is no automatic ‘true up’ to revenue. Instead, to the extent agreed upon outputs are achieved at lower cost, the entity keeps the benefit for a period of time. To the extent that exact costs exceed forecast, a claim can be made in certain circumstances to the regulator, but the success of a claim is not automatic. Otherwise, forecasts are reviewed for the full 5-year period.</td>
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<td>France</td>
<td>The rate setting mechanism is normally a price or revenue cap with revenue caps being set every 4 years based on forecast operating and capital expenditure. Revenue is normally linked to inflation. The aim of the rate setting mechanism is for an entity to over-deliver on customer service targets and outperform both the operating and capital expenditure targets (i.e., ‘incentive based’).</td>
<td>Entity’s right to operate, set by license with the regulator having powers to enforce compliance with the license and legislation. The regulator generally can terminate a license but with a number of years notice.</td>
<td>There are circumstances to the regulator, but the success of a claim is not automatic.</td>
<td>In the UK, where actual costs are different to those forecast, the regulation provides for an amelioration mechanism of the difference over the remaining term of the current tariff period. The amelioration is automatically added to or deducted from the forecast eligible costs of the following year (subject to a floor and cap). At the end of every year during a given tariff period, the cumulative amount of differences is recalculated and the amelioration is adjusted for the following year. At the end of a tariff period, an overall negotiation is held with the regulator to review the scope of eligible costs for the next period, and also to determine if and how the accumulated amount of unremitted differences at the end of the tariff period will be incorporated in the tariff of the new tariff period.</td>
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<td>Australia</td>
<td>Regulation in the individual states or a national regulator depending on the nature of the rate-regulated activity. Current rate setting mechanisms include local enforcement to prevent overcharging although reforms are underway in some areas to move towards a UK model where tariffs are based on a rate of return on operating and capital expenditure which is already used by some industries (i.e. Network operators). The objective of the rate regulation is to protect the interests of customers and to set fair prices and a certain level of service standards.</td>
<td>Entity’s are generally licensed to provide the goods and services and can choose to stop providing goods and services by relinquishing their license. There are circumstances where an entity may be the sole operator of a rate regulated asset, and there are restrictions or conditions on relinquishing the operating licence. Such terms may prevent simply relinquishing the licence.</td>
<td>There are circumstances to the regulator, but the success of a claim is not automatic.</td>
<td>Industries using the rate of return model require periodic reassessment, normally every 5 years of forecast expenditure similar to the UK model.</td>
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<td>USA</td>
<td>The objective of rate regulation is to set ‘just and reasonable’ rates or prices in the absence of competition. Regulation of retail rates is via the individual state regulators in the majority of cases although rates for wholesale and most transmission services are established by a federal regulator. Rates are normally set based on the submission by the entity of supporting evidence to the regulator containing the price of providing service and ensuring rate levels. The regulator will usually hold public and legal hearings as the evidence is examined. The primary objectives of the process is to set rates which will enable the entity to recover its costs to provide utility service which includes operating and maintenance expense, taxes, depreciation and an opportunity to obtain a fair return on investment.</td>
<td>The entity has an exclusive right to provide service in its designated service territory for the regulated service. The nature of that right varies somewhat by state: in most cases there is not a cost to acquire a license, but in some limited cases a fee is paid. The right is exclusively served a designated service territory can potentially be revoked with the entity being compensated if that occurs. The entity has an obligation to serve all potential customers in its service territory. The regulations give the entity the right to ‘just and reasonable’ rates to be set by the regulator with an appeal to the courts available. Regulated utilities cannot add, modify or abandon types of services or service areas without approval of the regulator.</td>
<td>The regulator sets the rates and prices and controls the entity’s ability to set prices. The entity has an expected return on investment; the entity has risks and opportunities</td>
<td>In most states periodic reports are filed in which the regulator monitors recovery of costs and returns earned. If those reports show the entity is recovering more than its costs plus its authorized return, the regulator may initiate a proceeding to potentially reduce rates. If the entity is under recovering it expects to soon under recovering, the entity may initiate a proceeding to request a specified increase in rates in the future. In those proceedings, the entity submits evidence of its required return and the costs expected to be incurred. For certain elements of costs that are tracked to provide actual recovery, there may be separate rate proceedings by the regulator to monitor that activity. In recent years, due in part to increased investments for reliability and environmental compliance, the amount by which many entities have been under recovering compared to costs plus authorized returns has been greater than in prior years, which has resulted in more frequent initiation by entities of proceedings to increase rates.</td>
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| Canada | Generally rate regulation happens at the provincial level and is aimed at electricity and natural gas transmission and distribution. These industries tend to create “natural monopolies.” Given this situation, one objective of rate regulation is to protect consumers by setting rates for transmission and distribution that are “just and reasonable.” Another objective is to allow utilities a reasonable opportunity to recoup costs and earn a fair return for the significant financial investment they make in order to supply and deliver energy to consumers. While the approach varies by jurisdiction, one common approach is to establish base rates for each distribution utility through a comprehensive review of the utility’s costs as detailed in its rate application. This review occurs periodically (e.g., every four to five years). In the intervening years, the regulator provides for inflationary increases adjusted by a productivity measure. Rates are set through a quasi-judicial process that requires utilities to present evidence to justify rate increases. 

(a) Recovery of or reversal of costs is only achieved with permission of the regulator. This permission may be implicit (e.g., based on the nature of the cost, such as commodity price variances) or explicit (e.g., for more unusual or one-off types of variances). 

(b) There is little or no experience of this happening. 

(c) There is limited experience with regulated entities ceasing to provide their services. It is unclear how this could be achieved, except for in extreme cases of bankruptcy and other similar situations. 

| Japan | There are various different types of rate regulations trying to achieve similar but slightly different objectives, such as: 

- Prices of public service ( tuition fee for national university and charges for document issuance) are regulated primarily on a national basis, because a sole supplier (often government agencies) dominates the market, and there could be no social mechanism other than regulations to set the price level that is appropriate politically and socially. 

- Prices of medical/healthcare service & medicines are regulated on a national basis to some extent, to achieve multiple competing objectives, such as setting a socially acceptable level of access to services/product, limiting public subsidy, compensating/promoting R&D activities by pharmaceutical or provision of quality services. 

- Public transportation (such as train, bus, domestic airline) are often regulated either nationally or locally, primarily to ensure a level of competition among less than the ideal number of competitors. Additional objective may be explicitly embedded such as promoting railroad development, or to prevent accidents by permitting too much price competition (that could result in less investment into safety). 

- Public utility prices (such as electricity, gas, and water) are regulated either nationally or locally, since the market tends to be naturally monopolized by one or a few limited numbers of providers. There are regulated markets (often for retail markets) and unregulated markets (often for whole sale or business to business market). 

- Certain types of insurance (such as compulsory automobile liability insurance that all drivers must purchase) may be viewed as price regulated, as a national regulator in consultation with public set the price. The objective is to ensure the constant pricing across the nation at an appropriate level of premium in light of the insurance risk that a private insurance company would be exposed to. 

- Rates are often set at a level in light of the cost (and a level of return in case a provider is private business) and are not flexible once approved or decided. Application for changes as well as regulator procedures are often necessary to change the price. 

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| (a) - Depending on how you view, exclusiveness right or may not exist. For example, on public service, the provider is naturally limited to government (or its agency), there is even need to make it clearly by giving a license. 

- On public transportation, a license to operate (certain train/route etc.) may need to be clearly granted but a different entity may be granted a similar license to operate the same or similar service, depending on demand etc. 

- On public utility, a permission by public authority is needed. Although it is often not anticipated that additional provider appear to whom a permission is given to, exclusiveness of the license is not necessarily evident. 

- Since explicit regulatory approval is required, it is broadly correct to deem a license is needed to get a right to operate. The cost to get a license is not necessarily clear cut, since regulated entity need to comply both with initial and on-going requirement etc., which is a cost. The license may be potentially revoked by regulators but such are rarely observed. 

- (d) - Depending on public importance and the existence of alternative service provider, hurdle for stopping could be difficult. In certain cases, an entity’s right to operate comes with obligations to provide to all the applicable customers being covered by the service provider. 

- (e) Often the cost considered in setting the price is based on estimate at a time of approval or on premise, the excess cost or unexpected favourable impact on actual cost may only be reflected to the next price setting. Accordingly, the cost is expected to be recovered broadly over periods. However, there is a scope of cost that can become a basis of price and certain cost overrun etc. may not be recoverable at all. 

- (f) - The regulation does not necessarily take such case into consideration but the loss, for example, would not be expected to be compensated at all time. 

- (g) It is also noted that the concept of ‘cost’ is rarely pure IFRS-based accounting concepts and is often more affected to local accounting and regulatory reporting standards. Considering such the link, if strict accuracy is to be established to state IFRS based cost is to be recovered/reversed, such could be difficult. 

| (a) - What is the mechanism for tracking the recovery or reversal of costs? 

(b) Has there been a recent trend of an increase in the variance between actual and recovered costs? 

(c) Can the entity chose to stop providing the goods and services and how is this achieved? 

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