



July 5, 2019

Oranjestad, St. Eustatius

Authoriteit Consument en Markt (ACM)

Den Haag, The Netherlands

Your reference : ACM/UIT/507415

Your Case number : ACM/18/034526 of : 16 May 2019

Re: reaction to the draft Method decision on electricity and drinking water in the Caribbean Netherlands 2020-2029

Dear Sirs,

Please find following STUCO's reaction to the Method decision on electricity and drinking water in the Caribbean Netherlands 2020-2029, as you have requested. We trust that our submission will have your due consideration, in arriving at the equitable Method that benefits all parties involved.

Kindly feel free to contact with any questions or comments.

Sincerely,

[Redacted signature]

Chief Executive Officer of STUCO.

OUR RESPONSE:

Section 2, 13, 28, 47

STUCO is of the opinion that the second regulatory period of 10-years is too long. We foresee a number of circumstances that could develop for which an adjustment in the methodology could benefit the company. Shorter application intervals would allow for quicker adapting to developments. To think of:

- a. changes in the law,
- b. legal pronouncements by a court of law
- c. changes in the business environment, including changes in the client base, a change of key suppliers, changes in the capital structure, economic developments
- d. changes in technology, e.g. developments with respect to renewable energy,

Case in point, at this very juncture we are facing another change in the law, which is expected to go into effect on January 1, 2021. ACM refers to this expected change in section 47. In the mean-time, the consultation period for this new law has been started. Further, a pronouncement by the court of appeal with respect to ACM's decision on the tariffs for water and electricity of 2017, is expected in mid-September 2019.

Both developments could influence the positions taken under this new policy method. Particularly in the case of the pending proceeding, it would seem prudent to await the outcome which, given that the topics in dispute, could materially affect the positions taken on the new policy method. By its intent to formally establish the new method by September 1, ACM ignores the possible effects of the legal pronouncements expected within weeks of formal acceptance of the new method, and the consequences this may have for the Companies.

STUCO is curious to know how, according to ACM, a 10-year regulatory period would be to the benefit of the Company, as opposed to the regulator. According to our understanding the regulatory period in the Netherlands is never longer than 5-years.

Under section 28, there is a reference as follows: "the method applies for a period of between three and ten years". It is not clear to STUCO how to interpret this comment, in light of the term defined under section 2.

Section 5

Giving the method the status of policy regulation, as opposed to an (administrative) decision, seems to be a choice that is more to the benefit of ACM than to the regulated entities. Since the tariffs decisions are in fact an extension of the policy and thus provide the framework against which tariffs are set, it would seem logical and practical for the regulated entities to address the underlying methodology in the event of disagreement, as opposed to initiating legal proceedings against the tariff decision, which to a great



extent, is driven by the policy. Our recent pleadings in the appeal case against ACM tariffs decision, proves the point. The issues coming up in the discussions, were not concentrated on the tariffs themselves but the underlying methodology. STUCO is therefore of the opinion that the status of the methodology should be such that will allow direct legal claims against it.

Section 6, 49, 51, 56, 57

The assumption taken by ACM is that the profit-sharing method is the best among the alternatives, in meeting the 3 objectives of the BES electricity and drinking water act. It is prudent to underscore here, that the law does not prescribe a preferred method. However, as referred to in section 49, the Explanatory Memorandum does amplify on the goals envisioned by the legislator; consumer protection, investor protection and efficiency of companies.

The choice for the profit-sharing method is not the obstacle in and of itself for STUCO. We concur that the model has a level of international standing. STUCO's concern centers on how the model is applied by ACM, in practice. In this regard, there are several considerations, the most important of which we will elucidate on in this response.

Here are some of our critical considerations:

- a. Given the length, in terms of the number of sections outlined in the new proposed method (at least 155 sections) and given the level of detail, to which the regulator finds it necessary to penetrate, STUCO questions whether the assumption of simplicity still holds. Comparing the method as presently applied with the new method now being proposed, it is obvious that the regulator is making the application more complex, under the notion of 'refinement'. This refinement according to ACM, is found in two driving principles, namely: 1. the taking into account of the actual cost incurred by the utility company 2. ensuring sufficient incentive for the utility company to operate efficiently.

In STUCO's opinion, this level of 'refinement' is being taken so far, that it could present a detriment to small entities like STUCO, as it represents a key driver of administrative overload and cost of application. ACM provides no indication of cost-benefit considerations. In the opinion of STUCO, the point of departure as described in section 57 and part of section 56, are not adhered to. In the first regulatory period the figures have shown that the profit-sharing method as actually applied by ACM, is skewed towards meeting the (short-term) objective of affordability, at the expense of the, equally important, objectives of reliability and sustainability. The experience so far has shown that ACM focuses solely on attaining one result, namely the immediate reduction in prices for consumers, forcing the companies to (pre-)finance cost increases, which are not fully compensated. Examples of the effect of this overreaching approach are its policies with respect to:

- i. the omission of certain investments from the assets base (RAB),
- ii. and the exclusion of certain expenses from the tariff-model
- iii. 50% - 50% sharing principle

ACM's strategy, ignores the balance intended in the law, as it infringes on the attainment of the other objectives, namely ensuring reliable and sustainable water and energy supply. The actual figures of the companies are a testimony that the profit-sharing method, as applied by ACM, cripples the company under the notion of "incentive to enhance efficiency". The profit-sharing method, as applied in practice by ACM, is focused on a short-term benefit for consumers, with a mid- and long- term risk to the company's continuity.

- b. In the documented elucidations surrounding the profit-sharing model, we read of 'values' such as, 'inclusion of the Islands' in the discussion and consideration for each Island specific circumstance. To this point however, STUCO have not sensed this level of open dialogue or flexibility. Except for one meeting of a visiting delegation of ACM in the month of June 2019, in which the method was addressed at a very high-level, there has been no approachable consultation or dialogue, certainly not to the level of detail described in the 155 sections of this memorandum. We sense a neglect of due process in this respect.

Further elucidation on this fundamental principle will follow throughout the rest of this document.

Section 7

Under this section, ACM introduces a new element referred to as 'major occurrences'. However, it leaves in the middle ambiguity as to what is 'major' and leave open significant room for the discretionary authority of the ACM.

Section 8

In the first regulatory period, the commissioning for the WACC study was flawed because of insufficient attention to the inclusion of the business and regulatory environment of the region in which the BES utilities operate. Whilst ACM claims to duly consider the region in which the companies operate, the selection of the investigating institution, once again, seems to follow the pattern as in the first regulatory period. At the very least, a prior consultation with the BES utilities on the commissioning instructions and the scope would have redressed the living concerns about insufficient attention to the regional operating realities.

Given that the WACC determination is not yet concluded, Annex 1 could not be provided for review under this consultation. This consultation therefore only permits the stakeholders to provide comments on a portion of the tariff regulation conducted by ACM. This consultation is largely geared towards obtaining comments on the operational costs as part of the regulatory costs at the base of the tariff determination by ACM. This consultation has partial merit in the entire context of tariff determination by ACM. This approach is not acceptable, as the results of the study and its effects on STUCO are simply not known.

Section 51 – 59, 64, 68, 73 - 86

Under the notion of ‘striking a balance between two basic principles’, ACM takes a number of fundamental positions in applying the profit-sharing method.

- a. Section 64 outlines the basic principle: tariffs must be based on costs. ACM immediately follows by introducing the term ‘regulatory costs’ and making the distinction between ‘capital costs’ and ‘operating costs’. For the determination of the regulatory costs, ACM in the first instance will use the audited financial statements of the company. This assumes that ACM will respect the integrity of the audit process and the auditor's opinion. However, by setting its own regulatory accounting rules (RAR), ACM in essence, wishes to ‘codify’ the exclusion of valid costs of operation from the tariff determination and this is done, contrary to ACM’s own suggestion, without adequate consultation with the regulated companies (Section 68). More so, in practice up to this point, ACM has often taken the position on the side of the least favorable option for the utility company.

In section 73, ACM proposes a treatment for incidental cost that again takes the position that these costs are somehow avoidable, resulting in further omission of actual costs incurred from the tariff setting. In the environment in which STUCO operates, where natural disasters occur with regularity, unexpected, unbudgeted business costs often present themselves. Whether these are considered incidental or not, seems to be left to ACM’s determination. Yet failure to incur such cost could be detrimental to the sustainability of the operation and by extension to the company’s ability, as sole provider, to service the resident community of Sint Eustatius.

It goes without saying that STUCO cannot support the codification of this approach in the new method, for in doing so, it would be acting against its own interest and the long-term interest of the consumer.

- b. Starting in the first regulatory period and continuing into the second regulatory period, ACM has arbitrarily chosen to apply the 50-50% profit/sharing principle. The basis for choosing a 50-50% distribution has never been provided. Section 87 does provide a clue as to the leading proposition of ACM, ‘the utility companies costs are not reimbursed like for like, if they were there would be too little incentive for the utility company to make cost savings. The reality however is, that the 50-50% method proves to be quite impacting on small companies facing annually increasing costs. In this environment, only 50% of the actual increase in costs are compensated for, leaving the Company to absorb the remaining 50%. For small emerging companies this is an unconscionable charge. That profits are also shared 50-50, is relevant only when there are profits realized. The latter scenario is however less likely. If the simplicity of this approach is considered of benefit to the company, then the 50-50% distribution absorbs that benefit. A less drastic distribution of 85-15% or even 80-20% would sustain the desired objective of cost efficiency, without unduly jeopardizing the company's financial position on the longer term.

According to section 56, ACM should exercise a great degree of flexibility following the four principles outlined, the first being that the method must pose ‘the least possible burden on businesses’’because businesses are small in terms of scale and usually do not have a separate regulatory department like most businesses in the European part of the Netherlands’.

- c. Imbedded under section 68, is the principle that regulatory asset base (RAB), according to ACM, may be different than the asset base recorded in the financial statements. Herein lies the basis for the exclusion of certain capital costs from the tariff determination.

The omission of donated assets from the regulatory asset base (RAB) immediately deflates the actual depreciation cost and deflates the WACC return on investments. With respect to the depreciation, STUCO has made this policy the basis for a legal case against ACM as, in the opinion of STUCO, this approach contradicts the stated position in the law that the actual cost of production (de werkelijke kosten van productie) must be considered in the tariff setting. The cost of production includes the cost of the use of the asset in production and is independent of the method in which the acquisition of the asset was financed. ACM's persistence in this approach is considered by STUCO an infringement on its ability to sustain itself in the future. Parties await the decision of the court, about this matter, amongst others, in September 2019.

From the discussion above, it should be clear that the approach of ACM, results in the omission of major and multiple categories of costs from the tariff determination. This approach, results in a cumulative effect and, as mentioned earlier, confirms the lack of attention for two of the three principles envisioned by the law maker.

Interest costs

While ACM discusses most costs of operation, lack clarity is lacking on the cost third-party financing, namely 'interest costs'. As 'interest costs' are a normal element in the cost structure of most businesses STUCO would appreciate the inclusion of ACM's position on the treatment of 'interest costs', as it relates to the determination of tariffs. This consideration is important to STUCO, as third-party financing may be needed in the future in support of the company's expansion.

Section 99

In this and the immediately following sections, ACM engages in a discussion as to how it allocates the revenues amongst different categories for which the tariffs are set. While this narrative is descriptive, it is difficult to follow without a good case study shared in an excel sheet, for example. When and where (T-2) and (T) are applied in the equation is confusing, in this narrative. One may even question whether there is not a simpler method, however, at the least, an example should be supplied for adequate verification. STUCO proposes that this would still be done and that it is granted the opportunity to dialogue with the appropriate persons involved with this aspect of the model.



Section 114

Under this section, ACM identifies network losses as costs to be omitted from profit-sharing. As network losses are inherent in the production and distribution of electricity and water and as they are, to a great extent, immutable without making large investments (which in term will result in higher depreciation costs), STUCO does not appreciate fully why these losses are subject to omission, particularly as losses realized in the case of STUCO tend to be well below the benchmark indicators of non-revenue (NR) in the region or even around the world.

Conclusion

In our remarks, we have not addressed every section, either because we are generally in harmony with the proposed approach or because the approach imbeds improvement over the first method. However, as alluded to throughout this response, there are several recurring themes, some of which STUCO considers to be critical to its long-term survival. STUCO wishes to reiterate that across the 165 sections of the method, little can be attributed to an awareness for the need to consider the envisioned principles of reliability and sustainability. Instead, most of the attention is focused on elements to be excluded from the determination of the tariff, in the interest to advance cost efficiencies and by extension, affordability. Ideally, STUCO would like to see another round of consultation, in which stakeholders who are intensely knowledgeable of the details of the propose method, can engage directly with us. This approach, would in our opinion, reflect the intent of the lawmakers and enhance the ultimate execution to the benefit of all parties. Finally, STUCO believes formal implementation should be delayed until the result of pending legal appeal is known