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PLAN FOR CONTINUED LEGAL AND REGULATORY REFORM OF THE GEORGIA POWER SECTOR

Georgia Power Sector Reform
Contract No. LAG-I-00-98-00005-00
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Draft Report

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This is the Plan for Continued Legal and Regulatory Reform called for by Subtask B of Contract No. LAG-I-00-98-00005-00, Task Order No. 4, that Hagler Bailly develop a plan "for moving the regulatory and legal framework forwards toward completing the formal separation of policy, regulatory, and operational functions in a manner that will improve the commercial provision of electricity services." The plan draws upon the following:

- The work plan for Subtask B of Task Order 4, submitted to USAID for review and comment in draft form in November, 1998;
- The Assessment of the Legal and Regulatory Framework of the Georgia Power Sector, submitted to USAID for review and comment in draft form in December, 1998 and in final form in March, 1999; and
- Hagler Bailly's work and experience under Task Order 4, which began in September 1998 and has continued to date.

Of necessity, Hagler Bailly's work under this Subtask relates to and must be integrated with our work under each of the other Task Order 4 Subtasks, particularly Subtasks A (Restructuring), C (Commercialization) and D (Privatization). This Legal and Regulatory Reform Plan therefore refers to activities under the other Subtasks, as appropriate.

This Plan identifies and discusses each of the major items of work that Hagler Bailly has been implementing and/or will implement under Subtask B for the duration of Task Order 4. In general, the plan lists the items of work in order of importance to the legal and effort.

1. Amendments to the Electricity Law

President Shevardnadze's Decree No. 421, "On Main Principles of the Georgian Wholesale Electric Market," issued 20 July 1998, ordered several agencies of the Government of Georgia (GoG) to collaborate in preparing amendments to the Electricity Law of 1997, to reflect the proposed new Georgia Wholesale Electricity Market. It had earlier been the opinion of the

Ministry of Justice that such amendments would be necessary, under Georgia law, properly to accommodate the new market.[1]

At the same time, as time had passed since enactment of the Electricity Law, the Commission, electric sector licensees, and donor groups had identified certain respects in which the Law should be clarified or strengthened. For example, Clause 38, which specifies the procedure and timing of rate changes by licensees, presented certain practical problems in GNERC's administration of the Law. Clarification of the Commission's enforcement authority also was appropriate.

Hagler Bailly has and will work with the GoG agencies designated by Decree No. 421, as well as donor groups, to craft amendments to the Electricity Law appropriate to address the foregoing issues.

Timing: Hagler Bailly commenced working with counterparts on the draft Electricity Law amendments under Delivery Order 14, and that work has continued almost without interruption under Task Order 4.[2] Hagler Bailly will continue working with counterparts on these amendments until Parliament has approved them.

2. Rates and tariff methodologies

GNERC issued a decision officially adopting a tariff methodology (formulated with technical assistance from Hagler Bailly) in July 1998. In October, 1998, GNERC raised retail rates to 6 tetri/kWh (from 4.5 tetri/kWh), noting that even the 6 tetri rate did not permit full cost recovery for electric sector enterprises, and that the new rate would only, therefore, serve as an interim measure, pending adoption of long-term, cost-based rates. Since then, GNERC has continually refined its approach to electric tariffs, as a combination of study tours (sponsored by USAID and conducted either by Hagler Bailly or by United States Energy Association) and technical assistance offered by Hagler Bailly's tariff experts have assisted the Commission to learn more about tariff methodologies.

With regard to rates and tariffs, Hagler Bailly has identified four items of work to which to devote its efforts under Task Order 4.

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[1] We describe the proposed wholesale electric market in more detail in the draft Restructuring Implementation Plan submitted to USAID for review and comment on 11 March 1999.

[2] Hagler Bailly has worked with counterparts on both the amendments to the Electricity Law described in this Plan, and, simultaneously, on the amendments to the Electricity Law designed to give GNERC authority over the supply, transportation and distribution of natural gas under Task Order 5. GoG has prepared both sets of amendments as part of a single package.

First, Hagler Bailly will continue to work with GNERC in teaching rate fundamentals.

Second, Hagler Bailly will work with the Commission to establish a prospective rate for generation projects to by privatized by GoG during 1999. These rates will include a return on investment and an allowance for rehabilitation costs sufficient to ensure that investors will be attracted to generation resources in Georgia, when GoG offers them for sale or concession.

Third, Hagler Bailly will work with the Commission on its long-term, cost-based rate proceedings for each of generation, transmission, dispatch, and distribution. These rates will be relevant both to ongoing operations of the system, and to GNERC's rate-setting responsibilities under the proposed wholesale electric market.

Fourth, Hagler Bailly will, time, interest, and the collection of data permitting, work with GNERC and Merrill Lynch/Kantor to establish rates for prospective investors in distribution enterprises, in the event that GoG offers distribution sector assets for sale or concession during the term of Task Order 4.

Timing: Hagler Bailly has worked with GNERC continuously for over a year on ratemaking fundamentals. Indeed, one of Hagler Bailly's local professionals works with the Commission weekly on rate matters. We anticipate that this work, which is at the heart of technical assistance offered to the Commission by Hagler Bailly, will continue through 15 July, 1999.

Hagler Bailly completed its basic work with the Commission on establishing rates for prospective private owners of hydropower plants in December, 1998 and January, 1999, and reviewed that work with GNERC during the Commission's regulatory study tour of the United States in February and March. If Merrill Lynch chooses to avail itself of these materials during the privatization process,[3] then Hagler Bailly will work with GNERC on formal adoption of the rates, with whatever adjustments are necessary. Hagler Bailly commenced working on a revised tariff for the Gardabani thermal generating station in March 1999, and expects to complete that work in April.

As with ratemaking work in general, Hagler Bailly has worked with GNERC on its long-term rate proceedings throughout the term of Task Order 4 to date, and expects to continue with that work for the remainder of the contract.

As to distribution rates, Hagler Bailly is in the process of gathering data for Georgian distribution enterprises, a task which is proving to be time-consuming and problematic, due to the far-flung locations of distribution enterprises and the spotty (in cases, non-existent) data kept by those enterprises. If the process of data collection is completed, and if Merrill Lynch shows an interest

[3] We describe the reason for this rate exercise—the rate issue that emerged in connection with privatization of Telasi, the municipal distribution system for Tbilisi—in our Assessment of the Status of Privatization of the Georgia Power Sector, dated 2 March 1999.

in having GNERC establish rates for newly-privatized distribution enterprises, then Hagler Bailly will work with the Commission to evaluate such rates.

3. Regulatory policy papers

Hagler Bailly will prepare regulatory policy papers, addressing key issues in the electric sector, as follows.

- **Terms and conditions of electric service.** Clause 34.3 of the Electricity Law requires each Distribution Licensee to submit to GNERC, for approval, terms and conditions of electric service to consumers. Hagler Bailly will prepare and submit to the Commission a policy paper outlining terms and conditions of service common to electric tariffs on file with regulatory agencies in the West, identifying the most common elements of such terms and conditions options for addressing common issues. The policy paper will include an analysis of the draft terms and conditions of electric service recently prepared by AES Corporation.

  Timing: Hagler Bailly compiled a database of sample electric terms and conditions of service on file with a variety of state commissions in the United States in February, and outlined the common elements of those tariffs in March. We expect to complete the analysis, and the policy paper, not later than the end of April.

- **Cross-ownership and direct contracts.** As regulatory authorities in the West move away from the fully-regulated model of the electric utility industry to a model based on competition, the structure of the industry is changing from the classic vertically-integrated model to one in which generation ownership is independent from ownership of distribution assets. Such a structure ideally promotes competition unrestrained by ownership considerations. That is the model on which the Georgian wholesale electric market is based. Georgia, however, faces a situation quite a bit different from the fully-developed markets on which the competitive model is based. It may be, for example, that ownership of generation assets by the owners of distribution systems is the best way to insure power supply, at least in the short run, without the loss of the benefits of competition in the long run. Hagler Bailly proposes to prepare a policy paper evaluating the issues relevant to cross-ownership of, and direct contracts between, generation and distribution.

  Timing: Hagler Bailly will complete this policy paper by the end of May, timed to anticipate GoG's offering of generation assets for sale to strategic investors.

- **Rates in the privatization context.** Hagler Bailly has offered substantial technical assistance to GNERC in connection with its establishment of a methodology for cost-based ratemaking, just as it has in the actual calculation of cost-based rates. We learned during the privatization of Telasi, however, that the privatization of electric assets presents rate issues quite different from those attending traditional cost-based ratemaking. In order better to prepare GNERC, the Ministry of State Property Management, other GoG officials, and perhaps private companies interested in bidding for Georgia electric assets to be privatized in the next six months, Hagler Bailly will prepare an analysis of ratemaking issues relevant to privatization. The analysis will include such issues as: the functions of valuation and depreciation of aged assets in calculating rate base, and alternatives for measuring them; the role of purchase price in setting rates for newly-privatized assets; the appropriateness of setting rates for privatized assets prior to bidding for those assets, and the calculation of such rates; the use of rate caps in privatization; and the effect of capital investment commitments on future rates. This policy paper will complement the rate work otherwise being undertaken by the Commission, by giving it the policy bases from among which to choose in dealing with issues relating to privatization.

  Timing: Hagler Bailly has begun the research on these issues, and expects to complete the policy paper by the end of April.

4. Public participation procedures/Code of Ethics

Evidence, anecdotal and otherwise, suggests that GNERC needs rules to govern such matters as public participation and permissible contacts with commissioners and other agency personnel. At a minimum, the Commission needs some procedure by which to seek the views of parties who might have an interest in an issue, once that issue has been presented to the Commission by a licensee.[4] Hagler Bailly will offer technical assistance to GNERC on these matters.

Timing: Hagler Bailly has prepared a draft set of procedures, including a Code of Ethics, which will be circulated to USAID for review and comment prior to translation and presentation to GNERC.

[4] For example, in one case in February, 1999, GNERC is reported to have rendered a decision on the allocation of margins for transmission rates at the request of the licensee for the 500 kV grid in Georgia, without seeking the views either of the transmission licensee for the rest of the grid or AES Corporation, which was paying the bulk of the sector's transmission charges at the time.

5. Implementation of restructured electric market

Task Order 5 (Scope of Work, Subtask B.4(vii)) provides that Hagler Bailly is to "advise and assist with implementation of electricity market in restructured power system (including such items as market agreements, scheduling and dispatch procedures, settlement and payment processes, identifying metering and communications needs)". Although this item of work is listed under Subtask B, Hagler Bailly has set out its plan for implementing these requirements in the Restructuring Implementation Plan for the Georgia Power Sector, which addresses the formation and operation of the wholesale electric market.

6. Least-cost plan (power sector simulation) model

Under a contract that expired in September 1998, Burns & Roe introduced a least-cost plan computer model to the Ministry of Fuel and Energy. Hagler Bailly will train personnel from the Ministry, from GNERC, and from other interested agencies of GoG in the use of the model.

Timing: Hagler Bailly will conduct training in use of the least-cost plan computer model, utilizing ICF Kaiser personnel under subcontract (ICF Kaiser authored the model in use in Georgia) in April and May.

7. GNERC oversight and enforcement procedures

The amendments to the Electricity Law that have been prepared by various agencies of GoG, with technical assistance from Hagler Bailly, will address certain deficiencies in the original, among them limitations on GNERC's ability to enforce the conditions of its licenses and the requirements of its rules and of the Electricity Law itself. If, as expected, the amendments to the Law are enacted, then Hagler Bailly will offer technical assistance to GNERC in implementing the amendments, including, if appropriate, the preparation of draft regulations.

Timing: May or June 1999.

8. Regulatory study tours

Task Order 5 (Scope of Work, Subtask B.4(xiii)) provides that Hagler Bailly is to

> arrange a visit for up to 5 regulators and staff to the US for the NARUC conference and visit to a regulatory commission; and send up to 5 regulators and staff to a CEE/NIS regional regulatory conference and up to two regulators to two Technical Committee meetings in the CEE/NIS.

On 20 February 1999, the three GNERC commissioners and two staff members (accompanied by Hagler Bailly's McNeill Watkins and local professional Maia Tevzadze) traveled to Washington, DC to attend the Winter Meetings of the National Association of Regulatory Utility Commissioners, which took place between Sunday, 21 February, and Wednesday, 24 February. While in Washington, the GNERC delegation met with representatives of the District of Columbia Public Service Commission (1 March) and the Federal Energy Regulatory Commission (3 March). As detailed in the trip report for the study tour, the delegation also met with several companies and organizations relevant to utility regulation, along with USAID and World Bank.

Hagler Bailly funded the visit by representatives of GNERC to the Energy Regulatory Conference for Central/Eastern Europe and the New Independent States, held in Warsaw on 7-9 December, 1998.

Hagler Bailly expects to send up to two GNERC representatives to the next CEE/NIS Licensing Committee meeting. The meeting has not yet been scheduled by USAID, but we understand that it is expected to take place in April or May.

9. GNERC annual report

Clause 21 of the Electricity Law provides: "Each year the Commission shall make an annual report regarding its activities and present it to the President, the Parliament, and the Ministry [of Fuel and Energy]." Task Order 4 (Subtask B.4(xii) requires Hagler Bailly to "assist with preparation of Commission's annual report". Hagler Bailly will assist the Commission.

Timing: Although the Electricity Law requires GNERC to prepare an annual report, it has not done so in the 18 months since the commissioners took office. Hagler Bailly has provided the Commission with a suggested outline of an annual report and, over the last year, examples of annual reports from several regulatory agencies in the United States, including FERC and the state commissions in Georgia, Virginia, New York, and the District of Columbia. We will continue to encourage GNERC to complete this task, although it should be understood that Hagler Bailly is powerless to make the Commission do anything it doesn't want to do.

10. Ongoing technical assistance to GNERC

Hagler Bailly personnel meet with, speak with on the telephone, send documents to, or otherwise interact with GNERC representatives on a weekly, often on a daily, basis. We offer a variety of technical assistance and information to the Commission, from relatively simple matters (such as, for example, the prevailing cost of construction per kilometer of new 500 kV transmission line)

to relatively subtle or sophisticated rate questions. This technical assistance will continue for as long as GNERC will stand for it.

Timing: Throughout the term of Task Order 4.

Conclusion

This Legal and Regulatory Reform Plan reflects information on the needs of GoG as of the date that we submit it to USAID. Those needs may change, however, in coming months, and Hagler Bailly proposes to remain flexible in the assistance that it offers, in consultation and cooperation with all relevant parties.