

# ORDINANCE ON REGULATING THE PRICES OF HEAT SUPPLY

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## CHAPTER ONE

### GENERAL PROVISIONS

**Article 1.** (1) This ordinance determines the methods of regulating the heat supply prices, the rules for their formation or setting and modification, the rules for provision of information, for submission of rate applications and for approval of prices.

(2) The ordinance establishes the mechanisms of compensating the costs incurred to meet the public obligations under the Energy Law (EL).

**Article 2.** The following prices are regulated as per the procedure of this ordinance:

1. the prices at which Producers sell heat supply ;
2. the prices at which the heat transmission companies sell heat supply to customers ;
3. the prices for connection to the heat transmission networks;

**Article 3.** For fulfillment of its authorities related to price regulation the State Commission for Energy Regulation (the Commission) carries out regular regulatory reviews which include:

1. analysis and assessment of reported and forecast information provided by the energy companies;
2. approval of estimated revenue requirements of the energy company, including economically justifiable costs of the licensed activity and rate of return on capital;
3. approval of prices based on forecast quantities;
4. in the cases of regulation under Article 4, paragraph 1, sub-paragraph 2 – setting the duration of the regulatory period and the values of the factors, on the basis of which the prices are changed during the regulatory period.

**Article 4.** (1) The Commission applies the following basic methods of price regulation:

1. “The rate of return on capital” (“cost-plus”) price regulation, where the Commission approves prices and monitors on an ongoing basis the actual values of the revenue requirements of the energy company and their components. The regulatory review is not shorter than one year. Follow-up regulatory review is carried out at the initiative of the Commission or of an energy company in case of substantial deviations between approved and actual costs and/or return. In the course of the regulatory period, the prices may be changed due to circumstances which could not have been foreseen at the time of approval of the prices.
2. Incentive-based regulation, where the regulatory period is from two to five years:
  - a) The “price cap” regulation, where the Commission approves prices of the energy company for the first year of the regulatory period and adjusts them at the end of every year of the regulatory period by an inflation factor, from which is deducted an efficiency improvement factor for the energy company according to the following formula:

$$P_t = P_{(t-1)} \times (1 + I - X)_t;$$

where:

- P are the prices of the energy company;
  - I inflation index for a prior period, which influences the costs of the company;
  - t the rate period;
  - X efficiency improvement factor;
- b) The “revenue cap”, where the Commission sets annual revenue requirements for the energy company for the first year of the regulatory period and adjusts these at the end of every year of the regulatory period by an inflation factor, from which is deducted an efficiency improvement factor for the energy company, and by differences between estimated and actual indicators for prior rate periods, such as changes in the heat supply sales, number of consumers, the capacity contracted, and the costs of heat supply production according to the following formula:

$$R_{ev,t} R = R_{ev,(t-1)} R \times (1 + I - X)_t \pm Z;$$

where:

- $R_{ev}R$  are the annual revenue requirements of the energy company;
- I inflation for a prior period;
- t the rate period;
- X efficiency improvement factor;
- Z differences between estimated and actual indicators.

(2) In addition to the methods under paragraph 1, the Commission applies performance based indicators (quality of energy, quality of service), where the recognized revenue requirements of the energy company are linked with achievement of targets set by the Commission. Revenues, respectively prices, thus set are based upon the achievement of indicators, beyond those related to the cost of service provided by the energy company.

**Article 5.** (1) The accounting of the energy companies is carried out and the financial statements are drawn up in line with the provisions of the Accountancy Act and the applicable accounting standards.

(2) For the purposes of regulation, the energy companies maintain accounting in accordance with Article 37 of the Energy Law.

(3) The accounting rules for regulatory purposes are adopted with a decision of the Commission.

(4) The rules under paragraph 3 constitute a Uniform System of Accounts (USOA) for regulatory purposes which ensure standardized approach in the accounting system of the energy companies.

(5) The format and contents of financial statements are an integral part of the USOA.

(6) The energy companies apply USOA through a Chart of Accounts adopted by the Commission.

(7) The financial statements for regulatory purposes are accompanied by reports and additional information as to demonstrate compliance with all provisions of this ordinance and with performance indicators relating to the quality of service.

(8) The Commission issues mandatory guidelines about the format and contents of the information needed for pricing purposes.

(9) The rules under paragraph 3 are amended at the initiative of the Commission or upon proposal of the energy companies.

(10) The rules under paragraph 3 are to be applied as from the beginning of the calendar year which follows the date of their adoption or their amendment.

**Article 6.** (1) The Commission may approve the prices of heat supply by components:

1. commodity charge in BGN per megawatt-hour or its derivatives;
2. capacity/availability charge in BGN per megawatt or its derivatives;

(2) The energy companies are allowed to negotiate, propose and apply prices lower than the prices approved or prices determined by the Commission provided that this does not result in cross subsidizing.

(3) The energy companies must demonstrate in their tariff filings that each of the price components is justified and can be properly accounted for in the calculation of final prices.

**Article 7.** (1) The Commission sets indicators for quality of energy and quality of service for each licensed activity and their annual target levels.

(2) The indicators for quality of energy and quality of service are elements of the license.

(3) For the purposes of price regulation, achievement of each of the target indicators is a measurement for the overall performance of the licensed activities by the energy company.

**Article 8.** (1) The Commission adjusts the revenue requirements of the energy company for every rate period within the regulatory period depending on the performance against the indicators for quality of energy and quality of service during the preceding year.

(2) If for a given rate period the energy company's average energy and service quality performance falls short of the target indicators, the corresponding performance level is reflected as reduction of the revenue requirements for the next rate period.

## CHAPTER TWO

## FORMATION OF PRICES

### SECTION I

#### PRICE FORMING ELEMENTS

**Article 9.** The annual revenue requirements for the respective licensed activity include costs subject to approval by the Commission, and a return on the invested capital, and are calculated according to the following formula:

$$R_{ev}R = C + (RAB \times RR_c);$$

where:

$R_{ev}R$  are the annual revenue requirements;

$C$  the allowed annual costs of operation for the licensed activity;

$RAB$  the Regulatory Asset Base;

$RR_c$  the rate of return on capital for the regulatory period.

**Article 10.** (1) The types of costs, which are directly connected to the licensed activity and may be included in the revenue requirements, are determined according to the rules under Article 5.

(2) The allowed level of costs under paragraph 1 is approved by the Commission.

(3) The Commission requires that the energy company submits a justification of all or some of the costs, as well as of the relevance of these costs to the performance of license conditions.

(4) Apart from the costs paragraph 1 the prices could include costs resulting from meeting public service obligations including those related to security supply.

(5) For the purposes of price regulation, the Commission will not allow the recovery of the following costs in rates:

1. costs not related to the performance of licensed activity;
2. costs which the Commission reasonably considers as not in the best interest of the consumers, or those that are not needed for performance of the licensed activity;
3. taxes paid in relation to the corporate income taxation of profit.
4. penalties and/or fines imposed by governmental bodies or by the Commission, as well as interest for deferment, default and other payments related to non-performance under concluded contracts.

**Article 11.** (1) The costs of the energy companies recognized by the Commission resulting from imposed public service obligations are recovered through the prices for all customers.

(2) The total amount of costs recognized by the Commission, that are related to public service obligations are included with their respective share into the annual revenue requirements of the energy companies.

**Article 12.** The regulatory asset base (RAB) for the assets which are directly related to the licensed activity is the recognized value of the assets on which the energy company earns return on its invested capital. The RAB is calculated according to the following formula:

$$RAB = A - CG - D + WC + INV ;$$

where:

RAB the Regulatory Asset Base;

A the recognized value of used and useful assets;

CG the value of assets acquired through gratuitous transfers;

D the accumulated depreciation for the period during which the asset are used to perform the licensed activity;

WC the working capital requirement;

INV the forecast average nominal amount of investments approved by the Commission, which will be invested during the regulatory period, in the cases of regulation under Article 4, paragraph 1. item 2.

**Article 13.** (1) The rate of return on capital for the regulatory period is equal to the estimated weighted average cost of capital (WACC). The WACC is the approved rate of return on debt and on equity for the energy company, weighted according to the share of each of these financing sources in the approved target capital structure.

(2) The rate of return on capital is estimated on a real, pre-tax basis from the following formula:

$$RR = C_{EP} \times \left( \frac{RR_{EQ}}{1 - \frac{TR}{100}} \right) + C_{DP} \times RR_D$$

where:

RR is the rate of return on capital, before taxation;

$C_{EP}$  the equity portion of capital;

$RR_{EQ}$  the rate of return on equity, after taxation;

TR the corporate profit tax rate in compliance with the Corporate Income Tax Act, %;

$C_{DP}$  the debt portion of capital;

$RR_D$  is the rate of return on debt;

## SECTION III

### FORMATION OF PRICES

**Article 14.** (1) The prices of heat supply when sold by the Producers to the heat transmission companies are based upon the annual revenue requirements in accordance with Article 9.

(2) The price includes the components: a capacity charge and an energy charge.

**Article 15.** Where the sold heat energy with heat carrier of water steam is not more than 25 percent of the total quantity of heat energy produced, it is admissible to form a capacity charge for the heat energy with heat carriers, water steam and hot water.

**Article 16.** (1) The price of thermal energy produced for sale is formed depending on the type of production.

(2) For thermal stations with two types of thermal energy carriers, steam and hot water, prices are set separately for the two types of carriers.

(3). When heat is produced as a result of a condensed production cycle, the prices of thermal energy are set in accordance with special instructions (nomograms, cost indicators) for the costs incurred by the production/generating facility.

(4) When heat is produced as a result of a combined production heat and electricity, the revenue requirements for heat production are the difference of the total revenue requirements of the producer and the forecasted revenue from the sale of electricity.

(5) Producers of heat and electricity whose production cycle involves certain peculiarities that do not allow them to apply completely the price forming principles contained in the Ordinance and the directions approved by the Commission may propose to SERC individually tariff setting methodology, that shall reflect the specificities of production and/or the specificity of fuels used by the energy company. Based on the approved methodology, the Commission shall examine and approve the tariff applications of these companies.

**Article 17.** (1) The capacity charge is formed as the ratio of the sum of the fixed costs and return for the activities of producing heat energy and the sum of the contracted capacities with hot water or steam of the producer that are approved by the Commission.

(2) The capacity charge is the same for the two types of heat carriers for the productions specified in Art. 16, paragraphs 3 and 4.

(3) When prices are set in compliance with Art. 21, paragraph 2, the Commission may limit the level of conditionally fixed costs and the level of return, included in the capacity charge. Costs above that level that are approved by the Commission will be included in the commodity component/charge.

**Article 18.** The capacity charge for the various heat carriers is calculated by dividing the variable cost for production of thermal energy with the two carriers to the respective amounts of thermal energy for sale.

**Article 19.** (1) The price of thermal energy with hot water or water steam is set for completely returned heat carrier.

(2) The price of the heat carrier is set by the seller/retailer depending on its quality and is announced in advance.

**Article 20.** (1) The prices of heat when sold by a transmission company to customers are based upon the sum of annual revenue requirements of the producer and the transmission company in accordance with Art. 9.

(2) The transmission companies set the prices of thermal energy depending on the respective heat carrier that has to be uniform for all customers supplied with heat with the same heat carrier on the territory for which the company is licensed.

(3) The price includes the components: a capacity charge, an energy charge.

(4) A single component price could be set with a decision of the Commission that will reflect the ratio between revenue requirements for the production and transmission of thermal energy and the amounts to be sold.

**Article 21.** The capacity charge for the various heat carriers is calculated as the total amount of fixed expenses plus the return for the activities of production and transmission of heat and the amount of negotiated capacity with steam and hot water respectively between the transmission company and customers.

(2) The Commission may set a price cap for capacity for the transmission company selling to customers. The conditionally fixed costs and return rate approved by the Commission that are not included in the capacity charge are to be included in the energy charge.

(3) The total amount due for capacity determined on the basis of the contracted capacity in a multi-owner apartment building is distributed among the consumers in the building according to a procedure set in the Ordinance under Article 125, paragraph 3 of the Energy Act.

**Article 22.** The price of thermal energy with the different heat carriers are calculated as the sum of variable costs for production and transmission of thermal energy with the two types of carriers divided by the respective amount for sale.

**Article 23.** (1) The Commission sets preferential prices for the customers' associations at the proposal of the heat supply company, as provided for in Art. 151, paragraph 3 of the EA.

(2) The preferential prices under item. 1 shall not be below the prices approved by the Commission for the respective company with return not included.

**Article 24.** The prices for connection of producers are individual and include the actual costs of constructing the facilities for connection to the network of the transmission or the distribution company.

**Article 25.** The price for connection of consumers to the transmission and distribution networks shall cover the costs of the transmission/distribution company for preparation and connection of customers' facilities to the respective network taking into consideration the total installed capacity and the type of heat carrier.

## CHAPTER THREE

**PROCEDURE FOR SUBMISSION OF PROPOSALS FOR APPROVAL OF PRICES.  
PRICE APPROVAL, DETERMINATION AND CHANGING**

**Article 26.** (1) The energy companies submit applications to the Commission in approved Sample Formats for approval of:

1. revenue requirements and prices, along with any related indicators and factors for their adjustment during the regulatory period;
2. change in the rate structure;
3. change in prices currently in effect;
4. other issues related to the Commission's authority in relation to price regulation.

(2) The applications under paragraph 1 are to be submitted not later than 4 /four/ months prior to expiry of the old rate period or coming into effect of the proposed change of enforced prices and/or tariff structures.

(3) An energy company for which the Commission applies "rate of return on capital" method of regulation is allowed to file in application for changing the approved prices before expiry of a rate period in which substantial increase of the estimated costs could not have been foreseen at the time of approval of prices.

(4) When during the ongoing monitoring of actual amounts of revenue requirements and their components the Commission finds circumstances under paragraph 3, it may issue instructions to these companies to file an application for change of their approved prices. Upon non-fulfilment of the instructions, the Commission may change these prices ex officio.

(5) In case that the prices changed according to paragraphs 1-4 impact the prices of other energy companies, the Commission may issue instructions to these companies to file an application for change of their approved prices. Upon non-fulfillment of the instructions, the Commission may change these prices ex officio.

**Article 27.** (1) The application and its attachments contain information about a 12-month reporting period referred to as test year for the purpose of reviewing all cost and revenue elements relevant to the setting of their respective levels for the next regulatory or rate period.

(2) The following documents are attached to the application:

1. audited certified financial statement with all its attachments, in line with the requirements of the Accountancy Act and the applicable Accounting Standards;
2. financial-accounting information for the test year, in accordance with Article 5, paragraphs 5, 7 and 8 for the test year;
3. technical-economic data, including monthly reports for the sales during the test year, as well as any other information related to the prices proposed for approval, which is required in accordance with Article 5, paragraph 8.
4. information by consumer groups for the test year, including number of consumers, energy sales, contracted capacity, revenues and billing information;
5. other data considered relevant by the energy company in support to the submitted application or requested by the Commission;
6. a document for a paid fee for examination of the application.

(3) In their applications for approval of prices, energy companies are allowed to apply formally for recognition and compensation of stranded costs and of costs resulting from imposed public service obligations.



(4) An energy company is allowed to adjust and submit separately, with justification, known and measurable cost and revenue elements from the test year, where the justification includes financial data and data about the activity. Each adjustment in the test year data must be supported by information which proves the need for the adjustment and may include:

1. new assets that will be useful and commissioned during the next rate period;
2. increase of the forecast number of consumers, which will result in extra costs for provision of the service;
3. increases of costs, which have not been accounted for in the test year;
4. changes in payables to the state (fees, taxes, etc.), which result in changes in the levels of costs or rate of return;
5. normalization of sales from the test year, for which extraordinary meteorological conditions have occurred, whenever these conditions have had an effect on the heat supply sales;

(5) The documents under the preceding paragraph are submitted to the Commission on paper media, signed and sealed by the energy company. The information under paragraph 2, subparagraphs 2, 3 and 4 is provided in electronic format as well.

**Article 28.** Within one month before submitting the application to the Commission, the energy company will announce in the mass media its proposal for new prices or for a change of existing prices.

**Article 29.** (1) The Commission sets a date for holding an open session for discussion of the application for prices within 2 months after completing the examination of the application and announces it on its Web page and through a press release to mass media.

(2) Along with the announcement under the preceding paragraph, the Commission publishes the application along with a report regarding the case file by the respective official.

**Article 30.** Within 10 days as from the date of the open session, the Commission holds a closed session to approve the draft decision on the application and make a decision for implementing a public discussion under Article 14 of the Energy Act.

**Article 31.** The draft decision includes:

1. the duration of the regulatory period for price cap or revenue cap regulation;
2. the revenue requirements for the first year of the regulatory period;
3. the efficiency factor;
4. the value of the regulatory asset base for regulatory purposes;
5. the allowed rate of return on capital;
6. the stranded costs and costs associated with public service obligations and their recovery;
7. the consumer groups;
8. the tariff structure;
9. the tariff prices.

**Article 32.** Implementation of the procedure under Article 14 of the Energy Act starts by announcing the draft decision on the Web page of the Commission and through a press release to mass media.

**Article 33.** (1) After completion of the procedure for public discussion at a closed session, the Commission makes a justified decision.

(2) The decision is handed over to the applicant and is published on the Web page and in the bulletin of the Commission.

(3) The energy companies publish the approved prices in one central and/or one local daily newspaper within 7 days after receiving the decision of their approval by the Commission.

(4) The new prices take effect for the next month, unless a change in tariff structure is required. When the Commission makes a decision for a change in tariff structure, through its application the energy company may request setting a later date for the new set of tariffs to take effect. In this case, with its decision the Commission determines the date for commencing with the new tariff structure.

#### **ADDITIONAL PROVISION**

**§ 1.** Within the meaning of this ordinance:

1. “Test Year” is the preceding calendar year or a twelve-month period that precedes the application submission for which the energy company provides information about the licensed service and which is used as the basis to set rates.
2. “Return on Invested Capital” is the product of multiplying the regulatory asset base by the allowed return on capital for the regulatory period.
3. “Contracted capacity between the heat transmission company and the consumers” is:
  - a. for consumers in an apartment building and for domestic consumers in autonomous building, this is the capacity of the installed heat substation.
  - b. For individual non-domestic consumers of heat energy this is the maximum limiting value for the substation, with technical means by the heat transmission company or under its supervision.
4. “Efficiency improvement factor” is a target set by the Commission for improvement of the energy company efficiency.
5. “Revenue Requirements” is the revenue level required by the energy company to supply a specified level of service and earn an allowed rate of return.
6. “Rate of Return on Capital” is return on invested capital, expressed as a percentage of that capital.
7. “Useful life” is the term, for which the Commission assumes that a given asset can be depreciated.
8. “Recognized capacity between the producer and the Commission” is the capacity in the production which is used and covers the maximum consumption of heat in MW.
9. “Regulatory Period” is the period between two regulatory reviews.
10. “Regulatory Asset Base” is the value of the tangible and intangible assets that are both used and useful for the provision of the services within the licensed activities.
11. “Capital Structure” is the proportion of relative shares of equity and debt in the capitalization of the energy company.
12. “Tariff structure” is a system of prices for sale of heat supply or for provision of service, the revenues from which correspond to the revenue requirements for the respective activity.
13. “Tariff price” is each individual price in the tariff structure.
14. “Energy charge” is the component of the price that covers variable (depending on the amounts of thermal energy produced and transmitted/distributed over the networks) costs of the energy company.

15. “Capacity charge” is the component of the price that covers the fixed costs of the energy company (those not depending on the amounts of thermal energy produced and transmitted/distributed over the networks) and the return on capital.
16. “Rate Period” is the period throughout which the rates remain unchanged by the Commission – usually a calendar year.

#### **TRANSITIONAL AND FINAL PROVISIONS**

§ 2. Till 31<sup>st</sup> of December 2004, the prices of heat energy for domestic needs in multi-owner buildings, supplied by heat transmission companies which are subsidized by the state budget is set in Bg. leva for a cubic meter of heated space.

§ 3. Upon entry into force of the Ordinance the “rate of return on capital” method of regulation is applied to the prices of all energy companies.

§ 4. The Commission makes a decision on applying incentive-based methods of regulation.

§ 5. The Commission will adopt the accounting rules under Article 5 within six months after entry into force of the Ordinance.

§ 6. The ordinance is adopted on the grounds of Article 36, paragraph 3 of the Energy Act.