

Märt Ots  
Competition Authority  
Auna 6  
110317 Tallinn

26 October 2010 No

Re: Recommended principles for calculating prices for water service

Dear Mr Märt Ots,

Thank you very much for the meeting on 18.10.10, in which you gave us the opportunity to explain some of the positions and opinions regarding the „Recommended principles for calculating prices for water service“ (regulation) presented in the letter from Eesti Vee-ettevõtjate Liit (EVEL) to the Competition Authority (CA) on 27.09.2010.

We are glad that you have taken into account some of our recommendations in the preparation of the next draft regulation of the regulation submitted on 21.10.10. Still to our mind it is unfortunate that from the thorough analysis on the regulation prepared by EVEL in cooperation with KPMG Baltics Sia (KPMG) you have only considered 5 proposals of the 45 submitted proposals.

In the light of the draft regulation submitted by the CA on 21.10.10 and the abovementioned comments we regard it unreasoned that the CA has made a reference to EVEL in the paragraph ‘Objective and scope’ of the regulation, according to which the CA has asked for an opinion from EVEL, at the same time not taking into account a significant part and main issues of our opinion.

This reference is even stranger, considering that as an association incorporating all larger water companies, the members of EVEL in cooperation with KPMG did a very extensive and thorough work for analysing the initial draft regulation. As a result of this we submitted the comments with justifications and explanations, adhering to the very short time limit (20 days), on more than 23 pages for establishing a regulation that takes into account the specific characters of the water sector. For us it is incomprehensible that the CA submits a new version of the regulation after 25 days mainly with cosmetic amendments, no considerable changes with regard to the content, on 12 pages and with no comments.

Based on the abovementioned, a question may easily be raised if the CA is not asking from the relevant parties of the Estonian water sector to comment on various versions of the regulation only for formality and in order to create an impression of going through the procedural approvals.

As we also comprehended in our initial letter, it is regrettable that legislator has obligated the CA to issue the regulation within an unreasonably short term. Yet when analysing this approvals process it seems to us that the CA has related to the performance of duties set by legislator too hastily and has not concentrated thoroughly enough in the specific characters of the water sector when establishing the regulation.

We kindly ask the CA to relate to the development of the regulation that will start to impact the development of the entire water sector of Estonia with utmost seriousness and professionally, involving the related parties with an interest in cooperation. Otherwise it is not possible to establish a transparent regulation that could be applied in a constant, similar and consistent manner in the following years, at the same time providing certainty for customers, water companies and local municipalities as creditors and investors financing the activities of the company.

As the CA has to a significant extent without any explanations ignored the comments submitted by EVEL, then we will enclose to this letter the proposals that we submitted on 27.09.10 (Annex 1) and ask to concentrate into all presented proposals and to take these into account in the future development of the regulation before the enforcement thereof. We kindly ask the CA to explain in writing the reasons for disregarding all these proposals of EVEL (incl. KPMG) that you decide not to consider.

In the light of the meeting of 21.10.10 we would like to once again emphasise the significance of the proposals of considerable financial impact that we submitted for changing the approach to regulatory asset base, invested capital, WACC and the related indexation, which we submitted in compliance with the known international best practice. Thus we asked KPMG to once again explain these issued and will submit you an additional analysis of KPMG in Annex 2.

As in the opinion of EVEL when revising the regulation you have introduced some new questionable points and contradictions, then in Annex 3 we shall present the comments to the respective issues that need to be solved in addition to the abovementioned before the enforcement of the regulation.

As the draft regulation does not cover all the aspects that we consider important, then once again we propose to CA to initially take over the principles and model of price regulation that have been used so far between the local governments and the water companies and when approving the prices as of 1 November to proceed from the practice so far and to take time to establish a regulation that complies with the interests of the consumers and supports the development of the water sector.

EVEL confirms its preparedness to be in transparent and professional dialogue with the CA during both the enforcement as well as the application of the regulation. Both EVEL as well as KPMG, who advised us, would be glad to additionally explain all the submitted comments and with CA to participate in the development of the objectives of the regulation compliant with the best practice and the implementing provisions required for the delivery thereof.

Sincerely

Veiko Kaufmann  
Chairman of the Management Board of EVEL

*ANNEXES:*

*Annex 1 Proposals by EVEL on 27.09.2010*

*Annex 2 Additional explanations by KPMG regarding regulatory capital, WACC and indexation*

*Annex 3 Additional comments and proposals to the draft regulation submitted on 21.10.10*

### **Annex 3 – Additional comments and proposals to the draft regulation submitted on 21.10.10**

In the following we shall submit comments to the paragraphs and clauses from the amended draft regulation that are incomprehensible, unclear or not suitable to the water business environment, without repeating the comments and proposals submitted by EVEL on 27.09.10:

1. Paragraph '**Objective and scope**' does not define the substantial objective of the regulation, as it confines in a restricted extent to the list of the technical principles of price regulation. Please specify the objective of the regulation in compliance with the principles described in EVEL's letter of 27.09.10.
2. Introducing the concept of regulation (**clause 2.11**) merely from the perspective of establishing the price does not comply with the international best practice in regulating the water sector. Please bring into compliance with the principles described in EVEL's letter of 27.09.10.
3. We kindly ask to specify the concept of water service referred to in **clause 2.16** and to add an addition to the end of this definition: "for the provision of which there are no alternatives and no competition". Explanation: CA should not regulate these services provided by water companies or between water companies for the receipt of which the customer or other water company has an alternative or a possibility to get this service from the competitive market.
4. The reference/concept 'prices that can be administratively regulated' referred to in **clause 4.5.3** requires clarification, as it is not unambiguously clear which prices and by whom can be administratively regulated in CA's approach.
5. The reference/concept 'fees paid to the mediators of water service' referred to in **clause 4.7.3** requires clarification, as it is not unambiguously clear who are meant under mediators and which fees have been considered.
6. The exclusion of the income tax cost from the costs to be included in the price for water service introduced in **clause 4.7.6** is not acceptable nor in compliance with the best practice, as the CA does not foresee taking the impact of income tax into account also in WACC. Either as an allowed cost or in the calculation of WACC the regulation must take into account the impact of the income tax. Otherwise the CA has to explain from which component the income tax calculated from dividends must be paid.
7. The entire meaning of **clause 5.4** and especially the reference to the temporary water service in this context is incomprehensible.
8. The ends of the accounting period referred to in **clauses 5.7 and 5.8** are incomprehensible as per the current structure of the regulation, as they rule out the inclusion of the investments to be made during the regulation period into the calculation of the regulatory asset base, as when following the structure all the principles listed in **clause 5.14** (incl. **5.14.12 and 5.14.13**) are valid only under the terms referred to in **clause 5.13** (in case of revaluation, etc).
9. In administrative terms it is unreasonably costly for the companies and CA to respectively implement and monitor the different depreciation principles (with or without residual value or acquisition value) as per **clause 5.14**. The effort of implementing various norms could be comprehensible.
10. It is not clear on which bases and by following which principles it is allowed and entitled to make adjustments in the value of fixed assets (**clause 5.14.4**).
11. We kindly ask for a sample in the format of an Excel table (with formulas) for understanding the example presented in table 1 of the **clause 5.16**.

General comment: regulation continues to superficially describe the bases of the relation of justifiability, inputs and outputs and the comparison of companies (e.g. clauses p 3.6, 4.3.-4.9), which is why it is incomprehensible how the CA ensures a similar and consistent treatment of water companies and precludes unequal treatment thereof.