NEW TARIFF METHODOLOGY FOR THE UNBUNDLED ELECTRICITY MARKET

PUBLIC HEARING ON THE 2018-2022 ESCOM BASE TARIFF APPLICATION HELD ON 6TH AUGUST 2018

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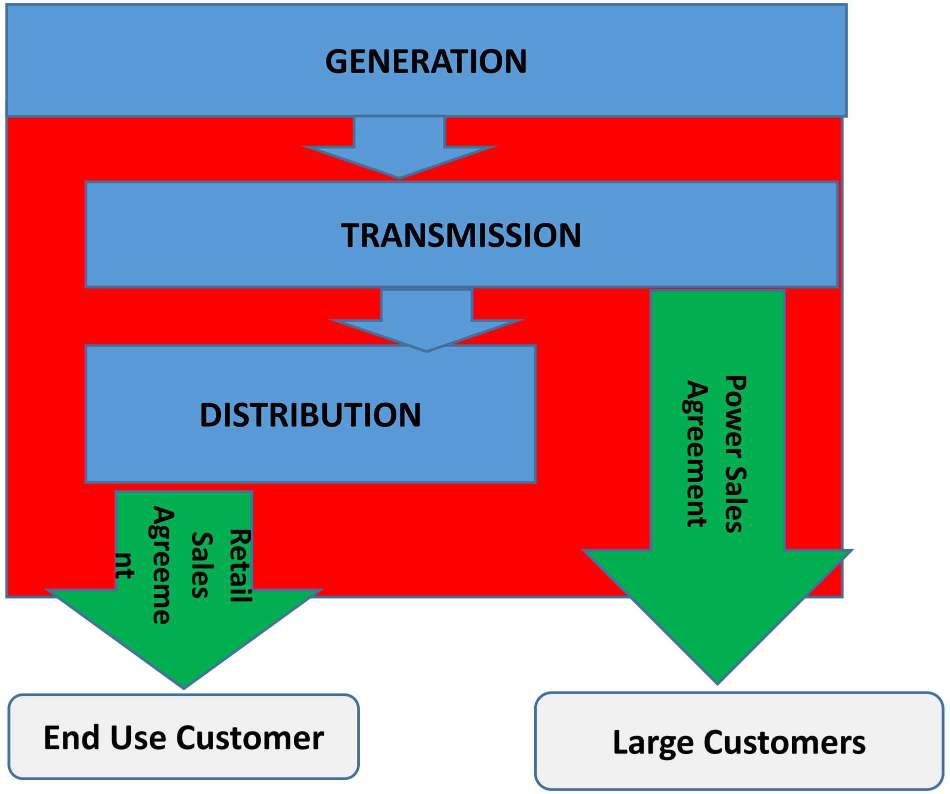
BRIEF ON THE NEW POWER MARKET

The electricity market was formally unbundled in December 2016.

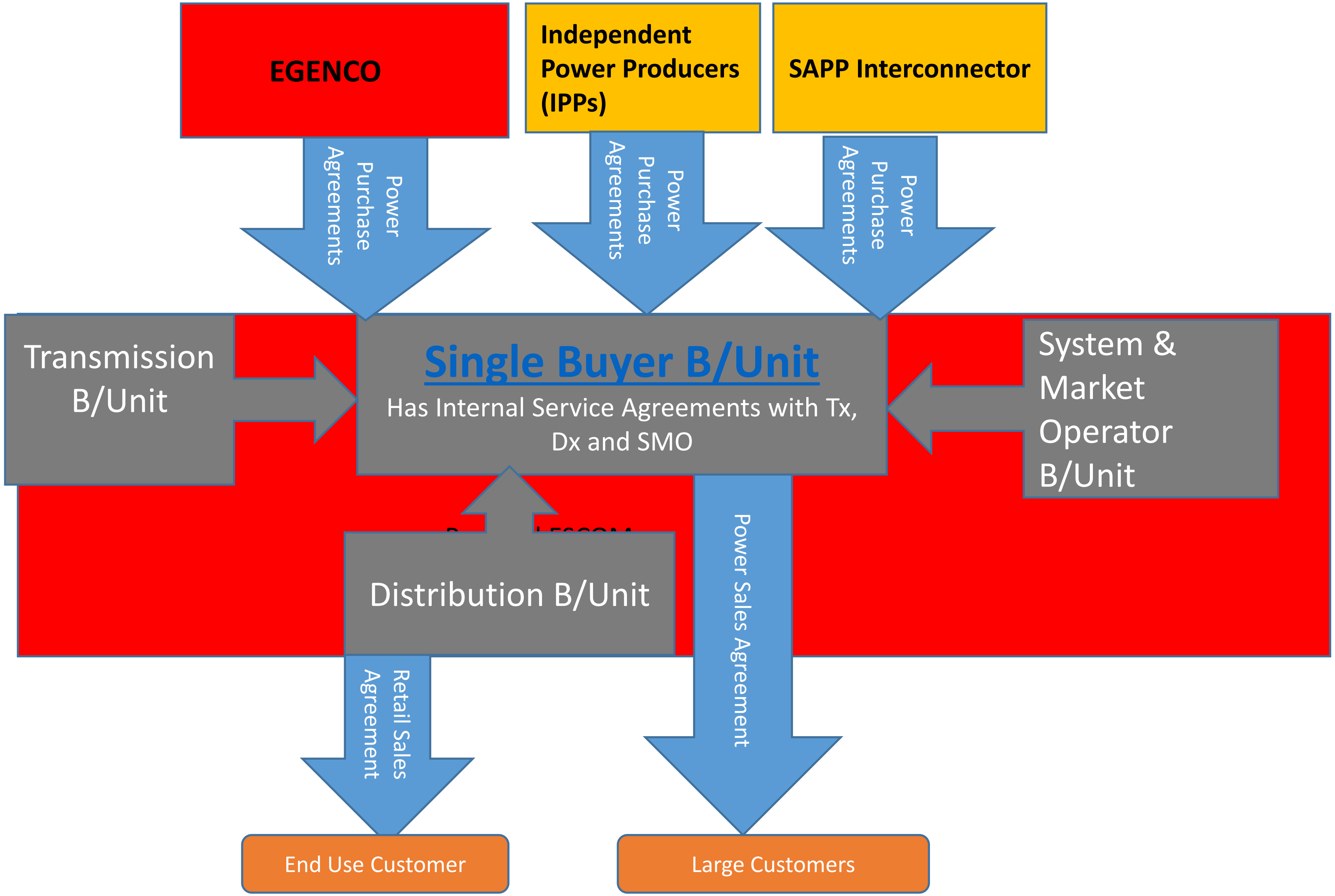
- Physical Unbundling of ESCOM asset–**Dec 2016**
- Formal establishment of EGENCO: – **Dec 2016**;

- New regulatory tools were developed to facilitate the regulation of the new market;
  - New Tariff Methodology,
  - Grid Code and
  - Market Rules

MALAWI POWER MARKET BEFORE UNBUNDLING

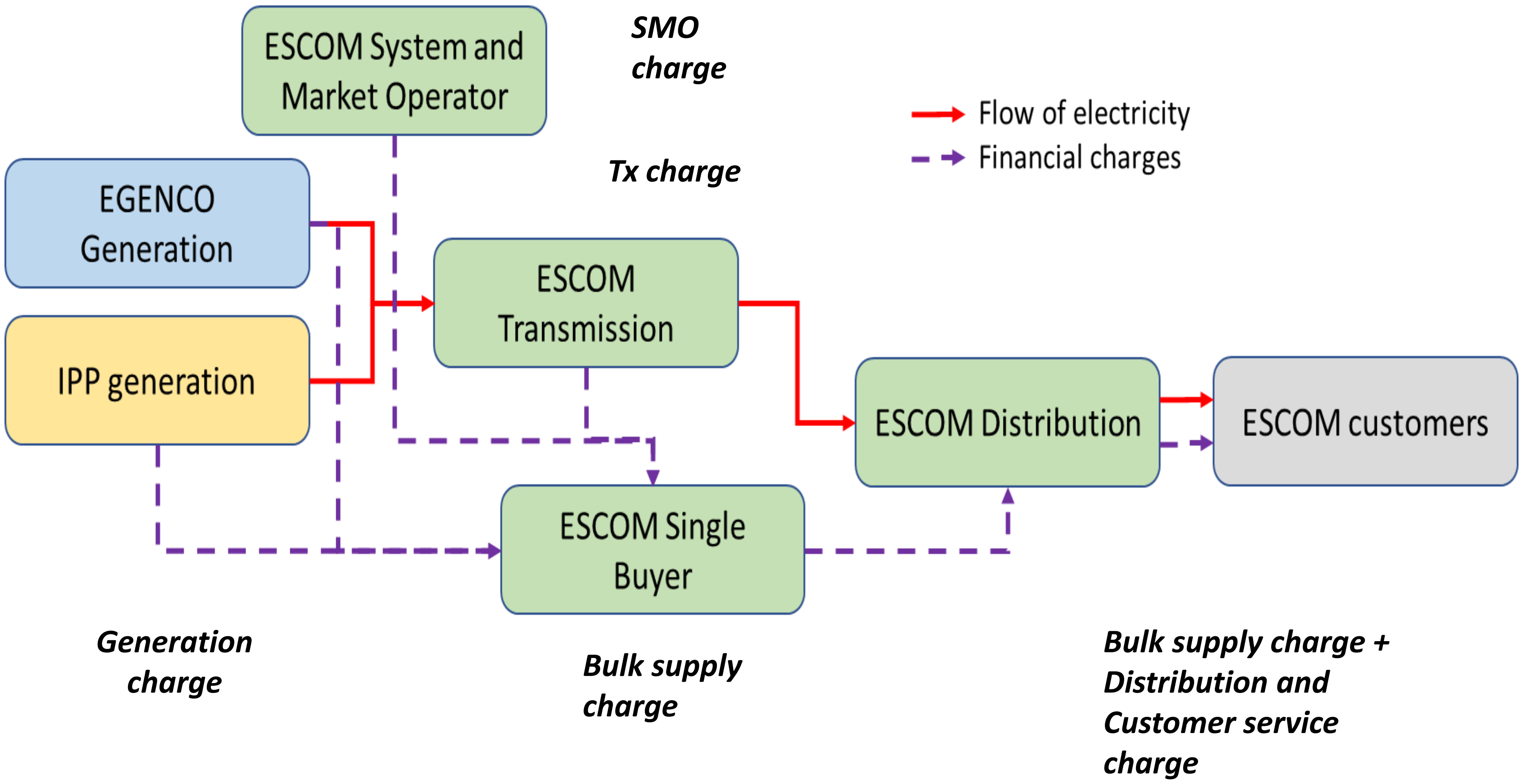


New Power Market Model



LICENSED ENTITIES & CONTRACTUAL OBLIGATIONS

LICENSEES/ BUILDING BLOCKS IN THE TARIFF METHODOLOGY-5



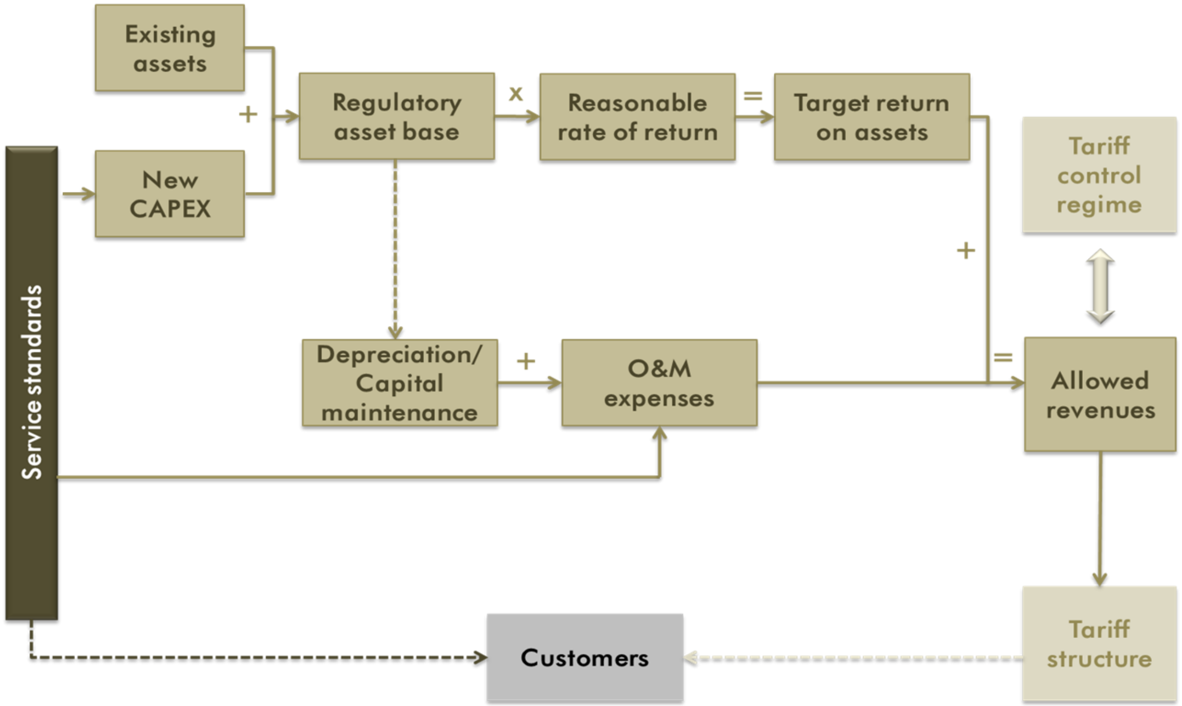
BUILDING BLOCKS – REVENUE REQUIREMENT

Revenue requirement =

O&M +

Depreciation +

Return on capital



CAPEX = capital expenditure
O&M = operation and maintenance

RR BUILDING BLOCK

- The building blocks approach is used to compute the allowable revenues for each business of ESCOM and EGENCO
- The operation and maintenance costs comprising;

➢ payroll and operation costs, Power purchase costs, Depreciation costs, Return on net assets

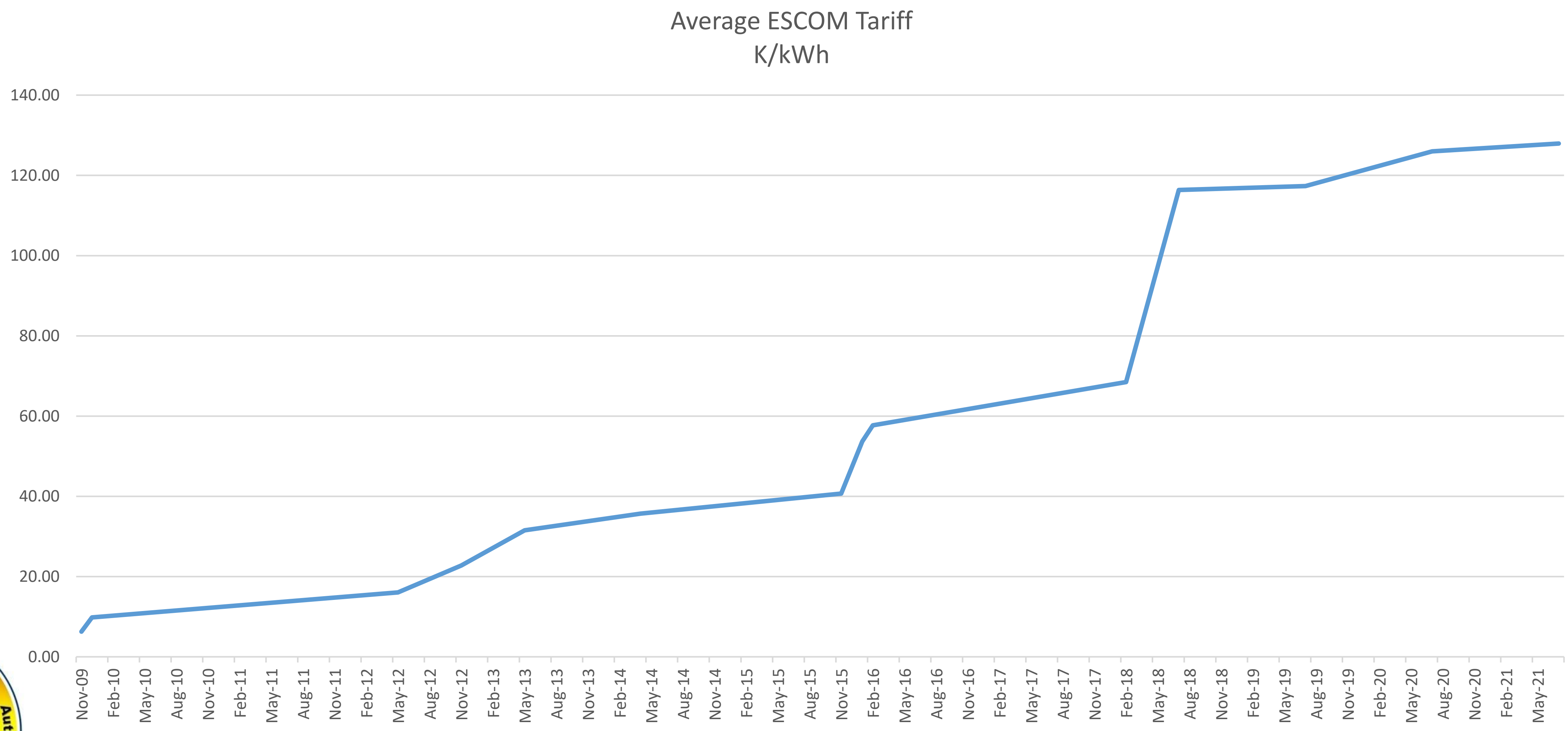
➢ Power purchase costs are treated as pass through costs at COD of projects

- The use of internal transactions for the business units ensures costs are accounted for once in the allowed revenue requirement
- Provides transparency in the operational costs build up of each business unit

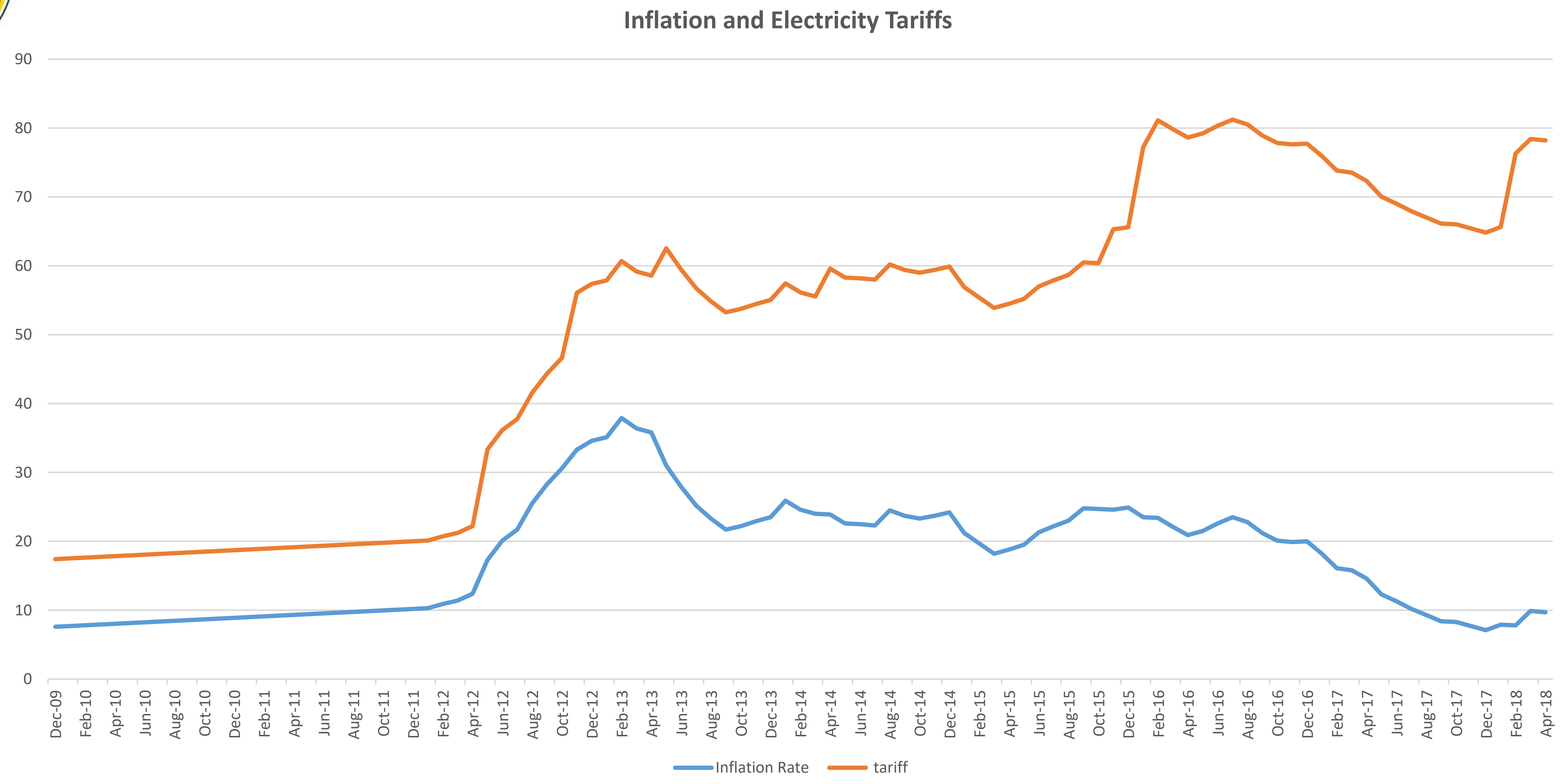
CONTRIBUTION OF EACH UNIT TO RETAIL TARIFF

PURCHASE COSTS (EGENCO +IPP)	54.8 %
DISTRIBUTION CHARGE	21.8%
TRANSMISSION CHARGE	9.8 %
SINGLE BUYER	5.0%
MAREP	4.1%
MERA LEVY	0.9%
BAD D	2.3%
	0.6

THE ELECTRICTY PRICE TRENDS WITH 1st , 2nd and 3rd BASE TARIFF



HISTORICAL TARIFF V'S INFLATION



FEATURES OF THE NEW TARIFF METHOD ….

REVALAUATION OF ASSETS

- The tariff methodology provides for asset revaluation through Depreciates optimised Replacement Value.
- This provides ESCOM and EGENCO additional cash flows from existing assets through increase provision for depreciation and return on capital.
- Donor or grant or third party funded assets excluded
- Requirement for ring fencing of assets and revenues to avoid duplications and the need for tracking the reinvestments from additional cashflow from revaluation process.

OPEX AND PRODUCTIVITY FACTOR

- Opex capped for each years of the base tariff and expected to grow by rate of inflation
- Build in incentive to retain any savings associated any reduction in O&M costs
- Productivity factor to be computed to recognise that labour should get more productive as new capital is added and systems improve which should reduce O&M
- This should be reflected through reduced pay roll costs and payroll taxes.
- Current Bench marks are around 1- 3%

RETURN OF CAPITAL

- Allowance for recover of financing costs - WACC
- Allowed return on capital investments done by EGENCO AND ESCOM
- Applied on the approved regulatory asset base made up of ;
  - Net asset base,
  - Capitalized cost of capital during construction,
  - Working capital
- Approved WACC to reflect;
  - Justification on cost of debt,
  - Benchmark for leverage
  - Justification on equity return Beta and market risk premium

PERFOMANCE STANDARD AND LOSSES

The tariff methodology apart from the Opex productivity factor provides for commercial performance standards on acceptable levels of energy and revenue losses

- Technical and Commercial losses through distribution not to exceed 12% of energy entering ESCOM distribution.
- Energy sent out by generation/IPP to take into account of up to 4% allowed transmission losses.
- Bad debts allowed for to 3% in the 1st two years of base tariff reducing further in the next years. Grossed up in the required revenues.

REVENUE AND SALES DECOUPLING/ REVENUE OUTTURNS

- Allowed revenues are defined during tariff proceedings based on the approved sales and revenue requirements
- Actual delivered revenue are reconciled against allowed revenues (targets) resulting in crediting or collecting the difference from customers
- This mechanism guarantees revenues in an environment fluctuating sales beyond the control of the utility
- Reduces the risks to investor which in turn reduces the cost of capital.

THANK YOU FOR YOUR ATTENTION