



**CONSULTATION DOCUMENT**  
**REGULATORY PERIOD FOR PRICE**  
**REGULATION OF DISTRICT COOLING**  
**SERVICES FOR COMMERCIAL BUILDINGS IN**  
**THE MARINA SOUTH DISTRICT**

*ENERGY MARKET AUTHORITY*

4 December 2002

## 1. INTRODUCTION

The Energy Market Authority (the “EMA”) published a Consultation Document on *Price Regulation for District Cooling Services* on 1 November 2002. This Consultation Document was discussed with the relevant industry parties on 21 November 2002.

In this Consultation Document, parties were invited to provide comments on the appropriate length of the regulatory period for district cooling services (DCS) for commercial buildings in the Marina South District. Most respondents to the Consultation Document were in favour of having a regulatory period longer than 5 years. However, some of the respondents were unclear on the elements of the formula that will be fixed *within* the regulatory period.

Taking this into consideration, the EMA has decided to issue a separate Consultation Document on the Regulatory Period for DCS for commercial buildings in the Marina South District. The objective of this new Consultation Document is to describe in greater detail the aspects that need to be considered in setting the length of the regulatory period and consult relevant industry parties on the issues related to the regulatory period.

All interested parties are invited to comment on the issues and proposals discussed in this Consultation Document (the ‘comment boxes’ indicate where the EMA is inviting comments on specific, key issues). Comments should be sent to the EMA by **no later than 18 December 2002**.

All comments should be submitted in writing and in both hard and soft copy (Microsoft word format). Respondents are required to include their personal/company particulars, as well as their contact details (address, telephone number, fax number and e-mail address), in their submissions. Comments should be addressed to:

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## 2. REGULATORY PERIOD DEFINITION

The regulatory period can be defined as the fixed period over which the parameters of the price control formula (e.g. benchmark costs) are fixed and average DCS prices are

updated automatically each year only by changes in input prices (e.g. electricity and water prices, inflation, etc) captured by the indices included in the formula. That is, the actual benchmark cost parameters and sharing ratio will not change *within* the regulatory period (except for the circumstances discussed in Section 4).

At the end of the regulatory period, the EMA will review the actual cost of the DCS operator, and the evolution of the district cooling demand. Based on this, the EMA will determine the appropriate changes in the parameters of the price control formula to reflect changes in the DCS operator's level and structure of costs and demand.

### **3. LENGTH OF THE REGULATORY PERIOD**

In general, in deciding the period of a price control formula, a trade-off must be made between productive efficiency (i.e. lowering costs), and allocative efficiency (i.e. keeping prices in line with actual costs) objectives, as well as short and long-term efficiency incentives. If the price control lasts for a long time, the regulated company will have a strong incentive to reduce its costs, since it will be sure of keeping the benefits for many years. By the end of the period, however, prices may be significantly above the company's costs, leading to allocative inefficiency and possible distributive concerns. Further, the company's sustainability could be endangered if the price control turns out to be too demanding. If the price control period is short, the regulator can ensure that prices are always close to the company's costs, protecting sustainability and allocative efficiency. The drawback is that the incentives for productive efficiency may be weakened if the review period is shorter.

In order to decide the appropriate length of regulatory period for the DCS it is important to consider the particular circumstances of the service and the regulatory framework.

The price control formula proposed by the EMA is based on the benchmark costs of a conventional in-house air-conditioning system. It is likely that the DCS operator will make financial losses in the early years of the service, which could be recouped with profits earned during the following years. Based on this, the EMA considers that a longer regulatory period of up to 10 years may be more appropriate. Some of the respondents to the Consultation Paper on *Price Regulation for District Cooling Services* were also in favour of a period longer than 5 years.

### **4. CONDITIONS FOR RE-OPENING THE REGULATORY FORMULA**

Given that the DCS for commercial consumers in the Marina South District faces some uncertainties, the EMA is considering combining the incentive provided by a relatively

long period of preset prices with an opportunity for re-opening (or re-setting) the regulatory formula. Such a reopening would only follow or be triggered by *very transparent and specific* events that can be clearly defined, easily measured and recognised and are not subject to possible misinterpretation.

To preserve the incentive properties of the price control formula, the specific “re-opening” events that would lead the EMA to review the price control formula before the due date should be clearly identified in advance. Thus the EMA will only include a condition for a re-opening if events can be clearly identified.

It is important to note that the EMA is considering imposing a restriction on re-opening the price control formula within the regulatory period as a result of the occurrence of a pre-determined re-opening event. Even if a re-opening event happens, the EMA will only consider a re-opening after half of the regulatory period has been completed and will only allow one such reopening to occur during a regulatory period. This will help to preserve the transparency, stability and predictability of the regulatory framework.

**Comment is invited on:**

- The length of the regulatory period
- Specific events that should lead the EMA review the price control formula before the end of the regulatory period
- Minimum period for considering a re-opening of the price control formula