



**Our reference:** « *wordt nog ingevuld* »

**Case number:** « *wordt nog ingevuld* »

# **DRAFT METHOD FOR SETTING THE RATES FOR THE PRODUCTION AND DISTRIBUTION OF ELECTRICITY AND DRINKING WATER IN THE CARIBBEAN NETHERLANDS 2017–2019**

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Determination by the Authority for Consumers and Markets of a method as referred to in Article 2.5, paragraph 4, and Article 3.14, paragraph 5, of the BES Electricity and Drinking Water Act.

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## 1 Introduction and reader's guide

1. In this document, the Authority for Consumers and Markets (hereinafter: ACM) sets down the method which it adopts under Article 2.5, paragraph 4, and Article 3.14, paragraph 5, of the BES Electricity and Drinking Water Act<sup>1</sup>. Under these articles, ACM is to adopt a method for calculating the production price of electricity and drinking water, which encourages effective business practice, as well as a method for setting the distribution rates for electricity and drinking water.
2. The method which ACM sets down in this document applies to the period from 1 January 2017 up to and including 31 December 2019 (hereinafter: the first regulatory period).
3. The BES Electricity and Drinking Water Act only applies to Bonaire, Sint Eustatius and Saba. As the circumstances under which electricity and drinking water companies operate may differ per island, the method to be adopted for these companies may also differ in part. Whenever that is the case, it is explained in this method.
4. The method to be adopted by ACM applies to the following companies:
  - Water en energiebedrijf Bonaire N.V. (WEB)
  - ContourGlobal Bonaire B.V. (ContourGlobal)
  - Stata Utility Company N.V. (STUCO)
  - Saba Electric Company N.V. (SEC)
5. WEB is an electricity distributor on Bonaire. It also produces and distributes drinking water on Bonaire. It produces electricity on Bonaire for what is known as 'peak shaving' as well.
6. ContourGlobal is an electricity producer on Bonaire.
7. STUCO is a producer and distributor of both electricity and drinking water on Sint Eustatius.
8. SEC is a producer and distributor of electricity on Saba.

<sup>1</sup> Law of 23 March 2016, containing rules for the production and distribution of electricity and drinking water on Bonaire, Sint Eustatius and Saba (*Wet elektriciteit en drinkwater BES*), *Stb.* 2016, 142.



*The structure of this document*

9. This document consists of a number of chapters. Chapter 2 describes the procedure and rationale for the formation of the method. ACM describes the legal framework in Chapter 3 and the principles underlying the regulatory framework in Chapter 4. These frameworks are essential for motivating ACM's ultimate choices and decisions in forming the method. In Chapter 5 ACM describes the regulatory method and the operation of the regulatory system during this first regulatory period. Chapter 6 contains the opinions of interested parties and ACM's response to these.

*Annexes to this document*

10. ACM has attached 1 annex to this document. This annex summarizes the elements relevant to the method as well as the elements determined in the rates or rate proposals.
11. ACM also refers to its website, where the so-called *Explanation of tariff regulation in the Caribbean Netherlands Starting Document*, prepared by ACM, can be found. ACM also publishes the opinions provided in writing by interested parties about the draft method on its website, insofar as the interested parties have given permission to do so.

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## 2 Procedure and rationale for the formation of the method

12. In this chapter, ACM describes the procedure it adopted for the formation of this method.
13. In summary, under the BES Electricity and Drinking Water Act it is ACM's responsibility to set a maximum production price for electricity and drinking water as well as a maximum distribution rate for electricity and drinking water. The production price is charged by the producer to the distributor. The distribution rate is charged by the distributor to the purchaser (the consumer).
14. Under the Act, the production price and distribution rate must be based on a method to be adopted by ACM. This method is to encourage effective business practices by the producer and the distributor, and is determined after consultation between ACM and interested parties. The method is adopted for a period from three to ten years.
15. In this method, ACM describes how the production price and the distribution rate are set in such a way that the method encourages effective business practices by the producer and the distributor. The method provides an economic return that is reasonable and it contributes to the objectives of the Act: a reliable, sustainable and effective functioning of the electricity and drinking water supply in the Caribbean Netherlands.
16. The method sets out how the expected efficient costs and the reasonable economic return are determined. In the method, ACM also sets down how the energy costs, as part of the production price, are determined.
17. In preparation of the formation of the method, ACM prepared a so-called *Explanation of tariff regulation in the Caribbean Netherlands Starting Document*. In this document, which ACM sent by email to WEB, ContourGlobal, STUCO and SEC in the months of April and May 2016, ACM explains how it wishes to organize rate regulations in the Caribbean Netherlands and how the rate regulation is ultimately set down in decisions on rates. The Starting Document mentioned has been attached to this document as an annex.
18. In order to flesh out the consultations between ACM and the interested parties as meant by the legislature, ACM will give the interested parties the opportunity to express an opinion to ACM based on this draft method. In the definitive method, ACM will summarize these opinions, including a substantiated explanation of the way in which ACM incorporated the opinions into the definitive method, or the reason why certain opinions or views were not incorporated. ACM will publish the opinions in complete form on its website, to the extent to which interested parties have given permission to do so.



### 3 Legal framework

19. Under Article 2.5, paragraph 1, of the BES Electricity and Drinking Water Act, ACM sets down the maximum production price to be charged by the producer of electricity and drinking water to a distributor for the produced electricity and drinking water.
20. Pursuant to Article 2.5, paragraph 4, of the BES Electricity and Drinking Water Act, for setting the production prices of electricity and drinking water respectively ACM will adopt a method which encourages effective business practice.
21. Under Article 3.14, paragraph 1, of the BES Electricity and Drinking Water Act ACM sets down the maximum rates to be charged by the distributor to the consumers for the distribution of electricity and drinking water.
22. Pursuant to Article 3.14, paragraph 5, of the BES Electricity and Drinking Water Act, for setting the distribution rates for electricity and drinking water respectively ACM will adopt a method which encourages effective business practice.
23. The method as referred to in Article 2.5, paragraph 4, and Article 3.14, paragraph 5, of the BES Electricity and Drinking Water Act is a generally binding provision. This is because ACM determines the method based on its legal powers and the discretionary powers allocated to it. The method contains binding norms that other decisions have to conform to<sup>2</sup>.
24. Article 3, paragraph 1, preamble and part a, of the Public Bodies Bonaire, Sint Eustatius and Saba Act<sup>3</sup> sets down, insofar as this is relevant here, that the General Administrative Law Act, excepting Chapter 9, does not apply to the decisions and actions of administrative bodies located in the European part of the Netherlands for the implementation of legislation that applies only within the public entities.
25. Pursuant to Article 3, paragraph 2, of the Public Bodies Bonaire, Sint Eustatius and Saba Act, in the cases referred to in paragraph 1, the BES Administrative Justice Act (*Wet administratieve rechtspraak BES*, War-BES) applies insofar decisions in the sense of that act are concerned.
26. Based on Article 3, paragraph 1, of the BES Administrative Justice Act, a decision is a written decision by an administrative body which is a legal act under public law and which is not of general scope.

<sup>2</sup> Trade and Industry Appeals Tribunal, 23 April 2013, ECLI:NL:CBB:2013:CA1052, r.o. 3.1.

<sup>3</sup> Act of 17 May 2010 for the introduction of regulation with regard to the public bodies of Bonaire, Sint Eustatius and Saba (Invoeringswet openbare lichamen Bonaire, Sint Eustatius en Saba), Stb. 2010, 346.



27. Pursuant to Article 7, paragraph 1, of the BES Administrative Justice Act, natural persons and legal persons whose interests were directly affected by a decision can appeal against it to the Court of First Instance of Bonaire, Sint Eustatius and Saba (the Court).
28. Based on Article 9, paragraph 1, of the BES Administrative Justice Act, an appeal can be made against a decision on the grounds that the decision conflicts with a generally binding provision or general principle of law.
29. Based on Article 55 of the BES Administrative Justice Act, natural persons and legal persons as referred to in Article 7, paragraph 1, of the BES Administrative Justice Act are authorized to lodge a complaint with ACM to protest the decision, and appeal to the Court after ACM has made a decision pertaining to the complaint.

*Application of the legal framework and legal protection*

30. ACM is located in the European part of the Netherlands and its responsibility is to ensure compliance with the BES Electricity and Drinking Water Act. This Act only applies to the public bodies of Bonaire, Sint Eustatius and Saba. For this reason, the BES Administrative Justice Act (instead of the General Administrative Law Act) applies to the ACM's decisions pertaining to the implementation of the BES Electricity and Drinking Water Act.
31. In this document, ACM sets down the method that forms the basis for the decision on production price and distribution rates. This method is a generally binding provision. The production price for electricity and drinking water as well as the distribution rates for electricity and drinking water are then established by ACM by means of a decision.
32. No (independent) appeal to the Court can be made with respect to the method adopted by ACM and, as this is a generally binding provision, no (independent) complaint can be lodged with ACM either.
33. Natural persons and legal persons whose interests were directly affected by the decision on production price and distribution rates can appeal to the Court or, if they prefer, first lodge a complaint with ACM. The appeal or complaint may also contain arguments opposing the method adopted by ACM.

*Conclusion*

34. In this method, ACM sets down the framework to serve as a basis for the rate decisions. ACM deems this method to be sound, carefully prepared and compliant with (the principles of) the BES Electricity and Drinking Water Act, and therefore with the legislature's intentions.



35. Unexpected circumstances in any of the public bodies may be grounds for changing or adjusting the method's implementation. The Explanatory Memorandum accompanying the BES Electricity and Drinking Water Act also explicitly mentions the specific circumstances on the islands which must be taken into account when organizing the supervision.
36. This change or adjustment will be implemented in the rate decision by ACM insofar as this cannot be put off until the second regulatory period.

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## 4 Regulatory framework

37. In this chapter, ACM describes the principles it applies when drawing up a regulation for the Caribbean Netherlands. We first explain what the Act says about regulation, after which we explain the principles applied by ACM and the choices resulting from them.

*What does the BES Electricity and Drinking Water Act say about regulation?*

38. The general objective of the law is the reliable, sustainable and effective functioning of the electricity and drinking water supply in the Caribbean Netherlands. In the Explanatory Memorandum, this general objective is split into three objectives for rate regulation:
- Consumer protection (against too high rates of a monopolist)
  - Investor protection (enough room for investments; reasonable return for the companies)
  - Efficiency of the companies (sufficient quality at the lowest possible costs)
39. Furthermore, the Explanatory Memorandum states that 'cost orientation' should be the basic principle. This means that the rates for any service provided must be related to the costs of that service as much as possible. For example, the costs for producing drinking water cannot be included in the electricity rates or vice versa.
40. It is ACM's task to set up a method that takes into account the costs that a company incurred *and* that stimulates the company to operate efficiently. These two basic principles must be linked to one another. If only the company's costs were to be taken into account, it would be called a cost-plus regulatory method. If the efficiency incentive was the primary focus, you would have various options. The Explanatory Memorandum lists the following options for stimulating companies to operate efficiently:
- i. Imposing a revenue cut by, for example, imposing a frontier shift, which is an expectation that companies are becoming more and more efficient.
  - ii. Based on studies or on a comparison with other companies in the region, determining what the costs are that comparable companies incur, and designate these as efficient costs ('benchmark').
  - iii. Applying a system such as profit sharing, where the revenues are set and any higher or lower costs are settled with the revenues in a subsequent year.

*ACM tries to find a balance between both of these basic principles.*

41. Imagine we (ACM) chose to set the company's revenues equal to the company's total costs. On the one hand, we would then know for sure that the company is able to recoup its costs (and is thus less likely to run into financial trouble as a result of the chosen regulatory method). On the other hand, the



company would have no incentive whatsoever to reduce costs, because all costs are covered by the rates anyway. Consumers may thus end up paying too much.

42. On the other hand: if we completely went for the efficiency incentive, we would be able to choose not to base the revenues on the company's own costs. For example, we would be able to base the revenues on a comparison of the costs of other companies. We would have the same effect if we set the revenues of a company for a longer period of time (multiple years). In both scenarios, the company would have a bigger incentive to reduce costs, because it would then have more money left (and would be able to make more profit, temporarily). In addition, the fact that the company might have to pay higher costs (or a share thereof) itself is a strong incentive to think about whether or not certain costs are really necessary. The drawback of this method is that the company's revenues and costs could diverge since the link between costs and revenues is weak, thereby resulting (temporarily) in high profits or big losses.
43. One option that takes into account both criteria (both cost-oriented revenues and an efficiency incentive) is the so-called profit-sharing method. This method bases the company's revenues at the start of the regulatory period on the actual costs including a reasonable return. If it turned out afterwards that the company actually incurred costs that were higher (or lower), part of the difference would be borne by the company itself and another part by the consumers.
44. Let us discuss a simplified example to illustrate this<sup>4</sup>. Suppose company A has USD 1 million in costs. The revenues of this company for 2017 would then be set at USD 1 million. We will then look at what the actual costs are in 2017. There are three scenarios:
- i. The company incurred USD 1 million in costs, which is equal to the revenues. We will then again set the revenues for the next year at USD 1 million.
  - ii. The company incurred higher costs, for example USD 1.1 million. The company will thus have posted a loss of USD 100,000. The profit-sharing method means that the company will have to bear part of this loss, for example half of it. We will then set the revenues at USD 1.1 million for the next year (the actual costs of 2017) plus USD 50,000 to compensate for half of the loss. Total revenues for the next year will thus be USD 1.15 million.
  - iii. The company has incurred lower costs, for example, USD 0.9 million. The company will thus have made a profit of USD 100,000. The profit-sharing method means that the company may keep part of this profit, for example half of it. We will then set the revenues at USD 0.9 million (the actual costs of 2017) and subtract USD 50,000 to return half of that profit to consumers. Total revenues for the next year will thus be USD 0.85 million.

<sup>4</sup> In this example we ignore the fact that normally speaking there is a year's delay between the year in which costs were incurred and the year in which they are processed. We will return to this in Chapter 5.2.



45. This method ensures that a company will have an incentive to reduce costs, if possible. These cost reductions will lead to lower revenues, and thus to lower rates, as a result of which, buyers will benefit, too. Moreover, a company would also not run into financial trouble as easily if costs did rise. In that case, the buyers will also pay part of the higher costs.

*What other basic principles are important to ACM when selecting a method?*

46. ACM has a certain degree of freedom when selecting a method. Besides the mentioned requirements that have been set down in the Act, ACM applies the following criteria that are important when making this choice:
- i. Feasibility: the method needs to be feasible in the sense that it actually can be implemented, and the burden on businesses must be as little as possible. This is particularly important in the Caribbean Netherlands because most businesses are small in terms of scale (they usually do not have a separate regulatory department, like most businesses in the European part of the Netherlands do).
  - ii. Explainability: the method needs to be easy to understand for consumers and businesses.
  - iii. Transparency: the method needs to be transparent. Consumers and businesses must be able to see how the rates have been set.
  - iv. The company's own responsibility: ACM does not wish to step into the shoes of the company's executives by, for example, deciding exactly what costs can or cannot be incurred.
47. Of the possible methods described above, ACM prefers the profit-sharing method. This method is relatively simple, and meets the aforementioned criteria. Furthermore, another option (the benchmark) is not possible because a proper comparison between the costs incurred by regulated electricity and drinking water companies in the Caribbean is lacking.
48. The profit-sharing method does justice to the company's own responsibility, and it also creates an incentive to realize cost reductions. Cost reductions eventually lead to lower rates for consumers. With this method, the administrative burden on companies is expected to be limited, even though, especially in the beginning, efforts need to be made in order to provide all of the necessary information.



## 5 Regulatory method

49. In this chapter, ACM describes the way in which it will set the production price and distribution rates for electricity and drinking water. ACM first explains the length of the regulatory period, followed by the manner in which the expected efficient costs are determined and the way in which ACM determines the reasonable return. Lastly, ACM will explain the way in which the energy costs are determined.

### 5.1 Length of the regulatory period

50. On the basis of the Ministerial Regulation, ACM may choose to set the method for a period of three to ten years. The advantage of a longer period is that companies have certainty and clarity for a long period on the way in which the rates are set. Moreover, in case of a longer period the workload for both the regulator and the regulated companies and other interested parties is less burdensome.
51. The advantage of a shorter regulatory period is that changes or adjustments to the method can be made relatively quickly. Because there is a new act involved, and because the setting of rates by an external regulator is new to all interested parties, ACM chooses to keep this first regulatory period as short as possible, i.e. three years. This means that this period runs from 1 January 2017 up to and including 31 December 2019.

### 5.2 Calculating the expected efficient costs

52. Based on the regulatory framework and the principles applied by ACM (see Chapter 4), ACM opts for a so-called profit-sharing method when setting the rates. This method will encourage effective business practice and provide a reasonable economic return. Moreover, this method helps to provide electricity and drinking water reliably, sustainably and effectively.
53. In this chapter, we explain how a profit-sharing method results in rates. This takes four steps:
- Step 1: Determining the costs
  - Step 2: Determining how those costs result in revenues
  - Step 3: Determine how those revenues result in rates
  - Step 4: Determining how afterwards any difference between costs and revenues may be settled.

*Step 1: Determining the costs (as rates must be based on costs)*



54. Before ACM determines the efficient costs of a company, it first determines that company's 'regulatory costs'. These regulatory costs are the costs which ACM uses for regulatory purposes. ACM distinguishes between two categories of regulatory costs for companies: capital costs (including a reasonable return) and operational costs. When determining the regulatory costs, in the first instance ACM will use the annual accounts that companies produce (or cause to be produced) and which have been checked by an independent accountant.
55. In principle, ACM will always use the most recent annual accounts that were checked by the accountant. In practice this means that ACM will be using the costs for 2015 as a point of departure for calculating the rates for 2017. At the start of the regulatory period ACM also determines the starting value of the companies' assets. ACM sets this down in the method or in the rate decisions.
56. It is possible that the annual accounts do not contain all the information that ACM needs to set the rates, or that not all of the costs have been allocated to a company's various activities. ACM will then ask for this information by means of a request for information. ACM can ask companies to supply an independent accountant's statement to accompany the information provided, in order to ensure the reliability of the regulatory costs.
57. If it should prove necessary in the future, ACM can set down more extensively and in greater detail what information is required to determine the regulatory costs. For this purpose, ACM can lay down Regulatory Accounting Rules (RAR) in consultation with the companies (similar to the RARs that ACM lays down in the European Netherlands for regulating electricity and natural-gas network operators).
58. ACM can apply adjustments to the data in the annual accounts and any additional information that may have been obtained. For example, when determining the regulatory costs ACM will not include any costs that were not required for implementing the statutory tasks. ACM can also make adjustments for reasons of comparability with other companies and/or consistency with other years.
59. For example, ACM may calculate the value and depreciation of assets differently from the appreciation and depreciation as recorded in the annual accounts. ACM applies the principle that assets are appreciated at their historical cost price and that any contributions by third parties (e.g. subsidies) are subtracted from the activated expenditure.
60. In its rate decision for a company, ACM sets down which changes ACM may have made to the costs or other data as checked by the accountant, as well as ACM's grounds or purpose for doing so. If it should prove necessary in the future, ACM can lay down the accounting principles that it applies in more expansive and detailed form (comparable to the Regulatory Accounting Rules (RARs) and lays down in the European Netherlands for regulating electricity and natural-gas network operators).



61. ACM does not regard penalties as operational costs to be taken into account when setting the rates, because this would mean that penalties (which can be avoided by management and therefore cannot be regarded as efficient costs) could be passed on to consumers. There can be no question of this. ACM will also take a critical look at allocations to provisions, instead of simply including these as operational costs when setting the regulatory costs. The reason for this is that these allocations do not necessarily provide a reliable estimate of future costs. In addition, ACM may average costs over several years in case of incidental costs or large cost fluctuations.
62. In the rate decision for a company, ACM records any changes that ACM may have made, as well as ACM's grounds or purpose for doing so.
63. Lastly, the amount of the reasonable return is an important element when determining the capital costs. The question is what amount an electricity or drinking water company may remunerate the investors in that company (banks, company shareholders). ACM determines this in the same way that it does for the European Netherlands. Using a standard method, the reasonable return or WACC (weighted average cost of capital) is determined. Naturally, ACM will take into account the circumstances in which companies in the Caribbean find themselves (e.g. what risk a company runs, in which markets it is active, et cetera). In Annex X ACM describes in detail how this matter was investigated. The results of this investigation lead to the following WACC remuneration or remunerations. This WACC applies to the entire period during which the method applies.
64. The amount of the WACC will be set by ACM in the definitive method. ACM will consult separately with interested parties on the substantiation of the WACC before AMC decides on its amount.
65. After the regulatory costs have been determined, the costs must be distributed objectively across various different components within the company. For this purpose, clear definitions and clear accounting rules are very important, as the rates for the various activities must ultimately be based on the related costs. ACM will ask the companies to submit a proposal for distributing the costs on the basis of transparent and objective criteria. ACM will test this proposal on the basis of generally accepted accounting principles and will, if necessary, set this down in an RAR for the Caribbean Netherlands. Generally accepted accounting principles assume, for example, that costs and assets are distributed in the first instance on the basis of demonstrable causality (direct costs). Costs that cannot be distributed in that manner (indirect costs, such as office, management and support costs) are allocated on the basis of the following criteria: reflection of the deployment of means of production, consistency and transparency.
66. The company will, in the first instance, distribute the costs between drinking water and electricity. If a company also has other activities (WEB, for example, also processes waste water), the relevant



costs must be distinguished clearly and certainly not be included in the costs for electricity or drinking water.

67. Then we separate the production costs and the distribution costs, both for drinking water and for electricity.
68. Step 1 as described in this section results in an overview of the regulatory costs for a specific year distributed across the activities. This involves the following activities:
  - The production of drinking water
  - The distribution of drinking water
  - The production of electricity
  - The distribution of electricity
69. ACM sets down this result in the decisions on production price and distribution rates. In the proposal for those decisions, a company may indicate in what way the costs are distributed and which distribution keys the company applies. ACM assesses this proposal (as mentioned above on the basis of the criteria of objectivity, transparency and generally accepted accounting principles) and sets down the ultimate distribution of the costs per activity in the decisions on production price and distribution rates.

*Step 2: From costs to revenues (incentivizing efficient operations)*

70. As explained in the preceding section, the costs of a company are not remunerated on a one-on-one basis, because that would insufficiently incentivize the company to realize cost savings. The profit-sharing method does provide an incentive to reduce costs, as part of the cost savings may be kept by the company. After that, the cost savings are passed on to consumers, as the rates for the following year will be set lower. In relation to this step we explain how we apply the notion of 'profit sharing' and in what way the costs determined in step 1 ultimately result in revenues. We perform this step for each activity, separating the production of electricity and drinking water as well as the distribution of electricity and drinking water.
71. Profit sharing involves part of the difference between the costs and the revenues being borne by the company itself. The exact percentage to apply is determined specifically. In theory, this could differ per island or per company. Because there is no reason as yet to apply different percentages per public body or company, ACM opts for a percentage of 50 during the first regulatory period, regardless of whether a company made a profit or a loss. In concrete terms this means that if a company incurs lower costs than previously determined – thus making a profit through efficient operations – the company is entitled to keep 50% of its profit and will pass on 50% to consumers in the first year this is possible in the form of rate reductions. The same logic applies in case of a loss,



when a company incurred higher costs than previously determined. In that case, the company must bear 50% of that loss itself and may pass on 50% to consumers in the form of a rate increase the first year this is possible.

72. Profit sharing entails that the revenues are based on a company's determined costs, as set down in step 1. This has the disadvantage of a slight delay, however, as the costs will only be known in retrospect while revenues are determined in advance. For example, the costs incurred by a company in 2015 will only be known in 2016. On the other hand, the revenues for 2017 must be determined in 2016, i.e. in advance. This means that the costs and the revenues will always be two years apart<sup>5</sup>. In the meantime, things may have changed.
73. ACM takes into account any differences between the costs determined for a year and the adjustments expected for the year for which the revenues must be estimated. In this method, ACM sets down in what way and for which costs items it does so. Then, in the rate decisions, ACM sets down the concrete adjustments to the costs which this results in.
74. The energy costs can fluctuate considerably. For this specific component, ACM estimates the costs for the coming years in a specific manner (see section 5.3).
75. It is possible that companies expect the costs to rise (or decrease) over a number of years as a result of extensive investment programs (or more sustainable production methods, resulting in lower fuel costs). ACM may take these estimations into account when determining the revenues. The Quality and Capacity documents that the companies will draw up in the coming two years may also be taken into account. When submitting a rate proposal, a company can indicate what additional costs (or cost reductions) are expected for the year in question and why these costs are reasonable and necessary. ACM will assess this and set down in the rate decision in what way it will handle this. In principle, ACM will exercise restraint in adopting companies' estimates and will require an extensive substantiation of such estimates.
76. ACM will also take inflation on the islands into account and will correct this inflation in order to translate costs for one year into revenues for another.
77. ACM has also considered already taking into account efficiency improvements, by using sector-wide data and imposing this frontier shift on the companies. This could mean, for example, that ACM lowers the costs for 2015 with 2% annually in order to determine the estimated costs for 2017. After all, as a result of improving technologies and increasing labor productivity companies are able to work more efficiently every year. The percentage can be based on sector-wide information on

<sup>5</sup> Any regulatory method that bases revenues on costs is subject to this delay, not just profit sharing.



realized productivity improvements. Because at the start of the regulation ACM prefers a pragmatic and relatively simple approach, it is omitting this frontier shift for the moment. When determining a future method, ACM will reconsider if this is desirable. In any case, the profit-sharing method incentivizes companies to exploit the efficiency benefits resulting from technological improvements.

78. This second step will result in the total revenues for each activity (production and distribution of drinking water and electricity respectively) for a specific year. ACM records these total revenues in the rate decisions.

*Step 3: From revenues to rates (as ACM ultimately assesses rates, not revenues)*

79. In this step we distribute the revenues from step 2 across the different categories for which there are rates. We will first explain this for production, then for distribution.
80. For production the procedure is relatively simple, as only one maximum rate applies that the producer may charge to the distributor for each kWh of electricity or cubic meter of drinking water. In order to be able to translate the revenues determined in step 2 into a rate, an estimate is required of the quantities of electricity and drinking water which a producer will be producing in a specific year and which the distributor will purchase. This estimate has to be reliable, i.e. based on previously realized amounts and substantiated with any expected mutations for the year for which the amounts are being estimated. If it turns out to be incorrect in retrospect, it will be corrected. This correction will be taken into account when determining the revenues and rates for the subsequent year (see step 4). Production companies will provide the estimate (including its substantiation) together with the rate proposal. ACM will assess whether the estimate is reasonable and then set down the total expected production in the production price decision. ACM determines the energy costs as a component of the product price independently (see section 5.3).
81. Whenever there are multiple producers in a public body, ACM will also set down multiple production prices. This will be the case on Bonaire, for example, where both ContourGlobal and WEB produce electricity. When calculating the variable distribution rate (see below) ACM will weight these production prices based on the expected total production.
82. For distribution, the calculation is a little more complicated. This is because there are various rate categories for distribution: the fixed consumption rate, the variable consumption rate, the connection rate, the reconnection fee and (for drinking water distributed by trucks) the road transport rate. Furthermore, within a rate category, a distributor may charge different rates for different groups of consumers, provided that this distinction is justified by the costs that the company incurs for those specific groups of consumers. For example:



- In a technical sense, large customers have bigger connections than households. A distributor can show how much the various kinds of connections cost to set up, resulting in a connection rate for each category.
- It is possible that a distributor provides more extensive customer service to certain groups of consumers (hotels or other businesses, for example) or spends significantly more working hours on these than on households. In that case, the fixed consumption rate for those categories will differ from that for households. The distribution company must be able to substantiate this on the basis of objectively verifiable data.

83. Lastly, there is one more reason why calculating the distribution rates is a little more complicated than calculating the production price: for the distribution companies in the Caribbean Netherlands, subsidies are available from the Ministry of Infrastructure and the Environment and the Ministry of Economic Affairs. The aim of these subsidies is to make the costs that consumers pay for the network (the fixed consumption rate) is closer to what consumers in the European Netherlands pay for using the network.
84. For the purpose of distributing the distributor's revenues across the various categories, ACM proposes a pragmatic approach. The distributor proposes a distribution based on the manner in which the costs have been distributed across these various categories. The distributor also determines which (technical) categories it wishes to apply. ACM assesses this and sets it down in the method. Both the categories and the cost distribution will then apply throughout the entire first regulatory period and will be recorded by ACM in a table included in the method.

Category	Variable distribution costs	Fixed distribution costs	Connection costs	Reconnecti on costs	Costs for transport by truck
Rate group 1 (households)	... %	... %	... %	... %	... %
Rate group 2 (businesses)	... %	... %	... %	... %	... %
Rate group 3 (...)	... %	... %	... %	... %	... %
Etc.	... %	... %	... %	... %	... %



85. We then distribute the distributor's revenues as determined in step 2 across the various categories on the basis of the percentages from the preceding table. This will result in the revenues per category, which will be set down in the rate decisions for each company.
86. In order to calculate the rates, we need to know the number of connections per category. That may be an estimate, as companies cannot know in advance exactly how many new connections there will be or how many customers will be disconnected and reconnected. Together with their rate proposal, the companies submit an estimate of the numbers of connections per category for the year for which the rates are being set. These estimates are based on previously realized amounts and substantiated with the expected mutation for the year involved. ACM assesses this for reasonableness and sets the numbers down in the rate decisions.
87. If the revenues for each category are divided by the number of connections for each category, the rates per category are the result. In order to determine the fixed consumption rate, the subsidy is first subtracted from the total fixed distribution costs, after which the rate is determined (through division by the number of consumers).
88. The rate for Pagabon is set in a slightly different manner. Consumers with Pagabon do not pay a fixed consumption rate. In order to ensure that the distributor can recover its fixed costs, the variable rate (the production price) is increased with a small surcharge. The surcharge is calculated by dividing the fixed consumption rate by the 'Pagabon consumption'. This consumption was set by a Ministerial Regulation at 2,500 kWh for electricity and 40 cubic meters for drinking water.
89. The rate for drinking water distributed by truck (in places where there is no distribution network) is set according to a different procedure. A consumer that purchases water transported by truck will pay the same variable consumption rate per cubic meter of drinking water as a consumer that uses the drinking water network. The only difference is that a consumer that purchases water transported by truck will also pay the costs incurred by the distributor for delivering drinking water by truck. These fixed costs are converted into an amount in USD per cubic meter of drinking water (see Article 3.18, paragraph 3, of the BES Electricity and Drinking Water Act).
90. In order to be able to make this calculation, the distributor must indicate the estimated quantity of drinking water distributed by truck in its rate proposal. The total costs for the distribution of drinking water supplied by truck are then divided by this quantity, resulting in the road transport rate for drinking water, added to the production price.
91. This third step results in the rates that a company is allowed to apply in a specific year for each activity and each individual category. ACM sets this down in the rate decision.



*Step 4: Determining how to handle differences between costs and revenues subsequently*

92. The profit-sharing method encourages efficient business practice at companies, for example by realizing cost savings. These are realized by looking afterwards at the difference between the determined revenues and the costs incurred by the company. A percentage of this difference is then offset against the revenues during a subsequent year. There may be grounds for making exceptions, as turned out to be the case in step 3. For example, if a company has indicated in advance that it will be producing 1 million m<sup>3</sup> of drinking water, but that amount turns out to be only 0.9 million m<sup>3</sup>, then the company will also have incurred lower costs. Or, if a company estimated to incur an additional USD 100,000 in costs as a result of additional investments, and only half of this amount was in fact incurred, ACM will not regard this as an improvement in efficiency, but as an incorrect estimate that must be corrected first.
93. In other words, ACM will first correct estimation errors with regard to the determined revenues and costs incurred for these estimation errors (and for changes resulting from the energy costs: see section 5.4). ACM then considers the difference between the determined revenues and the (corrected) costs incurred. This step will result in a total amount of correction revenues. These revenues are implemented in the following calendar year and used in step 2 for that new calendar year (from costs to revenues). ACM sets down this calculation in the rate decisions.

### 5.3 Calculating the reasonable return

94. In the definitive version this section contains an extensive description by ACM of the manner in which the WACC for the Caribbean Netherlands is determined.

### 5.4 Energy costs

95. The BES Electricity and Drinking Water Act provides a number of principles for setting the energy costs as part of the production price:
- The production price includes, among other things, the energy costs (Article 2.5, paragraph 2)
  - The energy costs can be set as a monthly variable part of the production price (Article 2.5, paragraph 3)
  - The variable consumption rate takes account of the production price (Article 3.17, paragraph 1) and can be set on 1 January and 1 July (while the fixed rates can only be set on 1 January) (Article 3.14, paragraph 6)
96. In the Explanatory Memorandum, the legislature also considers the following in this regard:  
*“Regarding the frequency with which the rates are adjusted, a number of factors is relevant.*



Consumers benefit from predictability, such as prices that are fixed for a longer period. In addition, they (and especially consumers in a vulnerable financial position) benefit from having to pay no, or only limited, subsequent payments (and, vice versa, receiving repayments). However, as the production costs are largely dependent on the oil price, the producer benefits from being able to pass on any changes to the oil price in the production price for electricity quickly. A final relevant factor is the fact that the feasibility of the rate regulation by ACM, as in the European part of the Netherlands, benefits from a low frequency of rate adjustments.

The proposed act strikes the following balance between these interests. The production price which the producer charges to the distributor (which will be an internal transfer price in the case of an integrated company) is set each time for a period of one year for the capital costs and operational costs. An exception to this are the costs of fuel or other energy, such as electricity in the case of a drinking water producer. Instead of applying a price (in USD per kWh or cubic meter) that is set for a year for these energy costs, ACM can set a variable component, related to the realized monthly oil price, which the producer charges to the distributor through the production price. The distributor can change the variable rate which it charges to consumers every six months, and the fixed consumption rate annually. This means that in case of very volatile energy prices the distributor will charge too much or too little for a number of months. In the subsequent six-month period, the distributor can offset this in the prices to be set anew for that period by means of subsequent calculation. In this system, consumers can anticipate rate adjustments well in advance. This system is comparable to the open-ended contracts used in the energy market in the European part of the Netherlands.”

97. The Ministerial Regulation specifies that it will be set down in the method in what way the energy costs are set as part of the production price. In the explanation accompanying this Ministerial Regulation the following is stated on this matter: “A connection to, for example, publicly quoted prices of oil products in the region would be the obvious choice here, as this incentivizes purchasing as cheaply as possible, as opposed to a method according to which the realized purchase price can be put down as costs in its entirety.”
98. Energy costs as part of the production price apply to both drinking water and electricity. In the case of drinking water, the energy costs are the electricity costs that have to be incurred to produce drinking water. In the case of electricity, they are the costs that have to be incurred to produce electricity using diesel generators. The Act prescribes describing specifically how to handle the fuel costs, as oil prices can fluctuate strongly, which should not lead to large rate fluctuations or liquidity problems for the producers. At the moment, all companies have the possibility of adjusting the rates per month, based on changing fuel costs.
99. With regard to the energy costs, ACM is to make the following choices:
- Are there grounds for setting the energy costs as a monthly variable part of the production price?
  - Are there grounds for adjusting the variable consumption rate biannually?



- Are the approaches used for drinking water and for electricity the same?
- In what way does ACM set the energy costs?

100. ACM will describe the consequences of and considerations with regard to these choices.

*How often does ACM set the energy costs?*

101. Setting the energy costs as a monthly variable part of the production price has the following consequences. ACM will *de facto* set the production price per month, which may vary every month, on the basis of a formula set out in the method. The distributor will pay the producer this variable production price each month for the quantity of electricity and drinking water produced. However, the distributor cannot account for this in the variable distribution rate on a monthly basis, as Article 3.14, paragraph 6, of the BES Electricity and Drinking Water Act only allows this to be done twice per year at the most. If ACM decides against setting the energy costs as a part of the production price that can be adjusted monthly, then the variable consumption rate can also not be adjusted biannually.
102. The way in which ACM sets down the energy costs, possibly performing a subsequent calculation<sup>6</sup>, results in companies ultimately being remunerated for the efficient energy costs, in all cases and regardless of monthly variations. ACM's decision to vary on a monthly basis or not, as referred to in Article 2.5, paragraph 3, of the BES Electricity and Drinking Water Act, only has consequences for *the moment when* the production companies recover the efficient costs, not for the question *if* they can recover these costs. In other words, ACM's decision is mostly informed by the question whether companies are capable of prefinancing any losses in case of increasing fuel prices, or whether that would mean an unreasonable financial disadvantage for the companies. Another question relevant to that decision is whether consumers may find themselves confronted with large rate increases if it were decided to recover the energy costs on an annual basis only. On the other hand, less frequent adjustments may also result in more stable rates, as rate increases and rate decreases may partially cancel each other out.
103. ACM holds to the principle chosen by the legislature that rates are set once per year, namely on 1 January. This will provide consumers with certainty regarding their rates for the coming year. This is an important principle, not just for the residents of Bonaire, Saba and Sint Eustatius, but also for the businesses situated on those islands which are active in the tourism sector, for which certainty regarding the rates is important. ACM wishes to handle energy costs in the same way, only deviating from the annual rate adjustment in exceptional cases.

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<sup>6</sup> Subsequent calculation means determining the real costs afterwards and offsetting the difference in a subsequent year.



104. Such an exceptional case may be determined by ACM based on the specific circumstances of a company, examples of which would be, among other things, the company's size, the options it has for prefinancing rate fluctuations temporarily, or the number of connections a company has.
105. In this draft method ACM applies the principle that, for all companies in the three public bodies, ACM will set rates once per year. These rates will be valid from 1 January of the relevant year. ACM may deviate from this principle if specific circumstances, indicated by interested parties, give it cause to do so. ACM will take a final decision on this matter in the definitive method. Companies and interested parties that are of the opinion that a semi-annual and monthly adjustment of the energy costs is necessary, in the sense of Article 2.5, paragraph 3, and Article 3.14, paragraph 6, of the BES Electricity and Drinking Water Act, will have to substantiate what specific circumstances are relevant in this.
106. For drinking water, the energy costs are the electricity costs. This means that the production price of the energy costs may vary. If the energy costs are not varied for electricity, this will not be required for drinking water, either. If it is decided to set the energy costs on a monthly basis as part of the production price for electricity, ACM will investigate if this is required for drinking water as well. In that case, ACM will ask the companies to provide insight into the costs of producing drinking water in relation to the electricity costs of the production price of electricity when producing drinking water (and, more specifically, the energy costs' share in this). If this share is low, for example, it is reasonable that ACM will not set the energy costs as a monthly variable part of the production price. If the share does turn out to be significant, ACM will do so. ACM will set this down in the definitive method.

*How does ACM determine the energy costs?*

107. ACM sees no grounds for one-on-one remuneration of the actually incurred costs, as this does not incentivize production companies to purchase fuel more efficiently. Nor does ACM want to prescribe the manner in which producers should organize their purchasing, or for what term they should be entering into purchasing contracts or in what way they should cover risks. It is ACM's opinion that the companies themselves are responsible for their operations. ACM does not want to take on any of a company's management's responsibilities.
108. A negative effect of the application of profit sharing to the energy costs is that a producer may benefit or be disadvantaged if the oil price increases. For energy costs, the legislature has made an explicit legal exception. Insofar, there is no obligation to apply profit sharing to energy costs.
109. That is why ACM opts for the possibility mentioned in the explanation of the Ministerial Regulation, which is to link to a public oil price index and to calculate (by means of a formula) what the energy costs for the production of electricity on the basis of that price index would be.



110. After consultation with the producers, ACM will set this formula down in the definitive method. ACM will determine the formula on the basis of the technical specifications of the generators and the fuel types used by the generation plants.

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## 6 Responses from interested parties

111. In the definitive method this section will contain a summary of the responses to this draft method by interested parties. In this section ACM will substantiate in what manner those responses were taken into account when establishing the definitive method.

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## 7 Provisions

The Authority for Consumers and Markets sets down a method as referred to in Article 2.5, paragraph 4, and Article 3.14, paragraph 5, of the BES Electricity and Drinking Water Act.

This method applies from 1 January 2017 up to and including 31 December 2019 according to the description in this method.

This method will be announced in the Government Gazette. Furthermore, the Authority for Consumers and Markets will publish this decision on the Authority for Consumers and Markets' internet page and on the internet page of the Rijksdienst Dutch Caribbean.

The Hague,  
[date]

Authority for Consumers and Markets  
on its behalf,

Chris Fonteijn  
Chair of the Board

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Given Article 7, paragraph 1, of the BES Administrative Justice Act, this method cannot be subject to an (individual) appeal or complaint. Interested parties that are directly impacted by the rate decisions that are adopted by ACM on the basis of this method can resort to legal means with regard to those decisions. They can then provide arguments against this method in their complaint of appeal.



## Annex 1 – Summary of the elements set down in the method as well as the elements set down in the rate decisions

In this method ACM sets down:

- The length of the regulatory period (three years)
- The starting value of the assets of all regulated companies
- The amount of the WACC
- The method of regulation (profit sharing) including the percentage (50%)
- The rate categories applied by each distributor
- A table for each distributor containing the distribution (in %) of the distribution costs across these categories

In its rate proposal, a company provides the following information:

- Annual report including an accountant's audit (may precede the rate proposal in time)
- If applicable, an estimate of increased costs resulting from investments or other matters (including a substantiation of their purpose and necessity)
- Producer: estimate of the produced quantity for the coming calendar year
- Producer: proposed calculation of the production price based on the method
- Distributor: a table containing an estimate of the number of connections for each rate category and, for drinking water, an estimate of the number of cubic meters of drinking water to be distributed by truck
- Distributor: proposed calculation of the rates per category based on the method

Rate decision (per company):

- Determination of the cost basis (based on the annual report of the most recent financial year, if possible with a number of adjustments (given the description of how ACM handles costs) and distributed across production/distribution and drinking water/electricity)
- Determination of the revenues (based on costs, if necessary adjusted with estimates for investments or other changes)
- For production price: determination of the total quantity produced
- For production price: the production price (including the size of the fuel share)
- For distribution rates: determination of the numbers of connections
- For distribution rates: the distribution rates including the rates for road transport and for Pagabon