

# **Water and Waste Regulatory Office**

## **Waste Disposal Tariff Policy**

December 2007

# **Water and Waste Regulatory Office**

## **Mission**

*“Water and solid waste utilities delivering a consistent, good quality and efficient service to all customers throughout Kosovo.”*

## **Vision**

*“To regulate the water and solid waste sectors in a transparent and equitable manner in accordance with good European practice which ensures that the water and solid waste utilities deliver a qualitative, sustainable, reliable and affordable service throughout Kosovo, with respect for both the environment and for public health.”*

# Waste Disposal Tariff Policy

## Table of Contents

<b>1.</b>	<b>INTRODUCTION .....</b>	<b>1</b>
1.1	RATE SETTING PROVISIONS OF THE WWRO REGULATION (UNMIK REGULATION No. 2004/49) .....	1
1.2	OBJECTIVES .....	1
<b>2.</b>	<b>JURISDICTION .....</b>	<b>1</b>
2.1	KOSOVO LANDFILL MANAGEMENT COMPANY (KLMC).....	1
<b>3.</b>	<b>PRINCIPAL TARIFF POLICY OPTIONS .....</b>	<b>2</b>
3.1	TARIFF STRUCTURES.....	2
3.1.1	<i>Uniformity of tariffs</i> .....	2
3.1.2	<i>Waste characteristics</i> .....	2
3.2	ENVIRONMENTAL CONSIDERATIONS .....	3
3.2.1	<i>Waste generation management</i> .....	3
3.2.2	<i>Establishment charges and deposit</i> .....	3
3.3	COST RECOVERY .....	4
3.3.1	<i>Definition</i> .....	4
3.3.2	<i>Time taken to achieve full cost recovery</i> .....	4
3.3.3	<i>Efficiency expectations</i> .....	4
3.3.4	<i>Recovery of capital investment costs</i> .....	5
3.3.5	<i>Grants and gifted assets</i> .....	5
3.4	CAPITAL STRUCTURE, VALUE AND RETURN .....	5
3.4.1	<i>Capital structure</i> .....	5
3.4.2	<i>Regulatory capital value</i> .....	6
3.4.3	<i>Working capital</i> .....	6
3.4.4	<i>Return on capital</i> .....	7
3.4.5	<i>Taxation</i> .....	7
<b>4.</b>	<b>PROCESS .....</b>	<b>7</b>
4.1	MAJOR TARIFF REVIEWS .....	7
4.2	INTERIM REVIEWS .....	8

## **1. INTRODUCTION**

### **1.1 Rate setting provisions of the WWRO Regulation (UNMIK Regulation No. 2004/49)**

This policy, issued by the Water and Waste Regulatory Office (WWRO), presents the WWRO's interpretation and elaboration of its statutory obligations with respect to regulated tariffs for waste disposal services.

In particular, Section 38 of the WWRO Regulation (*Rules Issued by the Regulator*) requires the WWRO to create rules for the setting and approving of tariffs. This policy is the foundation upon which such detailed rules can be developed.

Section 10 of the WWRO Regulation prescribes certain tariff obligations including:

- Consultation process (10.2)
- Expectations of efficiency (10.3 b), and
- Sufficiency to meet capital and recurrent costs (10.3 d)

The statutory obligations as set out in the WWRO Regulation permit a degree of regulatory discretion based upon professional judgement, understanding of the regulated entities (and their specific circumstances) and other socio-economic criteria.

Following an initial consultation process in May 2007 and subsequent representations from stakeholders this draft policy statement has been prepared.

### **1.2 Objectives**

The interests of the various stakeholders do not necessarily coincide; for example consumer interest in low tariffs is in conflict with investor interest in financial sustainability. It is the function of the WWRO to ensure that the tariffs provide an optimum balance between these interests and ensure the best possible value, including tariff and improved quality of service for society. This Tariff Policy is designed to deliver this best overall balance.

## **2. JURISDICTION**

### **2.1 Kosovo Landfill Management Company (KLMC)**

This policy document is based upon the current institutional environment whereby KLMC is the sole licensed provider of waste

disposal services. Although there are several unlicensed waste disposal service providers operating within Kosovo it is anticipated that they will eventually be taken over by KLMC and operated as licensed activities. The WWRO remit applies only to licensed (KLMC) waste disposal activities and therefore this policy is confined to KLMC's activities only. It is recognised that the institutional framework for waste (collection and disposal) is under review and any changes therein may require subsequent changes to this Tariff Policy.

***WDPS 1: Jurisdiction***

*This Tariff Policy applies to the activities of KLMC only and does not apply to the activities of unlicensed service providers.*

### **3. PRINCIPAL TARIFF POLICY OPTIONS**

#### **3.1 Tariff structures**

##### **3.1.1 Uniformity of tariffs**

It is recognised that the costs of waste disposal may vary across the country due to utilisation of available resources, economies of scale and other factors. Although economic efficiency would suggest that each individual facility should have tariffs set to reflect their costs the WWRO believes that such an approach is inappropriate at this stage on the basis of social considerations and the practicalities of financial reporting for individual facilities. In the longer term the WWRO shall examine the opportunities for more economically efficient cost reflective tariff mechanisms.

***WDPS 2: Uniformity of tariffs***

*In the short to medium term the tariffs should be uniform throughout KLMC's area of service. However, the WWRO should leave open the opportunity for tariffs to be set on a case by case basis in the future when reporting systems are sufficiently robust to facilitate detailed analysis of costs and revenues determined on an operating unit (individual landfill) basis.*

##### **3.1.2 Waste characteristics**

Different types of waste may require special disposal arrangements, e.g. electronic / electrical products, refrigerators containing CFCs etc. There is, therefore, a case for different tariffs for the disposal of different types of waste. However, the activities of KLMC do not, in the main, distinguish between

different types of waste and where they do there are no financial structures in place to identify any differences in costs with any degree of confidence. It is therefore appropriate to disregard the concept of different charges to reflect different types of waste until such time that different disposal techniques are actually employed and the financial management systems of KLMC are sufficiently developed to identify the differences in costs.

***WDPS 3: Waste characteristics***

*The waste disposal tariffs shall be uniform irrespective of the type of waste disposed of unless until such time that specialist different disposal techniques are employed and their costs are identifiable.*

## **3.2 Environmental considerations**

### **3.2.1 Waste generation management**

Many countries employ 'landfill taxes' as a means of reducing waste generation and to encourage recycling. Currently, Kosovo does not impose landfill taxes on the KLMC or its licensed customers and therefore does not have an impact on tariffs. The WWRO does, however, support the concept of landfill taxes and if the government chooses to impose such taxes in the future the costs should be passed through to the tariffs of waste disposal services.

***WDPS 4: Landfill taxes***

*If landfill taxes are introduced the costs shall be reflected in the waste disposal tariffs.*

### **3.2.2 Establishment charges and deposit**

Landfill management includes an obligation to reinstate the landfill sites in compliance with environmental standards at the end of their useful lives. To ensure against the management company abrogating their reinstatement obligations the government can require the landfill company to lodge a deposit in the form of cash or bank guarantee when the site is first established, the value of which is sufficiently high to provide an incentive for the operator to meet its environmental obligations. On meeting its obligations the deposit or guarantee is returned to the operator. The impact on tariffs is the opportunity cost of the capital that is required to provide such a deposit or guarantee, which the operator should be entitled to recover through its charges.

Under the current KLMC structure, however, the government is effectively underwriting the risk and no such deposit or guarantee is required unless the government divests itself of this activity.

*WDPS 5: Establishment charges and deposit*

*Under the current KLMC structure the government is effectively underwriting the risk and no deposit is necessary. However, should the government divest itself of this activity a deposit should be sought in order to protect the environment against failure to reinstate the site at the end of its useful life. The opportunity cost of such a deposit or guarantee shall be reflected in the tariff of services.*

### 3.3 Cost recovery

#### 3.3.1 Definition

*WDPS 6: Definition of cost recovery*

*In the short term full cost recovery is to be defined as revenues sufficient for KLMC to finance their activities on a cash flow basis but in the medium term, tariffs shall be determined on the basis of conventional accounting techniques including allowances for a return on capital.*

#### 3.3.2 Time taken to achieve full cost recovery

*WDPS 7: Time frame for attainment of cost recovery*

*Cost recovery should be a medium term objective, (within 5 years). As a minimum, revenue should cover all direct operating costs and allow for the costs of capital maintenance necessary to maintain compliance with service and environmental obligations.*

#### 3.3.3 Efficiency expectations

Tariffs should reflect realistic expectations of improved efficiency from KLMC which can be realised through greater involvement of the private sector and improved practices within the KLMC. The expectations shall be determined by the WWRO in consultation with the KLMC.

*WDPS 8: Efficiency improvement expectations*

*The WWRO shall determine realistic efficiency improvement expectations which shall be incorporated in the tariffs for services.*

### 3.3.4 **Recovery of capital investment costs**

Capital investment is recovered through depreciation provisions but should only relate to those investments made by KLMC (refer WDPS 10: Treatment of grants and gifted assets). Such provisions may be passed through in full on an annualised basis or through a longer run calculation methodology that distributes depreciation relative to waste disposal tonnages.

***WDPS 9: Recovery of capital investment costs***

*The WWRO may elect to pass the capital investment costs either through annual current cost depreciation provisions or over a longer run model depending upon whether the cost recovery process is short or longer term.*

### 3.3.5 **Grants and gifted assets**

KLMC should not be reimbursed for investments they do not finance, e.g. grants and gifted assets. Consequently, depreciation on such assets should not be passed through to tariffs. Alternatively, depreciation can be passed through but to be balanced by treating the grants (or value of the gifted asset) as income that is amortised over the life of the asset, the net result being equivalent to not passing through depreciation to tariffs.

***WDPS 10: Treatment of grants and gifted assets***

*The WWRO should treat assets funded by grants and gifted assets differently from those assets financed through the KLMC's own financial resources. The WWRO should apply depreciation rules that fairly reflect the return of capital invested.*

## 3.4 **Capital structure, value and return**

### 3.4.1 **Capital structure**

Conventional economic theory rules that capital structure has no bearing on the performance of a business and as such the capital structure is a KLMC management issue rather than a regulatory concern. Consequently, the return on capital (once applicable) shall be based upon a return on total capital value irrespective of capital structure. Until such time as a return on capital is permitted, however, the WWRO shall recognise the existing debt obligations of KLMC (interest and repayment of principal) in setting tariffs based upon the cash flow needs of the company.



***WDPS 11: Capital structure***

*Until there is full cost recovery the WWRO should consider capital structure in the tariff of services with respect to financing any existing debt obligations and maintaining cash flow. However, once full cost recovery is achieved the WWRO should consider the capital structure of KLMC as an internal management issue only and no longer a regulatory concern*

**3.4.2 Regulatory capital value**

The regulatory capital value (RCV) is defined as the value of assets upon which a return can be earned (once full cost recovery is attained). In accordance with regulatory principles KLMC should not be entitled to earn a return on assets that they do not finance, e.g. grants and gifted assets. Consequently, the RCV may be very different from the accounting book value of the assets. The RCV shall be initially established by the WWRO and any net additional investments financed by KLMC shall be added to the RCV and depreciation shall be deducted from the RCV (not including depreciation on grant financed or gifted assets (refer WDPS 10: Treatment of grants and gifted assets)).

If the government divested itself of KLMC the initial regulatory capital value at the time of divestment would be related to the tariff paid for the business and the long-term debt liabilities.

***WDPS 12: Regulatory capital value (RCV)***

*The WWRO should establish the capital value based upon the investments made by KLMC's own financial resources. However, if the government divested itself of the operations a different view on capital value will be required reflecting the purchase tariff of the business and any other long-term liabilities.*

**3.4.3 Working capital**

The working capital requirements of KLMC will directly impact on the cash flow of the organisation and as such will need to be recognised in the tariff of services. Furthermore, once a return on capital is permitted to pass through to the tariff the value of capital upon which a return can be earned should include the working capital requirements of KLMC.

***WDPS 13: Working capital***

*The cash flow stream for KLMC shall allow for any changes in working capital requirements. Once full cost recovery is attained and a return on capital is included in the tariff of services working capital shall be included in the total capital upon which a return can be earned.*

**3.4.4 Return on capital**

Until full cost recovery is attained the concept of a fair return on capital is superfluous. In the meantime return on capital shall be limited to cash flow debt service obligations only.

***WDPS 14: Return on capital***

*In the short term the return on capital should be limited to cash flow demands only. Once a return on capital is permitted to be included in tariffs the level of return shall be set at a level to reflect the risk category of the waste disposal business.*

**3.4.5 Taxation**

Until such time that KLMC generates a taxable profit the issue of taxation on profits is superfluous. Any other non-recoverable taxes shall be reflected in tariffs where appropriate. Once a return on capital is permitted to be included in tariffs the return on capital shall be based upon a 'post-tax' return with the value of taxes included in the cost build-up.

***WDPS 15: Taxation***

*Non-recoverable taxes shall be included in tariffs. When a return on capital is included in tariffs it shall be determined on a 'post-tax' basis.*

**4. PROCESS**

**4.1 Major tariff reviews**

***WDPS 16: Major tariff reviews***

*For the year 2007/8 tariffs shall be determined on an annual basis in which time the Tariff Policy can be developed with a complete set of rules that can facilitate longer periods between reviews.*

## 4.2 Interim reviews

In accordance with Regulation 2004/49 section 10.5 the WWRO shall review tariffs annually or 'at any other time the rules or an agreement with the Service Provider of Bulk Water Supplier specify'. The WWRO shall set tariffs tri-annually with the intervening annual review required by the regulation limited to inflationary adjustments and other extra-ordinary events.

*WDPS 17: Interim reviews*

*The WWRO shall undertake periodic interim reviews of the tariffs taking into account inflation and any extraordinary changes in the operating environment.*