



Please note that, although every effort has been made to ensure this translation is accurate and consistent, it is for informational purposes only. In case of any dispute or inconsistencies, the Dutch version is authentic.

Our reference: ACM/DE/2016/205454

Case number: 16.0635.53

METHOD FOR SETTING THE TARIFFS FOR THE PRODUCTION AND DISTRIBUTION OF ELECTRICITY AND DRINKING WATER IN THE CARIBBEAN NETHERLANDS 2017–2019

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



Contents

Summary.....	3
1 Introduction and reader's guide	6
2 Procedure and rationale for the formation of the method	8
3 Legal framework	9
4 Regulatory framework.....	12
5 Regulatory method	15
5.1 Length of the regulatory period	15
5.2 Calculating the expected efficient costs.....	15
5.3 Calculating the reasonable return.....	24
5.4 Energy costs	24
6 Responses from interested parties	30
6.1 Opinion of ContourGlobal	30
6.2 Opinion of Bonhata	36
6.3 Opinion of the Saba Electric Company.....	37
6.4 Opinion of the Bonaire Hospitality Group (BHG)	40
6.5 Opinion of Water- en Energiebedrijf Bonaire	41
7 Provisions	45



Summary

1. In this method, the Netherlands Authority for Consumers and Markets establishes the method of how it sets the tariffs for drinking water and electricity for the islands of Bonaire, Saint Eustatius and Saba. ACM has been charged with this task pursuant to the BES Electricity and Drinking Water Act, which came into force on July 1, 2016.
2. This method applies to the period of January 1, 2017 through December 31, 2019. This period is called the first regulatory period. ACM uses this method for the setting of tariffs of both producers and distributors of electricity and drinking water. This concerns the following undertakings:
 - a. Water en energiebedrijf Bonaire N.V. (WEB)
 - b. ContourGlobal Bonaire B.V. (ContourGlobal)
 - c. Statia Utility Company N.V. (STUCO)
 - d. Saba Electric Company N.V. (SEC)

What is the background of this method?

3. In the spring of 2016, ACM first drew up an *Explanation of tariff regulation in the Caribbean Netherlands Starting Document*. In this document, ACM explains its intended design of the tariff regulation. In July 2016, ACM subsequently drew up a draft method, and put this out for consultation. Interested parties such as utility companies and buyer organizations were given the opportunity to respond to this draft method. Based on these responses, ACM set the definitive method on September 12, 2016. ACM has published all responses on its website, and has explained in the definitive method how it has processed these responses.

Legal framework

4. The method that ACM must establish under said act forms the framework that is used for the tariff decisions. Interested parties cannot file objections or appeals against this method. However, they can do so against the tariff decisions. And in legal proceedings against the tariff decisions, interested parties can also put forward arguments against the method.

Regulatory framework

5. The aim of the BES Electricity and Drinking Water Act is to have a secure, affordable, and sustainable supply of electricity and drinking water in the Caribbean Netherlands. The tariff regulation needs to ensure that companies are stimulated to operate efficiently, but also that companies are able to make their investments. ACM has opted for the so-called profit-sharing method. This method means that ACM estimates in advance what the costs of the company will be. If it turns out afterwards that a company has incurred lower or higher costs, half of that overestimation or underestimation will be borne by or be given to the company itself, and the other half by or to consumers.



6. This will ensure that a company will seek to save costs so that it will have more funds left. These funds can be spent on projects or, for example, on dividend payments to the shareholder (the Public Body).
7. If a company manages to save money, ACM will then set the revenues lower for the subsequent year. The tariffs will also be set lower. In that way, consumers will also benefit from cost savings that the company achieves.

Method of regulation

8. The method of profit-sharing consists of four steps:
 1. Determining the costs. ACM follows the actual costs of the company. ACM will still be able to make adjustments, for example if not all costs that the company incurs are associated with the statutory tasks of the company. The costs consist of the operational costs and the capital costs. Capital costs are the depreciations and a reasonable return that a company is allowed to earn. The total costs of the company are split into costs for drinking water and costs for electricity and for the production and distribution of both utilities.
 2. From costs to revenues. ACM adjusts the actual costs from a previous year for inflation and, for example, planned investments. This will result in the company's revenues for the subsequent year.
 3. From revenues to tariffs. Next, these revenues need to be converted into tariffs. The law determines what tariff categories can exist (for both drinking water and electricity):
 - a. The fixed consumption tariff for covering the network costs, including the measurement, prevention and solving of disruptions;
 - b. The variable consumption tariff for covering the production price that the distributor pays to the producer;
 - c. The connection tariff for covering the costs incurred when connecting to the network;
 - d. The reconnection fee for covering the costs of reconnecting a buyer that had previously been disconnected;
 - e. The road transport tariff for drinking water that is distributed by truck, for covering the costs of transporting drinking water by truck.

For all of these tariff categories, ACM calculates the tariff by distributing the revenues from step 2 among these categories, and by dividing them by the number of buyers per category.

4. Settling any differences afterwards. At the end of a calendar year, it can be examined whether the revenues as determined by ACM are equal to the actual



costs of the company. If the costs turn out to be higher or lower, 50% of that difference will go to or will be borne by the company. ACM will settle the other half with the revenues (and the tariffs) of the subsequent year.

9. ACM had a study carried out to determine what a reasonable return is for utility companies. This reasonable return is called the Weighted Average Cost of Capital (WACC).
10. The fuel costs for the production of electricity can vary, because those costs depend on the oil price. The producer is therefore allowed to adjust the production price every month. For the first regulatory period, ACM will use the actual costs that the producer pays for the fuel. For the subsequent regulatory period, ACM also wishes to investigate for the purchase of this fuel whether or not an incentive can be created to make the purchasing process as efficient as possible.
11. Under the act, the distributor is allowed to adjust the variable consumption tariff as a result of adjustments in the production price no more than twice a year, which is on July 1 and January 1.

Responses from interested parties

12. ContourGlobal, WEB, STUCO, SEC, Unkobon, Bonhata and Bonaire Hospitality Group have submitted their responses to the draft method and/or the draft WACC method. Based on these responses, ACM has made several adjustments. The biggest adjustment is the opportunity to change the production price every month as a result of changes to the fuel costs.
13. Furthermore, ACM has explained for each opinion whether or not it has led to any changes to the method, and ACM has also clarified several parts of the method.



1 Introduction and reader's guide

6/45

14. In this document, the Netherlands Authority for Consumers and Markets (hereinafter: ACM) sets down the method which it adopts under Section 2.5, paragraph 4, and Section 3.14, paragraph 5, of the BES Electricity and Drinking Water Act¹. Under these sections, 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 tariffs for electricity and drinking water.
15. 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).
16. The BES Electricity and Drinking Water Act only applies to Bonaire, Saint 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.
17. The method to be adopted by ACM applies to the following companies:
 - Water en Energiebedrijf Bonaire N.V. (WEB)
 - ContourGlobal Bonaire B.V. (ContourGlobal)
 - Statia Utility Company N.V. (STUCO)
 - Saba Electric Company N.V. (SEC)
18. 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.
19. ContourGlobal is an electricity producer on Bonaire.
20. STUCO is a producer and distributor of both electricity and drinking water on Saint Eustatius.
21. SEC is a producer and distributor of electricity on Saba.
22. This method also applies to undertakings, entities or legal entities which, during the regulatory period, either as a result of a merger or a change of name or legal form, are granted a license by the Minister of Economic Affairs and/or the Minister of Infrastructure and the Environment to produce electricity and/or drinking water in the Caribbean Netherlands. The foregoing also applies to undertakings, entities or legal entities which are appointed distributor of electricity and/or drinking water by the Ministers referred to.

The structure of this document

23. 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

¹ Law of 23 March 2016, containing rules for the production and distribution of electricity and drinking water on Bonaire, Saint Eustatius and Saba (*Wet elektriciteit en drinkwater BES*), *Government Gazette* 2016, 142.



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.

Annex to this document

24. ACM has attached one annex to this document. In the so-called WACC Annex, ACM describes the Weighted Average Cost of Capital method (WACC).
25. 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. On this website, ACM has also published the opinions provided by interested parties about the draft method and about the WACC on its website, insofar as the interested parties have given permission to do so, given the possibility that confidential business data may be contained in the opinion. This concerns the opinions of the following interested parties:
 - ContourGlobal
 - Bonaire Hotel and Tourism Association (Bonhata)
 - Bonaire Hospitality Group (BHG)
 - SEC
 - WEB
 - STUCO
26. On 7 July 2016, ACM enabled buyer's organizations to present their thoughts and questions based on the draft method during a meeting organized by ACM. At the meeting, ACM explained the draft method. The meeting was attended by representatives of Unkobon, Bonhata and the Bonaire Business and Employers Association (BBE).
27. For determining the WACC method, ACM had Boer & Croon Corporate Finance conduct external research. ACM published the findings of this research on its website.



2 Procedure and rationale for the formation of the method

28. In this chapter, ACM describes the procedure it adopted for the formation of this method.
29. 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 tariff for electricity and drinking water. The production price is charged by the producer to the distributor. The distribution tariff is charged by the distributor to the purchaser (the consumer).
30. Under the Act, the production price and distribution tariff 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, as laid down in section 2.1, paragraph 1 of the Ministerial Decree setting out rules concerning the production and distribution of electricity and drinking water on Bonaire, St. Eustatius and Saba. The method is adopted for a period from three to ten years.
31. In this method, ACM describes how the production price and the distribution tariffs 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 secure, sustainable and effective functioning of the electricity and drinking water supply in the Caribbean Netherlands.
32. 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.
33. 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 tariff regulations in the Caribbean Netherlands and how the tariff regulation is ultimately set down in decisions on tariffs. The Starting Document mentioned has been published on ACM's website.
34. In the present – definitive – method, ACM took into account the written opinions (submitted on time) in its assessment. Chapter 6 contains a summary of these opinions, and ACM's responses thereon.
35. On August 15, 2016, ACM published the draft method for determining the WACC. In connection therewith, ACM received various opinions. In the definitive WACC method, which ACM will publish later in 2016, ACM will indicate in what way these responses have been taken into account in the determination of the definitive WACC.



3 Legal framework

9/45

36. Under Section 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.
37. Pursuant to Section 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.
38. Under Section 3.14, paragraph 1, of the BES Electricity and Drinking Water Act ACM sets down the maximum tariffs to be charged by the distributor to the consumers for the distribution of electricity and drinking water.
39. Pursuant to Section 3.14, paragraph 5, of the BES Electricity and Drinking Water Act, for setting the distribution tariffs for electricity and drinking water respectively ACM will adopt a method which encourages effective business practice.
40. The method as referred to in Section 2.5, paragraph 4, and Section 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 to².
41. Section 3, paragraph 1, preamble and part a, of the Public Bodies Bonaire, Saint Eustatius and Saba Act³ 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.
42. Pursuant to Section 3, paragraph 2, of the Public Bodies Bonaire, Saint 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.
43. Based on Section 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.

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

³ Act of 17 May 2010 for the introduction of regulation with regard to the public bodies of Bonaire, Saint Eustatius and Saba (Invoeringswet openbare lichamen Bonaire, Sint Eustatius en Saba), *Government Gazette*. 2010, 346.



44. Pursuant to Section 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, Saint Eustatius and Saba (the Court).
45. Based on Section 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.
46. Based on Section 55 of the BES Administrative Justice Act, natural persons and legal persons as referred to in Section 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

47. 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, Saint 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.
48. In this document, ACM sets down the method that forms the basis for the decision on production price and distribution tariffs. This method is a generally binding provision. The production price for electricity and drinking water as well as the distribution tariffs for electricity and drinking water are then established by ACM by means of a decision.
49. 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.
50. Natural persons and legal persons whose interests were directly affected by the decision on production price and distribution tariffs 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

51. In this method, ACM sets down the framework to serve as a basis for the tariff 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.
52. Unexpected circumstances in any of the public bodies of Bonaire, Saint Eustatius and Saba may be grounds for changing or adjusting the method's implementation. The Explanatory Memorandum accompanying the BES Electricity and Drinking Water Act offers room for that, as it has been laid



down therein that the specific circumstances on the islands must be taken into account when organizing the regulation.

53. This possible change or adjustment will be implemented in the tariff decision(s) by ACM insofar as this cannot be put off until the second regulatory period.



4 Regulatory framework

54. 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?

55. The general objective of the law is the secure, 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 tariff regulation:

- Consumer protection (against too high tariffs 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)

56. Furthermore, the Explanatory Memorandum states that 'cost orientation' should be the basic principle. This means that the tariffs 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 tariffs or vice versa.

57. 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.

58. Imagine we (ACM) chose to set the company's revenues equal to the company's total costs. On the one hand, we would 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 tariffs anyway. Consumers may thus end up paying too much.
59. 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. After all, it would 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.

60. 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.
61. Let us discuss a simplified example to illustrate this⁴. 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.
62. 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 tariffs, 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?

⁴ 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.



63. 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 tariffs 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.
64. 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.
65. 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 tariffs 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

66. In this chapter, ACM describes the way in which it will set the production price and distribution tariffs 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

67. 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 tariffs 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.
68. 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 tariffs 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.

15/45

5.2 Calculating the expected efficient costs

69. Based on the statutory framework and the principles applied by ACM (see Chapter 4), ACM opts for a so-called profit-sharing method when setting the tariffs. 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.
70. In this chapter, we explain how a profit-sharing method results in tariffs. 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 tariffs
 - Step 4: Determining how afterwards any difference between costs and revenues may be settled.

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

71. Before ACM determines the efficient costs of a company, it firsts 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 (depreciation and a reasonable return on the invested capital) 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.

72. 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 tariffs 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 production price and in the tariff decisions.
73. It is possible that the annual accounts do not contain all the information that ACM needs to set the tariffs, 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 instruct companies to supply an independent accountant's statement to accompany the information provided, in order to ensure the reliability of the regulatory costs.
74. 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).
75. 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.
76. 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.
77. In its tariff 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).
78. ACM does not regard penalties as operational costs to be taken into account when setting the tariffs, 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.

79. In the tariff decision for a company, ACM records any changes that ACM may have made, as well as ACM's grounds or purpose for doing so.
80. 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 1, ACM describes in detail how this matter was investigated, and in what WACC this has resulted. This WACC applies to the entire period during which the method applies.
81. After the regulatory costs have been determined, the costs must be distributed objectively across the company's various activities for which ACM sets tariffs (production and distribution of drinking water). For this purpose, clear definitions and clear accounting rules are very important, as the tariffs 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.
82. 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.
83. The company will then separate the production costs and the distribution costs, both for drinking water and for electricity.
84. 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

85. ACM sets down this result in the decisions on production price and distribution tariffs. 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 tariffs.

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

86. 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 tariffs 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.

87. 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 tariff 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 tariff increase the first year this is possible.

88. 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 apart⁵. In the meantime, things may have changed.

89. 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

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



sets down in what way and for which costs items it does so. Then, in the tariff decisions, ACM sets down the concrete adjustments to the costs which this results in.

90. 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).
91. 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 tariff 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 tariff 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.
92. 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.
93. ACM has also considered already taking into account efficiency improvements, and imposing an estimated 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. This does not necessarily mean though, that the total costs (and, by extension, the revenues and tariffs) drop, too. Total costs could increase, for example because of investments. The percentage can be based on sector-wide information on 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 application of a frontier shift is desirable. In any case, the profit-sharing method incentivizes companies to exploit the efficiency benefits resulting from technological improvements.
94. 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 tariff decisions.

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

95. In this step we distribute the revenues from Step 2 across the different categories for which there are tariffs. We will first explain this for production, then for distribution.
96. For production the procedure is relatively simple, as only one maximum tariff 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 tariff, 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 tariffs for the subsequent year (see step 4). Production companies will provide the estimate (including its substantiation) together with the tariff 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 5.4).

97. 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 tariff (see below) ACM will weight these production prices based on the expected total production.
98. For distribution, the calculation is a little more complicated. This is because there are different tariff categories for distribution, which are to cover various costs:
 - the fixed consumption tariff, to cover the network costs, including measurements and preventing and fixing malfunctions;
 - The variable consumption tariff, to cover the production price that the distributor pays to the producer;
 - the connection tariff, to cover the costs of making a connection to the network;
 - the reconnection tariff, to cover the costs of reconnecting an end user who was disconnected from the network;
 - the road transport tariff for drinking water that is distributed by truck, to cover the costs of transporting drinking water by truck.
99. Within a tariff category, a distributor may charge different tariffs for different groups of end users, provided that this distinction is justified by the costs that the company incurs for those specific groups of end users. For example:
 - In a technical sense, large end-users have a bigger connection than small end-users (such as households). In that case, a distributor can show how much the various kinds of connections cost to set up, resulting in a connection tariff 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 tariff 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.



100. Lastly, there is one more reason why calculating the distribution tariffs 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 tariff) is closer to what consumers in the European Netherlands pay for using the network.
101. For the purpose of distributing the distributor's revenues across the various categories, ACM adopts 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 tariff decisions. This is a change with respect to the draft method. ACM opts for setting down the categories in the tariff decisions as this provides more flexibility than setting them down in the method would. If it becomes clear during the first regulatory period that another division would suit the actual or new situation better, or if there are other grounds for adjustment, ACM can make adjustments in the next tariff decision.
102. Both the categories and the cost distribution will be recorded by ACM in a table included in the tariff decisions.

Category	Variable distribution costs	Fixed distribution costs	Connection costs	Reconnecti on costs	Costs for transport by truck
Tariff group 1 ()	... %	... %	... %	... %	... %
Tariff group 2 ()	... %	... %	... %	... %	... %
Tariff group 3 (...)	... %	... %	... %	... %	... %
Et cetera	... %	... %	... %	... %	... %
Total	100%	100%	100%	100%	100%

103. 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 tariff decisions for each company.
104. In order to calculate the tariffs, 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 tariff proposal, the companies submit an estimate of the numbers of connections per category for the year for which



the tariffs 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 tariff decisions.

105. If the revenues for each category are divided by the number of connections for each category, the tariffs per category are the result. In order to determine the fixed consumption tariff, the subsidy is first subtracted from the total fixed distribution costs, after which the tariff is determined (through division by the number of consumers).
106. The tariff for Pagabon is set in a slightly different manner. Consumers with Pagabon do not pay a fixed consumption tariff. In order to ensure that the distributor can recover its fixed costs, the variable tariff (the production price) is increased with a small surcharge. The surcharge is calculated by dividing the fixed consumption tariff 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.
107. The tariff 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 tariff 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 Section 3.18, paragraph 3, of the BES Electricity and Drinking Water Act).
108. In order to be able to make this calculation, the distributor must indicate the estimated quantity of drinking water distributed by truck in its tariff proposal. The total costs for the distribution of drinking water supplied by truck are then divided by this quantity, resulting in the road transport tariff for drinking water, added to the production price.
109. This third step results in the tariffs that a company is allowed to apply in a specific year for each activity and each individual category. ACM sets this down in the tariff decision.

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

110. 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 m³ of drinking water, but that amount turns out to be only 0.9 million m³, 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.



111. 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 tariff decisions.
112. Following WEB's opinion, ACM will also explain how it will deal with force majeure. If a company has incurred extra costs as a result of an unforeseen, extreme circumstance, ACM will make a subsequent calculation for these extra costs, and these extra costs can thus be recouped through the tariffs in a subsequent year (or in subsequent years, if there is a reason to spread out these costs over multiple years). If a company is of the opinion that a circumstance should be considered 'force majeure', it should, if such a situation were to occur, notify ACM of this as soon as possible, after which ACM will assess whether this is indeed the case. A company must make the effort to record separately the costs that this circumstance creates as much as possible.

Example

113. ACM will explain Step 4 using several simplified (and fictitious) examples. ACM will conveniently assume in these examples that the same regulatory regime applies to 2020 and 2021.
114. Imagine a company starts with annual costs of 1,000. Imagine also that this company manages to reduce its costs in 2017, only once. In the following table, we can see what this would mean for its revenues within the profit-sharing system.

Year	Total revenues	Actual costs	Difference between costs and revenues in each year
2015		1,000	
2016		1,000	
2017	1,000 (costs 2015)	900	Profit of 100 (1,000 minus 900)
2018	1,000 (costs 2016)	900	Profit of 100 (1,000 minus 900)
2019	900 (costs 2017) minus 50% of the profit in 2017 = 850	900	Loss of 50 (850 minus 900) Compensating 50% profit of 2017
2020	900 (costs 2018) minus 50% of the profit in 2018 = 850	900	Loss of 50 (850 minus 900) Compensating 50% profit of 2018
2021	900 (costs 2019)	900	Profit nor loss (900 minus 900 = 0)

115. In 2015 and 2016, ACM does not determine any revenues yet. The first year for which ACM does so, is the year 2017. This happens in the year 2016. At that point, the most recent costs that are known, are those from 2015. That is why ACM uses those costs (so from 2015) in order to determine the revenues for 2017. For the revenues for 2018, ACM uses the costs from 2016.



116. In 2018, the actual costs for 2017 are known. That is the first year for which ACM has determined the revenues, and to which the profit-sharing method applies. ACM subsequently establishes that the company earned a profit of 100 in 2017. The company is allowed to keep half of that, 50, as a one-off profit. The company will return the other half to the buyer in 2019. The revenues for 2019 are thus lowered by 50.
117. This will happen in a similar fashion in 2020. The revenues are lowered by 50, as a profit of 50 is achieved in 2018 too.
118. The revenues for 2021 are then determined based on the costs of 2019. The difference between the costs of 900 and the revenues of 850 are not taken into account in the determination of the revenues for 2021. After all, this difference is not caused by higher or lower costs than initially projected, but this difference was a compensation of a part of the profits in 2017.
119. For the sake of completeness, we have also drawn up a table for a scenario in which the company unexpectedly sees its costs structurally increase in 2017.

Year	Total revenues	Actual costs	Difference between costs and revenues in each year
2015		1,000	
2016		1,000	
2017	1,000 (costs 2015)	1,100	Loss of 100 (1,000 minus 1,100)
2018	1,000 (costs 2016)	1,100	Loss of 100 (1,000 minus 1,100)
2019	1,100 (costs 2017) plus 50% of the loss in 2017 = 1,150	1,100	Profit of 50 (1,150 minus 1,100) Compensating 50% loss of 2017
2020	1,100 (costs 2018) plus 50% of the loss in 2018 = 1,150	1,100	Profit of 50 (1,150 minus 1,100) Compensating 50% loss of 2018
2021	1,100 (costs 2019)	1,100	Profit nor loss (1,100 minus 1,100 = 0)

120. This example shows that the company is compensated part of its loss through the revenues for 2019 and 2020, and that, in 2021, the revenues are once again determined at the cost level of 2019.

5.3 Calculating the reasonable return

121. In the WACC annex, ACM describes the manner in which the WACC for the Caribbean Netherlands has been determined.

5.4 Energy costs

122. 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 (Section 2.5, paragraph 2)
- The energy costs can be set as a monthly variable part of the production price (Section 2.5, paragraph 3)
- The variable consumption tariff takes account of the production price (Section 3.17, paragraph 1) and can be set on 1 January and 1 July (while the fixed tariffs can only be set on 1 January) (Section 3.14, paragraph 6)

123. In the Explanatory Memorandum, the legislature also notes the following in this regard: *“Regarding the frequency with which the tariffs are adjusted, a number of factors are 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 tariff regulation by ACM, as in the European part of the Netherlands, benefits from a low frequency of tariff 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 is 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 tariff which it charges to consumers every six months, and the fixed consumption tariff 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 tariff 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.”

124. 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.”*

125. 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 tariff fluctuations or liquidity problems for



the producers. At the moment, all companies have the possibility of adjusting the tariffs per month, based on changing fuel costs.

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

127. ACM will describe the consequences of and considerations with regard to these choices. ACM has made a number of changes with respect to the draft method.

How often does ACM set the energy costs?

128. 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 tariff on a monthly basis, as Section 3.14, paragraph 6, of the BES Electricity and Drinking Water Act only allows this to be done every six months at the most. If ACM decides against setting the energy costs as a part of the production price that can be adjusted monthly, then (considering said statutory provision) the variable consumption tariff can also not be adjusted biannually.

129. The way in which ACM sets down the energy costs 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 Section 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 tariff 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 tariffs, as tariff increases and tariff decreases may partially cancel each other out.

130. ACM adopts the possibility provided by the legislature to set the energy costs for electricity as a monthly variable part of the production price. This is different from the draft method. Based on the opinions of CountourGlobal, Bonhata, SEC, Bonaire Hospitality Group and WEB, and on the calculations, ACM has come to the conclusion that the financial risk borne by producers when prefinancing a rising fuel price over the course of an entire year, is disproportionately high. With regard



to distributors, ACM, as explained in marginal 107, does not have the option of monthly settlements of adjustments of the fuel price in the tariffs that consumers pay.

131. The variable consumption tariff for electricity that distributors are allowed to charge is therefore adjusted every six months, on 1 January and on 1 July. This will provide consumers with certainty regarding their tariffs for the coming six months. Producers can charge adjustments to the fuel price to the distributor on a monthly basis, while distributors can settle these adjustments in the end user tariffs on a six-monthly basis.
132. For drinking water, the energy costs are the electricity costs. Because the energy costs for electricity are set as a monthly variable part of the production price, ACM has investigated whether this is also required for drinking water. On the basis of information provided by companies on the fuel costs over the past years and the amount of electricity required for producing drinking water, ACM concludes that for drinking water the variation in the electricity price is not so great that it justifies a monthly adjustment. Companies should be able to compensate for these fluctuations themselves.

27/45

How does ACM determine the energy costs?

133. The basic principle laid down in the act is that the maximum production price that the producer will charge the distributor is set once a year (on January 1), pursuant to Section 2.5, paragraph 1. An exception can be made with regard to the energy costs only. The energy costs can be set as the monthly variable component of the production price, under Section 2.5, paragraph 3 of the act. In that context, the legislature notes in the Explanatory Memorandum that the producer has an interest in passing on the adjustments to the oil price as quickly as possible, as the production costs of electricity largely depend on the oil price.
134. For the purchase of fuel, too, ACM would ideally like to use an incentive for production companies to purchase fuel as efficiently as possible. Full compensation of the fuel costs thus lacks such an incentive. However, ACM also does not 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. After all, 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.
135. Considering that desired incentive, ACM would like to use a public index of the oil price, and calculate each month (by way of a formula) what the energy costs of the production of electricity of that index would be. Based on the opinions of ContourGlobal, Bonhata and WEB, ACM comes to the conclusion however that further study is needed, both into suitable indices as well as into the extent to which the purchasing costs of fuel can be estimated. ACM will use this (the upcoming) regulatory period to carry out this further study, and will reconsider, for the next regulatory period (so the second regulatory period) in what way the purchasing of fuel can also be stimulated through efficiency incentives.



136. For the first regulatory period, ACM will therefore, each month, settle the purchasing costs of fuel for the production of electricity with the production price. ACM will do so in the following manner. In the production price decision, ACM will lay down the level of the production price. This price has two components: the energy cost component and other costs.
137. The other costs that are part of the production price consist of the capital costs and the operational costs that are needed for the production of electricity. In order to determine the price per kWh, ACM divides these total costs by the expected volume of electricity to be produced. The profit-sharing system applies to this calculation, as described in section 5.2.
138. The energy costs component consists of an amount per kWh, and is calculated by estimating the costs per liter (or barrel) of fuel, and how much electricity this amount will generate (the technical efficiency). In the production price decision, ACM lays down what the expected technical return is with efficient use of production resources. By an efficient use of production resources, ACM means that the producer needs to produce as economically as possible by choosing his production resources (wind power, solar power, and diesel) in such a way that the costs are as low as possible. Should it turn out afterwards that the producer achieved a higher or lower technical efficiency than estimated in advance, this difference will go the producer in its entirety, and, when determining the production price for the subsequent year will do a subsequent calculation.
139. ACM will explain this using the following (fictitious) example.
140. When determining the production price for 2017, ACM has the following data of a certain producer:
- The production mix consists of solar power (4,000 kWh), and diesel generators (6,000 kWh).
 - The estimate of 4,000 kWh is based on an amount of Y sun hours during the entire year.
 - The technical efficiency of the diesel generators is 0.6 MWh per barrel of fuel.
 - The purchasing price of 1 barrel of fuel is USD 90 (based on the most recent purchasing price).
 - The other production costs total USD 500,000 for the entire year.
141. Based on these data, ACM determines the production price as follows:
- USD 0.05 per kWh for the other production costs (USD 500,000 / 10,000,000 kWh)
 - USD 0.09 per kWh for the energy costs component (USD 90 per barrel / 600 kWh per barrel multiplied by 3/5 part diesel production)
 - In that case, the total production price per January 1, 2017 is USD 0.14 per kWh.
142. For this energy cost component, ACM sets the fuel price factor at 0.001. This means that purchasing price of the fuel, multiplied by this factor, results in the energy cost component. This figure is the result of the share of diesel in the total production (3/5) divided by the technical efficiency (0.6 MWh per barrel).



143. The first possibility that this production price can be adjusted is per February 2017. In January, the producer determines the purchasing price of the fuel as paid for in December 2016. Based on the fuel price factor, the energy cost component of the production price per February 2017 will change.
144. Suppose that, in this example, it turns out in January 2017 that the purchasing price of the fuel in December was USD 100 per barrel. The production price per February 2017 will then change as follows:
- USD 0.05 per kWh – other production costs remain the same.
 - USD 0.10 per kWh for the purchase of the energy (USD 100 per barrel * fuel factor of 0.001)
 - Total production price per February 1 2017 is USD 0.15 per kWh.
145. To complete this example, we will also indicate what would happen in 2018 if the total costs and total production for 2017 are known. In that case, suppose we have the following data of this producer:
- Actual production as 3,500 MWh from solar power, and 6,500 MWh from diesel.
 - The actual number of sun hours was exactly what was estimated, amount Y.
 - The total fuel costs were USD 1 million (10,000 barrels multiplied by an average fuel price of USD 100 per barrel).
 - The actual other production costs were USD 500,000.
146. This will lead to the following conclusions with regard to the question of which costs are taken into account in the determination of the production price for 2019 as subsequent calculations:
- The producer was able to generate more electricity from solar power than he actually has (given the number of sun hours).
 - The producer generated electricity more efficiently with diesel than was projected beforehand (6,500 MWh was generated with 10,000 barrels, which is 0.65 MWh per barrel compared with the estimated 0.6 MWh per barrel beforehand).
 - Both differences in efficiency go to the producer. Given the average fuel price of USD 100 per barrel, the producer had been able to generate for USD 1 million ($100 * 0.001 * 10,000,000$). This is exactly the amount of the producer's costs, as a result of which the loss of sun hours is offset by a more efficient use of the diesel generators.



6 Responses from interested parties

147. This chapter presents interested parties' responses⁶ to the draft method. In this section ACM will substantiate in what manner those responses were taken into account when establishing the definitive method.

148. The following interested parties have presented opinions to ACM in connection with the method:

- ContourGlobal
- Bonaire Hotel and Tourism Association (Bonhata)
- Bonaire Hospitality Group (BHG)
- SEC
- WEB

30/45

6.1 Opinion of ContourGlobal

149. In its opinion, ContourGlobal presents a number of arguments, which ACM categorizes and summarizes as follows:

- a) General objections to the law, tariff regulation and the method used for this;
- b) Arguments related to the WACC;
- c) Arguments related to the fuel costs;

Re a) General objections to the law, tariff regulation and the method used for this

150. ContourGlobal is of the opinion that the tariff regulation established by law is unnecessary and that it is an unjustified infringement of its freedom of contract. The power purchase agreement (PPA) that ContourGlobal has concluded with WEB, and which provides for a remuneration of energy costs, is already based on the actual production costs. According to ContourGlobal, this remuneration is not excessive. Moreover, the electricity prices on Bonaire are comparable to those in Curacao and in Aruba, and according to ContourGlobal there are no indications that the production price applied by ContourGlobal on Bonaire is excessively high. It is therefore ContourGlobal's fundamental conviction that there are no grounds for the BES Electricity and Drinking Water Act, insofar as the regulation of the electricity production price is concerned.

151. However, now that the law has been adopted, ContourGlobal is prepared – while reserving all rights – to cooperate with ACM to find an appropriate method. In this regard, ContourGlobal considers it significant (marginal 14 of its opinion) that the Minister of Economic Affairs is of the opinion that ContourGlobal is already running the production plant on Bonaire efficiently. According to ContourGlobal, this fact is to be taken into account in the assessment (by ACM) when determining a prudent and feasible method.

⁶ As referred to in Article 2.1, paragraph 1, of the Ministerial Regulation.



152. ContourGlobal accepts ACM's decision (and the substantiation thereof) to set the first regulatory period for a term of three years. ContourGlobal also accepts ACM's decision not to give a discount on the revenues for reasons of so-called dynamic efficiency improvement (frontier shift) in the chosen regulatory method.
153. In its opinion, ContourGlobal expresses its concern (marginal 9) that ACM will focus too strongly on cost reduction, without taking into account that some of those costs (namely, a part of the capital costs and the fuel costs) cannot be influenced by ContourGlobal and therefore cannot be lowered. Because of this, only the operational costs that ContourGlobal can influence remain, but that leads to risks with regard to maintenance, employment and security of supply.
154. According to ContourGlobal, additional tasks for ContourGlobal arise from the BES Electricity and Drinking Water Act, namely guaranteeing the security of supply. ContourGlobal is of the opinion that it should be allowed to charge additional costs to WEB as a result. If ACM does not allow ContourGlobal to do so, ContourGlobal will not be able to execute the additional tasks properly. ACM should formulate a clear position on this in the method.
155. ContourGlobal remarks that the draft method does not indicate that profit-sharing only applies to profit that exceeds the reasonable return. Given section 2.5, paragraph 2 of the BES Electricity and Drinking Water Act, ContourGlobal is of the opinion that a consumer can only *share* in the *profit* made by ContourGlobal if this is an amount that exceeds the reasonable return that ContourGlobal is allowed to enjoy. ACM should also explicitly include this in the method.
156. ContourGlobal argues that the electricity production price to be determined by ACM should at all times cover the efficient costs incurred by ContourGlobal that are connected to running the production plant and performing maintenance on this. In this connection, ContourGlobal points out the obligations that it has as a result of the financing agreement with Rabobank. On the basis of that agreement, ContourGlobal is obligated to invest in the maintenance of the production plant, for which amounts have already been earmarked for 2016-2020. According to ContourGlobal, a feasible regulatory method will entail that the necessary and efficient costs of an investment, including a reasonable return on that investment, are compensated completely by the tariffs to be set by ACM. According to ContourGlobal, this is part of the investor protection mentioned by ACM in marginal 38 of the draft method.
157. According to ContourGlobal, it would be a violation of that investor protection if it cannot completely compensate the losses it may incur in the tariffs. This is especially the case if those losses are the result of unforeseen circumstances. ContourGlobal also states in this connection that it is not reasonable to deny it the possibility to recoup its losses while it is obligated to hand over 50% of its profits to WEB, in the form of a lower production price. It reserves the right to present its opinion on the 50%-50% ratio at a later stage, after the WACC method has been published.



158. ContourGlobal suggest that it would be more suitable and fairer to apply a method that would enable it to pass on any losses it incurs to future years in which profits are made. In ContourGlobal's view, setting up an equalization reserve would be a suitable instrument for this purpose.
159. Where the setting of the regulatory costs and ACM's ability to adjust the data provided by ContourGlobal in its annual accounts are concerned, ContourGlobal is of the opinion that ACM should consult with it first, before making any adjustments. Otherwise, any inaccuracies in those adjustments could only be corrected by means of a legal procedure, which would have an adverse effect on the setting of the tariffs. In this connection, ContourGlobal also remarks that it has not yet received any feedback from ACM with regard to the information presented to ACM in June 2016.

ACM's response to part a) of the opinion

160. As the legislature has chosen to adopt the BES Electricity and Drinking Water Act, it is a given that ACM must set tariffs based on costs. With regard to the costs, the companies are allowed to achieve a reasonable return. This is also laid down in the method set down by ACM. The objective of the BES Electricity and Drinking Water Act is that quality and security of supply of electricity are safeguarded, too. The costs incurred by a producer of electricity when helping in achieving those objectives are part of the cost base for the tariff regulation that is introduced with this act. Separately charging costs that are associated with additional tasks stated by ContourGlobal, has no basis. This part of the opinion does not result in a change to the method.
161. ContourGlobal's position that it is not correct that only 50% instead of 100% of any losses can be passed to future years is not shared by ACM. The legislature chose a specific form of regulation because of the absence of competition. In a competitive market, there are built-in incentives (or more incentives) to achieve efficiency: better performing businesses make more profits, and badly performing businesses usually suffer losses. Since there is no competition in the Caribbean Netherlands, the legislature chose a form of regulation that creates incentives to achieve efficiency. With the regulatory method of profit-sharing, the incentives that are present in a competitive market are mimicked. A company that performs well, for example by saving costs and operating efficiently, is able to make more profit than a company that does not perform well. And the costs of companies that are already fully efficient are fully compensated. If ACM did not apply this regulatory method, fewer efficiency incentives would be in place. With the limit of 50%, ACM has already reduced the incentives by half compared with full profit-sharing. ContourGlobal's position would, if implemented by ACM, lead to weakening it even further. This is not desirable with an eye to the law's objectives to create incentives to realize effectiveness and efficiency. This part of the opinion does not lead a change of the method.
162. Incidentally, ACM points out that the notion of 'profit' in the method is based on lower costs than the previously determined costs, including a reasonable return. So, if a company makes the exact amount of costs as previously estimated (including the reasonable return as part of the capital costs), in that sense there is no 'profit' of which 50% has to be passed on to WEB in the form of a lower production price in the following year.



163. With regard to determining the regulatory costs, ACM will make it clear to companies in a timely manner whether any adjustments are made to the data supplied and what these are. Companies will still be given the opportunity to check the adjusted data for any factual inaccuracies. This follows from the idea of careful decision-making.

Re b) ContourGlobal's arguments with regard to the WACC

164. ContourGlobal indicates that, as a commercial company, it wishes to achieve a reasonable economic return on its activities and investments. Such a return was also ContourGlobal's point of departure when agreeing the PPA with WEB. Its future investments on Bonaire are also based on this return.

165. ContourGlobal indicates that with regard to the methodology for establishing the WACC, ACM should only assume that there is a peer group of undertakings in the Caribbean.

166. ContourGlobal bases its position in this matter on the formation of the BES Electricity and Drinking Water Act. ContourGlobal argues that according to the Minister of Economic Affairs, when determining the reasonable return, a comparison should be made with the return on investments in the energy industry in the Caribbean, not the return on investments in the energy industry in the European part of the Netherlands. Any other comparison would be *contra legem* in ContourGlobal's view. The fact that the Minister of Economic Affairs, in response to questions from the Dutch Senate, replied that a peer group consisting of companies from the Caribbean should be assumed implies that such companies – apparently – exist. On those grounds, ContourGlobal argues, ACM lacks the power to compile another (i.e. European Dutch) peer group in case that this peer group is lacking.

167. In this matter, ContourGlobal concludes that ACM cannot compare an electricity producer to an electricity distributor given the difference in risk profiles. Nor can ACM compare electricity producers in the Caribbean and in the European part of the Netherlands. Lastly, ACM cannot compare a private-law company to a public-law company.

ACM's response to part b) of the opinion

168. With regard to the electricity production price to be determined by ACM and to be charged by ContourGlobal to WEB at most, ACM takes into account the fact that companies should be able to achieve a reasonable return. That return is based on what is reasonable.

169. Determining the reasonable return (the WACC) is done, in short, by comparing companies, ideally companies that engage in the same activities within the same market. That way, investment options are compared and the risks of such investments can be determined.

170. The companies selected are part of a peer group. It is then determined which risk profiles apply to those companies. Neither the law nor the Ministerial Regulation prescribes the manner in which ACM is to put together said peer group, but in the Explanatory Memorandum the legislature notes the following:



“The return allowed should be low on the one hand, to limit the final costs for the end user, but sufficiently high on the other to make investing attractive. A comparison with the risk and expected result of comparable projects in the energy and drinking water sector in the Caribbean is an obvious choice.”⁷

171. ACM disagrees with ContourGlobal’s statement that the peer group should only consist of undertakings from the Caribbean. When determining the risk profile of an undertaking or investment, many factors are relevant, such as the geographical component. Another relevant factor is a country’s investment climate, and as such its state structure. After all, a stable state structure is relevant to undertakings’ risk profiles and desired investments. It would be improper – and that is why ACM disagrees with ContourGlobal’s position – to only focus on one component/factor and ignore other relevant factors when establishing a peer group, the power of which lies in its representativeness. ACM finds no support for ContourGlobal’s position in this matter in the formation of the law either.

172. This part of the opinion does not result in a change to the method.

Re c) Arguments related to the fuel costs

173. ContourGlobal states that it should be able to charge the fuel costs, as part of the electricity production price, to WEB on a monthly basis. The law explicitly allows for this. According to ContourGlobal, it would have (in case of increasing oil prices) negative or even disastrous effects on ContourGlobal’s financial position if it could only index the fuel costs once per year.

174. Moreover, annual indexation would mean that – still assuming increasing oil prices – end users would be confronted with (much) higher tariffs the following year. Charging fuel costs on a monthly basis is ultimately easier for end users to cope with. ContourGlobal also remarks that it is up to ACM, and not up to interested parties to specify circumstances that would lead to a monthly charging of the fuel costs.

175. ContourGlobal agrees with ACM that the profit-sharing method is not to be applied to fuel costs, but considers it unfair and therefore also disagrees with ACM’s principle that the fuel costs are to be based on a public indexation of the oil price. The situation on Bonaire is such that ContourGlobal is not in a position to influence the oil market, which is dominated by Curoil, and therefore the price that Curoil sets. Insofar as such an index is still to be applied, ContourGlobal is of the opinion that the formula for calculating the fuel costs should take into account transport, storage and other costs related to fuel purchasing. This applies to the same extent to the wind/fuel dispatch system.

176. Lastly, ContourGlobal states that the proposed regulatory method is not suitable for the – in its view – competitive market for electricity production on Bonaire. In this context ContourGlobal points out that there are various producers and sources for electricity production on Bonaire. ContourGlobal

⁷ *Kamerstukken II*, 34 089, no. 3, p. 7



produces electricity using wind energy and HFO, among other things, as opposed to WEB, which produces electricity using costly diesel generators. In that respect, the draft method is lacking consideration of the so-called 'merit order' – an instrument for determining the order in which production power and sources are deployed. In this matter ContourGlobal is in favor of the order: wind/PV, HFO, diesel. Future investments will actually be based on a merit order, says ContourGlobal.

ACM's response to part c) of the opinion

177. On the basis of this opinion, expressed by ContourGlobal and others, ACM has adjusted the method.

ACM will make it possible to set the fuel costs as a monthly variable part of the production price (section 2.5, paragraph 3 of the law). ACM has explained this further in section 5.4 of this method. Also considering what has been put forward in the opinions, ACM has decided, as yet, not to use a public index based on which the fuel costs (read: the costs of HFO and/or of diesel) are determined.

178. With regard to ContourGlobal's mentioned 'merit order', ACM notes that this is already included in the setting of the production price. After all, the level of the production price assumes the efficient use of production resources.

Final remark by ContourGlobal

179. ContourGlobal closes its opinion by expressing concerns regarding the fairness and feasibility of the regulatory method. ContourGlobal remains of the opinion that there are no grounds for the BES Electricity and Drinking Water Act, insofar as the *ex ante* tariff regulation of the electricity production price is concerned. *Ex post* regulation, for example by applying the Dutch Competition Act (abuse of dominant economic position), would be much easier and more effective in ContourGlobal's view. Moreover, that would grant ACM the power to address the monopolistic behavior of Curoil and BOPEC, which could lead to lower electricity and drinking water prices. Cost reduction by ContourGlobal will not be possible, given the fact that it already operates its power plant in the most efficient manner. Any further cost reduction to which it could be forced by the method will be detrimental to the security of supply and may even result in ContourGlobal having to cease its activities on Bonaire.

180. ContourGlobal urges ACM to revise and determine the method, taking into account the considerations presented in its opinion.

Response to the final remark by ContourGlobal

181. This part of the opinion does not result in a change to the method.

182. It has been the choice of the legislature to introduce *ex ante* tariff regulation with the implementation of the BES Electricity and Drinking Water Act. In the context of the determination of this method, this choice cannot be under discussion.



183. The goal of tariff regulation as such is not to lower tariffs. As has already been mentioned before, it is an instrument with which the objectives of this law can be reached: a high-quality, affordable, and secure supply of electricity. The instrument of tariff regulation ensures that the interests of interested parties are assessed in the right manner. ACM has been charged with this assessment, and thus with taking into account all of these different interests, including that of ContourGlobal.

184. ACM would like to add that ContourGlobal apparently entertains the notion of ceasing its activities on Bonaire because of the introduction of the BES Electricity and Drinking Water Act and the tariff regulation it becomes subject to as a result.

In this connection, ACM points out that the Minister of Economic Affairs sent a letter to the Dutch House of Representatives on 17 December 2012 containing a report entitled 'Main points for the regulatory framework pertaining to electricity on Bonaire, Saint Eustatius and Saba', dated 23 October 2012.⁸ In this report the main points with regard to electricity provision in the Caribbean Netherlands are laid down. One of these main points is the introduction of ex ante tariff regulation by ACM with regard to both the production and distribution of electricity.

185. ContourGlobal Bonaire was established in May 2013 and then started its production activities on Bonaire. ACM is therefore forced to conclude that ContourGlobal could have been aware of the fact that electricity provision on Bonaire would be regulated before starting its activities, and in the manner that has now been laid down in the law.

186. ACM takes note of the fact that ContourGlobal (apparently) entertains the thought of suspending all of its activities on Bonaire as a result of the introduction of the BES Electricity and Drinking Water Act and the tariff regulation that, as a consequence, affects ContourGlobal.

6.2 Opinion of Bonhata

187. In its opinion, Bonhata presents a number of arguments, which ACM categorizes and summarizes as follows:

- a) An appeal to determine a benchmark as a matter of urgency;
- b) An opinion on fuel purchasing;
- c) An appeal to adjust the sustainability conditions and tariffs.

An appeal to determine a benchmark as a matter of urgency

188. Firstly, Bonhata asks, with regard to the regulatory method, whether it would be possible to determine a reliable benchmark and whether it would be possible to determine and put into use this benchmark as a matter of the utmost urgency.

⁸ *Kamerstukken II*, 31 568, no. 125



189. This opinion has not led to any changes to the method. ACM will take this input into account when researching the possibilities for setting up a benchmark to be able to compare the costs incurred by companies in the Caribbean. ACM is of the opinion that the application of profit-sharing provides a sufficient incentive for the utility companies to make efficient choices.

An opinion on fuel purchasing

190. Bonhata further states that, with regard to the processing of the energy costs, it would prefer a twice-yearly price adjustment. Bonhata is hesitant to apply an index and states that the price formation for fuels is outside the control of energy companies. Applying an index could force producers to make risky investments to anticipate price fluctuations.

191. ACM has adjusted the method with regard to energy purchasing costs, partially on the basis of this opinion. ACM explains the adjustment in section 5.4 of this decision.

An appeal to adjust the sustainability conditions and tariffs

192. Lastly, Bonhata makes an appeal for adjusting the tariffs and conditions for feeding electricity back into the grid in such a manner that this will be incentivized and encouraged.

193. This opinion has not led to any changes to the method. Feeding electricity back into the grid does not form part of the method for determining tariffs. The compensation for feeding electricity back into the grid has been laid down by the Minister in a Ministerial Regulation and falls outside ACM's powers. It is ACM's task, however, to regulate the conditions applied by WEB, together with the Dutch Human Environment and Transport Inspectorate.

6.3 Opinion of the Saba Electric Company

194. In its opinion, the Saba Electric Company (SEC) asks various questions and presents a number of arguments, which ACM categorizes and summarizes as follows:

- a) What are the consequences for SEC if the interest on a loan is too high?
- b) In what manner should regulatory costs be distributed across business units?
- c) A proposal for creating a 'fuel provision' as a buffer in case of increasing fuel prices
- d) An alternative to profit-sharing
- e) Allocation of costs to various items
- f) Question on the introduction of the possibility of compensation on non-delivery of electricity

What are the consequences for SEC if the interest on a loan is too high?

195. With regard to WACC, SEC asks what the consequences would be if in ACM's view the interest on a loan were too high. If these interest charges are not taken into account in the tariffs for the following year, the result would be a loss for SEC. A greater loss will in turn lead to higher interest charges for SEC.



196. ACM will take into account this opinion together with the other opinions about the WACC in its assessment that will result in the establishment of the definitive WACC. With regard to this point, ACM refers to the WACC annex.

In what manner should regulatory costs be distributed across business units?

197. SEC wonders how marginal 65 of the draft method is to be interpreted. It gives the impression that the regulatory costs should first be distributed across the business units, and should only then (marginal 67) be divided further into distribution and production. SEC wonders if this can't be done in a single step.

198. This opinion of SEC has resulted in a clarification in section 5.2 of the method. As the cost allocation as proposed by SEC is what ACM has in mind, ACM has clarified the relevant section in the definitive method.

A proposal for creating a 'fuel provision' as a buffer in case of increasing fuel prices

199. SEC states that it cannot afford prefinancing any fuel price increases, now that it can no longer adjust consumer tariffs on a monthly basis. Therefore, SEC proposes to create a fuel provision. This provision could receive a part of the profit that is outside the scope of the shift to the consumers. The provision is to serve as a buffer: when fuel prices are low the positive difference will be added to it, to be used in times of high fuel prices.

200. This opinion has resulted in a change to the method. ACM will determine the energy costs as a monthly-variable component of the production price of electricity. The distributor is subsequently able to adjust this every six months in the variable distribution tariffs. Distributors have the freedom to make arrangements in order to anticipate any increases in energy costs.

An alternative to profit-sharing

201. With regard to the decision to use profit-sharing at a 50% rate as a regulatory method, SEC states the following.

202. Suppose that SEC incurs a loss in 2017. According to SEC, 50% of that loss would be recovered from consumers in 2018, while 50% remains a loss to be borne by SEC. If another loss is incurred in 2018, that would mean both a loss for 2018 and a remainder of the loss in 2017 on the balance sheet. SEC thus understands the draft method in that 50% of a loss from 2018 could be recovered again in 2019, but the loss of 2017 could not and would remain on the balance sheet until SEC made a profit again. Because SEC has to finance the losses, the finance charges will rise and will again be borne by the consumers, while only being advantageous for the local banks.

203. SEC proposes that, in a scenario in which losses are incurred several years in a row, the losses incurred earlier should be gradually recoverable through tariff increases. This would avoid higher



financing charges. The same thing could be done with profits. If SEC were to make a profit year-on-year, it would be fair to channel these profits back to the consumers.

204. Lastly, SEC states that, as a shareholder, the public body of Saba keeps a close eye on the company's costs, sufficiently incentivizing SEC to realize cost savings. Therefore, in SEC's view the incentive provided by profit-sharing is not needed.
205. This opinion has not led to any changes to the method. ACM did, however, explain in greater detail the operation of the method, by adding an example in section 5.2, among other things. SEC's interpretation that part of the loss will be borne by the company, and cannot be passed on to consumers, is correct. This is part of the profit-sharing system, and creates an incentive to execute the statutory tasks as effectively as possible. ACM does note that this loss will come at the expense of the reasonable return that the company is able to achieve, which means from its equity. There is no obligation or need to take out a loan in order to finance this loss.
206. ACM additionally notes that ACM bases the revenues on the most recent year for which data is available. If a company has incurred higher costs than projected, and thus suffered a loss, ACM will then include this higher cost level in the establishment of the revenues for the next year. The loss will therefore not have an effect lasting for several years. This is different (obviously) if a company in the subsequent year incurs even higher costs than projected.
207. ACM concludes that the method proposed by SEC does not differ essentially from the profit-sharing method. If a company incurs losses for several years in a row, profit-sharing will not prevent the losses from increasing cumulatively, but the company is allowed to increase the tariffs. If a company makes a profit for several years in a row, this profit is passed on to end users in terms of lower tariffs (because of lower revenues for the company). Next to this process, ACM sees no reason to compensate companies for the 50% of their losses that they need to bear. This would result in a weakening of the efficiency incentive.

Allocation of costs to various items

208. SEC states that its current records are not set up for allocating the total distribution costs to the various base tariffs. For example, reconnection costs cannot be allocated to the various tariff categories. SEC proposes to determine these percentages based on the revenues. ACM interprets this as follows: SEC proposes to distribute the total reconnection costs on the basis of the revenue per tariff category.
209. This opinion has led to a change to the method (section 5.2, step 3). ACM has decided to lay down the tariff categories and the distribution of costs in percentages across the various categories in the tariff decisions instead of the method. That way, the companies and ACM can adjust this more flexibly (for example, once a year). If the records cannot provide certain matters, ACM is of the opinion that pragmatic choices should be made. For example, by allocating costs on the basis of turnover per category or on the basis of other (possibly estimated) distribution keys. If need be, this



can be adjusted in a later tariff decision for a following year if new insights or superior allocation methods are available then.

Question on the introduction of the possibility of compensation on non-delivery of electricity

210. Lastly, SEC states that the law mentions the option of offering compensation if, for example, during a certain period no electricity can be supplied. This possibility can be laid down in a ministerial regulation. Until now, this has not been done. SEC indicates that it cannot guarantee a constant supply of electricity, for example because of the risk of hurricanes. SEC asks ACM whether it is correct that this ministerial regulation will either not be introduced or provides an exemption for Saba.

211. This question has not led to any changes to the method. ACM does not have the power to introduce or adjust ministerial regulations. The Ministry of Economic Affairs is the competent body in this matter. Therefore, ACM has passed on this question to said ministry.

6.4 Opinion of the Bonaire Hospitality Group (BHG)

212. In its opinion, the Bonaire Hospitality Group presents a number of arguments, which ACM categorizes and summarizes as follows:

- a) Current prices are too high; subsidy is required
- b) Monthly adjustments of tariffs on the basis of changes in the price of oil

Current prices are too high; subsidy is required

213. BHG states that the current prices for electricity and drinking water are too high given the quality provided. BHG is of the opinion that a subsidy is required and that the current subsidy is insufficient to bring the costs to an acceptable level. Furthermore, BHG indicates that at the moment 14% to 17% of a middle-class income is spent on electricity costs. The high costs can partially be explained by the fact that more expensive transformers are required because in the past it was decided to make the electricity supply in Bonaire suitable for electrical equipment from Europe as well as the US.

214. This opinion has not led to any changes to the method. The amounts of subsidies fall under the authority of the Ministry of Infrastructure and the Environment and the Ministry of Economic Affairs. Costs and choices made in the past are outside the control of ACM. The tariff regulation method does, however, from this point on incentivize companies to make efficient choices.

Monthly adjustments of tariffs on the basis of changes in the price of oil

215. BHG states that in the past electricity and drinking water prices were increased quickly when the price of oil went up, while decreases were always put off. BHG argues in favor of a transparent system, requiring a monthly adjustment on the basis of a set formula based on the price of oil. The yields of wind energy should also be taken into account in this.



216. ACM has adjusted the method for processing the costs for the purchasing of energy, partially on the basis of this opinion. ACM has explained this adjustment in section 5.4 of this decision.

6.5 Opinion of Water- en Energiebedrijf Bonaire

217. In its opinion, WEB presents a number of arguments, which ACM categorizes and summarizes as follows:

- a) General
- b) Opting for profit-sharing
- c) Remuneration of energy costs
- d) Charging of production prices
- e) Hoe does ACM deal with force majeure?

General

218. WEB would appreciate it if, after the assessment of its responses by ACM, it could take cognizance of ACM's considerations to include or not to include certain responses in the definitive version. WEB would like to get the opportunity to put forward further arguments, if necessary.

219. ACM responds to this opinion as follows. In order to make a careful assessment of all interests, ACM designed an extensive process in order to give all interested parties the opportunity to provide input. As part of that process, ACM had already drawn up the previously mentioned Starting Document, discussed this document with all utility companies, and sent it to all interested parties. ACM subsequently published a draft method to which interested parties were able to respond to. ACM is of the opinion that, with these actions, ACM has met (more than met) the discussions as referred to by the legislature in Section 2.1, paragraph 1 of the Ministerial regulation to come to the establishment of a method. The process designed by ACM also means that, after assessing all interests, ACM will proceed with the decision-making, and will not (before going to the decision-making phase) organize yet another round of opinions. Should WEB disagree with the decision-making, then there is still the option of file an objection with ACM against the tariff decision as yet to be determined by ACM. In that objection, WEB will be able to put forward any arguments against the method.

Opting for profit-sharing

220. WEB states that it serves a general good and does not aim to make a profit or pay dividends to the shareholder. In the case of a positive difference between the revenues and the costs, WEB will not be strongly inclined to pay dividends, but would rather use the money for investments or tariff reductions. In the opinion of WEB, a negative difference will have detrimental effects on investments or the service provision to end users.



221. Moreover, WEB states that significant investments have been planned for the coming years. These are complex projects, with their own dynamics, which may lead to unforeseen costs or a shift in planned investments. It is not clear to WEB what effects this will have on the application of the profit-sharing method proposed by ACM. WEB asks in what manner ACM takes these investment programs into account when budgeting these revenues (or not). WEB wishes to avoid a situation in which ACM is to decide on whether or not to carry out planned investments.
222. Moreover, WEB wonders if a system based on cost-plus regulation would not be more suited to a company like WEB, which is not guided by profit-maximization, but by cost-coverage. WEB argues that, referring to section 5.2 of the draft method, ACM already assesses which costs can and cannot be included in the tariffs. WEB argues that, in marginal 72 and 73 of the draft method, ACM indicates that ACM calculates all costs within the context of effectiveness and efficiency. The method of profit-sharing therefore is a redundant incentive, according to WEB. WEB is in favor of the cost-plus method, considering the simplicity of it, and given the fact that WEB has always aimed for an effective operation. In addition, WEB indicates that ACM's position that cost-saving always leads to lower tariffs for consumers is not entirely correct. Cost savings can be undone by, for example, inflation or other rising costs. As an example, WEB names costs in connection with the increased administrative burden and requirements that follow from the legislation.
223. This opinion has not resulted in any changes to the method. ACM will explain this further below.
224. The legislature has explicitly laid down that the regulatory method should include an incentive to promote effective business practice. ACM has described which methods are suitable from this point of view. In the Explanatory Memorandum (page 10, second paragraph), the legislature states that the cost-plus regulatory method is simpler (indeed) in terms of execution since all costs that a company incurs are compensated. However, cost plus does not incentivize efficiency improvements, according to the legislature. The profit-sharing method does provide such an incentive, because it is aimed at executing the statutory tasks as efficiently as possible. That is why this method, in the opinion of ACM, is suitable for companies in a monopoly position, regardless of whether they have a societal task. The cost testing that ACM performs, as described in section 5.2, Step 1, of the method, is not to test the efficiency of the costs, but to assess whether the costs are related to the company's statutory tasks and not, for example, to other activities of the company (such as sponsoring certain activities).
225. If ACM were to test all individual costs for efficiency as well, that would not just entail a lot more effort, both on ACM's part and on the companies' part. But it would also mean that ACM is de facto taking the place of the company's board. In that case, ACM would have to determine for all individual costs whether they were useful, necessary and efficient, for example by seeing if there were any cheaper alternatives. It just up to the executives of an undertaking to make such assessments. The profit-sharing method places that responsibility with the companies themselves.
226. Furthermore, ACM notes that WEB does not provide a concrete alternative to the regulatory method other than the cost-plus method. ACM has already explained why it does not opt for that method.



WEB's argument that cost savings do not necessarily always have to lead to lower tariffs, is correct. It is possible that cost savings with regard to one aspect can be undone by cost increases with regard to another aspect. On balance, tariffs should remain the same in that situation, which would not be the case if the cost saving were cancelled. In any case, it has been the legislature's intention to create an incentive to strive for effectiveness. With ACM's chosen method, that objective can be pursued.

227. As an additional clarification, ACM will explain how it handles investment prognoses. First of all, ACM is cautious with regard to these. It is not desirable that end users should pay for investments that have not yet been used and therefore do not yield any advantages for the end users yet. On the other hand, ACM offers companies the ability (see section 5.2) to present substantiated investment plans when the tariffs are being set, which ACM may use to determine the revenues for a particular year.

Remuneration of energy costs

228. WEB states that it only has very limited influence on the purchase price of oil products and that it is dependent on the only supplier on Bonaire. The principle that producers should be able to optimize energy costs as a result of an incentive to purchase cheaply is therefore not applicable to the local situation, WEB states. ACM should let energy price formation match the already agreed upon systems of the current contract, and only consider which principles are feasible when these contracts expire.

229. Moreover, WEB states that in the case of annual adjustment to the tariffs WEB will have to compensate for interim variations itself and may have to prefinance this. WEB enquires after the possibilities for creating funding to finance such fluctuations.

230. WEB additionally states that legal inequality has been created between a producer and a distributor in the sense that the producer is allowed to change their prices every month, while the distributor is not. A monthly adjustment of the tariffs would be better for everyone, WEB believes.

231. Finally, WEB argues that a combination of rising energy prices and a system of profit-sharing carries great risks for the continuity of WEB, and, as such, jeopardizing the delivery and desired quality of electricity and water. After all, rising energy prices take up much of the liquidity because of the prefinancing by WEB. The system of profit-sharing with the WACC as determined by ACM results in a considerably lower return on the operation.

232. This opinion has resulted in a change to the method. ACM will determine the energy costs as a monthly-variable component of the production price of electricity. The distributor is subsequently able to adjust this every six months in the variable distribution tariffs. Distributors have the freedom to make arrangements in order to anticipate any increases in energy costs. ACM cannot change the legal inequality WEB refers to, if it existed at all. The law does not offer the distributor any freedom to settle in the tariffs any changes in the fuel costs more frequently than every six months (see Section 3:14, paragraph 6 of the BES Electricity and Drinking Water Act).



233. ACM is of the opinion that, with the introduction of the option of passing on the changes to the energy prices every six months to the variable distribution tariffs, WEB's wish has been sufficiently met of reducing the risks of prefinancing as much as possible. ACM further believes that a company with an efficient operation has no reason to be worried for its continuity, given the system of profit-sharing, where a company gets its efficient costs plus a reasonable return compensated.

Charging of production prices

234. WEB refers to the risk that it may not be able to fully charge prices that are higher than was estimated to its customers. After all, when calculating the variable consumption tariff a certain production, estimated in advance, is assumed. If in fact WEB has to purchase additional electricity, or produce at a higher price, this cannot be charged, according to WEB. Therefore, WEB argues for a margin to be added to the variable consumption tariff to compensate for such fluctuations.

235. ACM believes that there is a misunderstanding here. It is true that the variable consumption tariff is based on an estimate of the amount of production in a specific year for various means of production (wind, diesel, solar). However, ACM has taken into account the possibility that incorrect estimates are compensated subsequently. For example, if the wind share is smaller than estimated, causing an increase in the actual production costs, this will be compensated subsequently and taken into account by ACM when setting the tariffs in a later year. Incidentally, the total amount of electricity to be produced by producers will be laid down by the Minister of Economic Affairs in the production licenses. A difference between the estimated production and the actual production will, in principle, not lead to higher costs to be borne by WEB; at most there will be a delay between incurring those costs and their compensation in a subsequent year. Moreover, ACM again stresses that there is no conceivable scenario in which WEB has to purchase electricity at a higher price than previously determined. This is because the production price is set by ACM and producers cannot charge WEB a higher price than this price set by ACM.

How does ACM deal with force majeure?

236. WEB asks ACM how it will deal with force majeure with regard to converting the costs to revenues in section 5.2.

237. This question of WEB has resulted in a change to the method. In section 5.2, ACM has added that, in case of high costs resulting from extreme circumstances (force majeure), where these are clearly circumstances beyond one's control, such as hurricanes or other extreme weather conditions, ACM can make subsequent calculations of these costs.



7 Provisions

The Netherlands Authority for Consumers and Markets establishes a method as referred to in Section 2.5, paragraph 4, and Section 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.

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

The Hague,

Date:

The Netherlands Authority for Consumers and Markets
on its behalf,

Henk Don

Member of the Board

Given Section 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 tariff 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.