Regulating Electricity, Promoting Our Energy

TARIFF REGIME

FOR

DOMINICA ELECTRICITY SERVICES LTD

CONSULTATION DOCUMENT

Document Ref: 2009/004/CD-02

Independent Regulatory Commission

42-2 Kennedy Ave. 3rd Floor,

Roseau, Commonwealth of Dominica

Office: 767 440 6634/7247 Fax: 767 440 6635

www.ircdominica.org

CONSULTATION PROCESS

Persons who wish to participate in this consultation and to express opinions on this Document are invited to submit comments in writing to the IRC. Reponses/Comments should be sent to:

Executive Director
Independent Regulatory Commission
P.O. Box 1687
42-2 Kennedy Ave
Roseau
Commonwealth of Dominica

The Document is available from the IRC's offices at the address above or may be down loaded from its website at www.ircdominica.org. Responses, clearly showing the Document Reference identification, may be sent by mail or fax to the address or fax number above or by e mail to: ircdominica@gmail.com.

Confidential information provided with responses should be submitted as a separate document and clearly identified as such.

In order to stimulate debate, the IRC will place any responses received on its website at www.ircdominica.org immediately following the last date for receipt of responses. Comments on the responses will also be entertained by the IRC which should, likewise, be submitted by the date indicated.

The references and proposed time table for this consultation are:

Document Ref No: 2009/004/CD-02.
Document Title: Tariff Regime for Dominica Electricity Services Ltd. – Comments on Responses to Consultation Document Ref: 2009/004/CD-01

Event	Proposed Date
Publication of Document	October 12, 2009
Responses close	November 15, 2009
Comments on responses	December 20 ,2009
Decision by Commission on overall Consultation	March 17, 2010

Tariff Regime For Dominica Electricity Services Ltd

Introduction
The Independent Regulatory Commission established pursuant to the Electricity Supply Act 10 of 2006 (the ESA, the Act) has responsibility for regulating the electricity sector in the Commonwealth of Dominica. Amongst its principal responsibilities is the duty to set tariffs that are cost reflective and balance the interests of consumers and the service providers alike.

The procedures for setting tariff are provided for in the Act and notwithstanding the provisions that previously obtained in the 1996 Act, the Commission determined on November 27, 2008 that it would not undertake further tariff adjustments under those arrangements. The Commission is mindful that a new tariff regime has to be established with some urgency and in January 2009 it signaled that it would be initiating a proceeding on the matter. The Commission has also been of the view that a new tariff regime must be cast as a long term arrangement, perhaps even in the context of a new Licence for DOMLEC and therefore it has been seeking to identify and address the critical issues that would inform the development of the tariff regime.

The Commission issued the first consultation document - Tariff Regime For Dominica Electricity Services Ltd - Ref No: 2009/004/CD-01 on August 6 2009 and invited comments to be submitted by September 18, 2009. The issue of tariffs is of such critical importance to all stake holders that the Commission has extended the consultation period to allow for further rounds of discussions and has therefore decided that it will target its January 2010 meeting for taking a decision on the tariff regime.

DOMLEC provided a formal written response (the only response received) to the Consultation Document, which is available on the Commission's website at www.ircdominica.org. The Commission now sets out its comments on that response. The Commission wishes to thank DOMLEC for its participation in this important discussion.

For ease of reference, the relevant response from DOMLEC is reproduced in *italics* and the IRC's comment is inserted immediately below.

Comments on DOMLEC's Responses

DOMLEC welcomes the opportunity to present its comments on the referenced Consultation Document. We are of the opinion that the proposed rate regime, being essentially a continuation of the cost-based rate that was formerly in place, is appropriate for DOMLEC at the present time. However, we are very aware that the mechanism and approach outlined in the Document is still very "high level" and still leaves many areas either undefined or poorly defined. We believe this will lead to a longer, and perhaps more contentious, rate filing process. We also believe that this will result in the need for a considerable amount of interchange between DOMLEC and the IRC during the filing process, resulting in increased time and cost being expended by both parties. We feel that more time should be made available at this stage to further define the mechanism, as it will result in a quicker filing process.

The Commission agrees that the time should be spent at the developmental and consultation stage to define the regulatory framework and tariff regime. At the same time however, there are certain issues which cannot be codified but will be resolved in the analysis and evaluation of a tariff review request.

During our review, an area of concern that has become apparent and that is not addressed at all in the proposed regime is that of energy purchased by DOMLEC from other producers, e.g. small renewable systems, IPP's, etc. In reviewing how possible mechanisms to include such payments might be developed, we have concluded that this is an area that needs significantly more consultation with the IRC before we can present possible solutions. DOMLEC requests that this be given very urgent priority and that no final decision be taken on the tariff regime by the IRC until we have had a chance to discuss and present possible solutions.

The Commission agrees that the methodology for handling "purchased power" must be included in the tariff regime. The intent is to adopt the formula prescribed in the 1996 Electricity Supply Act, with appropriate adjustments to reflect the current environment. The Commission will issue a supplemental consultation addressing the issue.

DRAFT

Page 2, paragraph 2
In the last sentence "…the Act provides for competition in generation, transmission, distribution and supply, and this regime is expected to continue at least until 2015 …" please explain what regime is being referred to. DOMLEC is also disappointed that the Commission has omitted language that it has included in the past, suggesting that competition in transmission and distribution is impractical given the very small size of the Dominica electricity system. We believe that a clear and consistent message from the IRC is extremely important for all stakeholders.

The Commission's position on competition in the transmission and distribution has been in the public domain for some time having been stated in a number of documents issued by the Commission. It is not considered necessary to restate this position on every occasion that a document is issued. The Commission however draws attention to its proposals for the option of issuing transmission licencees to Independent Power Producers under certain conditions. This is discussed in Document Ref: 2009/001/CD Regulatory Policy and Procedure – Licensing Procedures.

Page 8
DOMLEC has several comments on the formula for revenue requirements:

- *Clarification on Terms and Definitions: The term "tariff" usually defines all aspects of service provision, including individual rate components, such as but not limited to, customer charge ($/month), electric rate ($/kWh), demand rate ($/kW), special riders such as a fuel charge ($/kWh) or environmental compliance charge ($/kWh), taxes and fees ($/kWh) as well as the terms under which the services are provided (e.g. Winter v. Summer periods, Time of Use, etc). Throughout the document, we need to be careful to establish and use terms appropriately to avoid confusion. An "average rate" in $/kWh is an appropriate way of presenting the rate at which the Revenue Requirement ($) is recovered from customers via sales (kWh). The tariff contains all the rate components, charges and terms that are used to develop the customer bill. DOMLEC has attempted throughout these comments to use the terms "tariff" and "rate(s)" following the definition described above.*
- *The IRC shows that three items (RR, GO and RF) add up to T, which is the Average Rate. The Average Rate – by definition - would be in cents per kWh, but none of the terms to the right of the "=" sign are in cents per kWh. We think that this formula is incorrect, and it should instead read:*

DRAFT

RR = OC + FC + GO + RF

OC equals operating costs, and FC equals financing costs, as defined on Page 9. Once we have the revenue requirement (RR), we can decide how to spread those costs out over the various customer classes, and set tariffs and apply rates designed to allow DOMLEC to collect revenues equal to the total Revenue Requirement, including DOMLEC's return.

- *The "Average Rate" then becomes the Revenue Requirement ($) divided by the forecast sales (kWh).*

  Average Rate = Revenue Requirement ($) / Sales (kWh)

- *The formula contains terms "GO" for Government Obligations and "RF" for Regulatory Fees. It shows that these terms can be either plus or minus, but it would be quite unusual for these terms to be negative (particularly RF). This could only arise if it were assumed that DOMLEC over-collected either of these items and needed to refund some amount of GO or RF. It does not hurt to have the minus term, however.*

The Commission accepts and agrees with DOMLEC's comments.

Page 9
DOMLEC proposes to further modify the Revenue Requirement definition to clearly establish the concept of the non-fuel base revenue requirement and the fuel revenue requirement to be consistent with the discussion of the non-fuel operating costs which follows later in the document. The non-fuel revenue requirement is developed based on a combination of demonstrated historic costs and forecast costs. The fuel revenue requirement is by definition a 100% pass-through of actual costs and will change monthly according to an agreed-to formula and process and will not be subject to the procedures outlined in Sections 23 and 24 of the 2006 Electricity Supply Act except as might pertain to the mechanism itself.

RR = NFOC + FOC + FC +GO + RF

Where

RR = Total Revenue Requirement
NFOC = Non-Fuel Operating Costs
FOC = Fuel Operating Costs
FC = Financing Cost (including DOMLEC return)
GO = Government Imposed Obligations

DRAFT

RF = Regulatory Fees

DOMLEC also suggests introduction of some additional definitions at this point. Assuming that fuel costs will be a 100% pass through, the concept of a non-fuel base rate (Base Rate) and a fuel rate (Fuel Charge) helps to clarify and define the ultimate tariff structure. The revenue requirement for the Base Rate is then:

Base Rate RR = NFOC + FC + GO + RF
Fuel Charge = Cost of Fuel

Separating these two key components is important.

For purposes of clarity here, DOMLEC defines the Cost of Fuel as the cost of fuel delivered to its storage facilities at its thermal generating stations. Further, for the purpose of calculating the monthly FOC to the customer DOMLEC will use the weighted average cost of fuel consumed during the month in question.

The Commission has no objection to these suggestions offered by DOMLEC.

In the fourth paragraph, the following statement is made: "In any event, in all cases, the expenses that are ultimately approved for inclusion will be those that are determined by the Commission to be prudent." DOMLEC has significant concerns regarding this statement. Unless there is a clear and unambiguous definition of what constitutes "approved" non-fuel operating expenses, we believe that there is potential for significant contention during the rate filing process. We would have preferred to clarify this as much as possible in advance of the filing but the time constraints imposed by the IRC have prevented this. The sentence also implies that the IRC can determine if all or any of the GO and/or RF should be included in the Revenue Requirement.

The concern about the determination of "prudent expenses" is noted. The Commission is of the view that the rate making process involves an assessment by the Commission of the utility's expenses and the company's arguments to satisfy the Commission that expenses are not just legitimate but are prudent. While much of these expenses will be and are obviously legitimate, there will be cases during the rate review where a particular expense will be questioned by the Commission and which the company must justify. The Commission does not understand the concern raised regarding GO and/or RF.

DRAFT

DOMLEC would like to modify the last paragraph by inserting the word "including" as follows: "Non–fuel operating costs are all prudently incurred costs which are not directly associated with investment in capital plant including salaries and wages; other employee costs; operating costs of generation, …..".

Also in the last paragraph, we contend that income taxes are a component of operating expenses and therefore it is incorrect to exclude them as done in the last sentence of the paragraph: "…information technology costs; taxes other than income taxes; and other costs that are determined to be reasonably incurred."

The Commission has no objection to these suggestions.

Page 10, paragraph 3
DOMLEC is concerned by the following language: "An example of one-time expenditures to be removed would be costs of one off specific studies that will not be continued or replicated in the future." This seems to imply that certain costs e.g. loss reduction study, hydro expansion study, regulatory consultancy, could be considered "one-off specific costs" and be disallowed. We contend that such costs are very real and form part of the costs of operating a reliable utility. Rather than being removed, such costs should be averaged over an agreed time period and included in operating expenses.

The Commission notes the comment and does not disagree with the principle being enunciated.

Page 14, paragraph 3
As discussed, DOMLEC has applied for changes to legislation to allow for the setting up of a tax-deductible self-insurance fund. We anticipate that this will be completed before the tariff filing and therefore will be taken into account then. In addition, DOMLEC is pursuing another option being investigated by CARILEC and may wish to entertain this facility as secondary insurance. Further details will be made available to the IRC at filing.

The Commission has no further comment beyond that of noting its anxiety to ensure that arrangements to secure a sustainable and cost effective disaster recovery financing arrangement is of critical importance for consumers.

DRAFT

Page 16, paragraph 2
DOMLEC is again encouraged by the last sentence of the paragraph. However, we are disappointed that the IRC has not already taken definitive action on this issue. DOMLEC knows that it is well within the powers of the Commission to order the cessation of the 2.5% penalty that Domlec now bears. Such an order would clearly demonstrate the independence of the Commission and its desire to act in good faith.

The Commission is of the view that this comment is not germane or relevant to this proceeding.

Page 14, Treatment of Costs resulting from Natural Disasters
The IRC says that DOMLEC should self-insure against natural disasters by adding into its revenue requirements an amount need to collect funds that it would have on hand to restore service. This approach does not address several key issues:

1) *How large can this amount be? What if there are damaging hurricanes two years in a row? What if a hurricane occurs next year before there are sufficient funds in the account to restore service? Can DOMLEC set aside enough funds to restore service in this case? The IRC requires DOMLEC to make a proposal on this fund within 90 days. DOMLEC may wish to consider approaches other than self-insurance, including the sale of bonds to investors (if feasible) to build up such funds, which will incur interest costs, but not affect consumer rates nearly as much as direct payments into this fund. Also, such funds could be raised much more quickly than a "disaster tax" on consumers.*
2) *If there are remaining costs after DOMLEC restores service, does the IRC agree that DOMLEC can file a special one-time rate request to recover those costs over time? If so, then there should be another term added to the revenue requirement formula above to allow for disaster-related funds collected over time.*
3) *Can DOMLEC use funds collected in this self-insurance fund to "harden" the system and lessen the impact of disasters?*

The Commission notes DOMLEC's suggestions and comments. The question of appropriate arrangements for self insurance has been occupying minds of the regulators and utility companies in the region over the last few years and there are a number of models which have been implemented and which should be examined. The Commission and DOMLEC will have to work collaboratively to develop a model that is appropriate for Dominica and in so doing the tariff regime will reflect any

DRAFT

associated tariff implications. The Commission will issue discussion papers outlining its thoughts over the course of this consultation.

There is a real risk that a call can be made on the fund before sufficient funds have accrued to finance the cost of recovery and it is also possible that the costs associated with a single event could exceed the available funds. In such circumstances, the Commission of the view that recovery would have to be through the tariff, over time and therefore, provision will have to be made in the tariff formula. The Commission would welcome comments on the mechanism to achieve such recovery.

With regard to the question of whether these funds could be used to harden the system and lessen the impact of disasters, the Commission would respond that the "disaster recovery fund" cannot be used for such purposes. System reinforcement would either be financed through OPEX or CAPEX depending on the circumstances.

Pages 14 - 22, Treatment of Fuel Costs
DOMLEC believes that this entire section becomes largely irrelevant pursuant to our agreement, at the meetings of April and August 12/13, to treat fuel costs as a 100% pass-through. DOMLEC has prepared a proposed formula to be used to calculate the monthly fuel cost and which will incorporate the fuel efficiency target desired by the Commission. Please see Appendix A.

This is agreed; the fuel recovery formula will be addressed in a separate discussion.

Pages 24 – 25
DOMLEC is pleased to see that the IRC acknowledges that DOMLEC must undertake a major capital investment program. We also note that the IRC require DOMLEC to justify every major project before it can be included in rate base. However, even with a hybrid test year, DOMLEC's expenditures will span multiple years, and DOMLEC cannot make initial expenditures (e.g., in new generation) without completing those expenditure programs in following years. Thus, DOMLEC would like to point out that the IRC's agreement to include certain costs in rate base this year will imply that certain future costs will be included in rate base as well.

DOMLEC notes that the IRC has suggested that DOMLEC develop costs associated with the future multiple year capital programs necessary for reliability improvements and use the "blended approach" for adjustments to the test year.

DRAFT

We interpret this to mean that DOMLEC can develop the test year underlying costs using historic normalized expenditures and then adjust those cost levels by the average of the relevant cost elements forecast for the rate period (in this case 3 years). We believe this approach is consistent with 1) the IRC acknowledging forward capital spending patterns are NOT consistent with historic patterns and 2) that the IRC wants to reduce volatility of rates. Again, DOMLEC points out that capital investment programs anticipated will require multiple year commitments and expects that the Capital Investment Program review in combination with DOMLEC's demonstrated commitment to cost and schedule of such investments will assure that all planned and prudent capital investments will be incorporated into Rate Base and recovery through rates assured in future years and future rate cases.

The points raised here are standard treatment for capital investment with which the Commission has no issue. For the avoidance of doubt, the Commission full appreciates that the commitment to capital projects in an electric utility is long term and the Commission's goal is to ensure that the environment and regulatory regime is such as to engender the confidence of the utility to undertake these long term commitments.

We note that the IRC raises a concern that is very common in cost of service ratemaking - if DOMLEC has to defer the specific capital investment, those costs have already been embedded in the approved rates, and thus DOMLEC is receiving revenue to cover costs that did not occur. In the case of deferral of planned spending, DOMLEC will have to explain the deferral in subsequent rate proceedings. The IRC would then make a ruling based on the entire circumstance, allowing or disallowing the alternative spending as prudent AND determining if the original proposed spending was appropriate and still required, if the deferral of the specific project was prudent and that the alternative spending (if applicable) was prudent given the circumstances.

The treatment of deferred capital investments costs can indeed be problematic and while there are a variety of regulatory treatments, the Commission intends to write specific rules addressing this issue into the regulatory framework. In this regard the Commission will be minded to minimize the impact on consumers by ensuring that the applicable rates reflect as closely as possible the costs associated with the provision of service.

The IRC says on Page 25 that the IRC "does not expect to manage the Company's capital budget"; however, it also says that DOMLEC must justify each capital

DRAFT

project, and DOMLEC must submit an updated 5-year Capital Investment Plan every year. We believe that there needs to be a mechanism to implement this philosophy. DOMLEC requests that there is some threshold – either above $x million or above some percentage of the overall capital plan (e.g., 10%) – below which DOMLEC has the discretion to undertake projects without project-specific approval. Unless there is some threshold, we believe that the IRC could question every computer, every spare part and every automobile that DOMLEC purchases. Justifying small expenditures would be onerous, unnecessary and an inefficient use of IRC and DOMLEC resources. We note that the IRC does suggest a "blanket work order" approach for smaller, routine annual capital expenditures and are in agreement with this approach.

The Commission has no disagreement with this proposal and will in the course of the consultation seek views as to the appropriate level for this discretionary sum and would welcome DOMLEC's recommendations.

In paragraph 2 on page 25, please provide an explanation of what is meant by item 4) "lost generation" in the context of capital investment.

The Commission will delete this reference.

Pages 28 – 30, Weighted Average Cost of Capital
As stated at the recent meeting DOMLEC rejects the concept of determining return on equity (ROE) using the actual ROEs earned over the last ten years. The actual earnings are not representative of the returns expected by any of DOMLEC's investors in today's climate, especially in light of the significant changes in legislation and policy that have occurred within the last three years. DOMLEC is of the opinion that the risk to investors is now significantly higher than it has been in the past and hence their return on equity invested should be commensurately greater.

The Commission rejects the assertion that the environment is now a significantly more risky one than in the past. The regime that has been established by statute creates an independent regulator to regulate the sector and in doing so ensure that all stakeholders, the company, consumers and the country generally enjoy a fair deal. In doing so the interests of all stake holders must be balanced. The Commission believes that DOMLEC's investors must receive a fair return in exchange for demonstrably acceptable service. Contrary to DOMLEC's view, in establishing the Commission, the government has sought to introduce

stability and fairness to the environment in which DOMLEC operates and thereby created a less risky environment.

DOMLEC suggests that the methodology proposed for deriving the cost of equity capital (based on average of DCF and CAPM approaches) is appropriate. These methodologies (along with the Risk Premium approach) are most commonly adopted in rate-making proceedings worldwide.

However, the choice of comparable companies is the key to determining the cost of capital, and DOMLEC feels there are real problems with the approach recommended in the IRC document:

1) *The IRC states that it intends to use comparable companies based purely on bond ratings and ranking across various industries with no regard to industry affiliation. DOMLEC contends that the bond ratings for other industries (e.g., metals, refining, etc.), where there are a variety of companies with different ratings, cannot possibly apply to DOMLEC.*
2) *Since DOMLEC has no bond rating, it is not clear how to select comparable companies based on that factor.*
3) *The IRC does not mention country risk. If DOMLEC uses comparables from less risky and more liquid markets, there needs to be a positive risk adjustment for operating in Dominica.*
4) *The IRC does not take into consideration the small size of the utility in terms of market capitalization and geographic expanse, which makes its earnings largely a function of the economic, social, and regulatory factors affecting its limited service area.*

In lieu of the significant challenges associated with identifying regional comparables as well as inaccuracies associated with picking companies in other industries, DOMLEC is submitting a position paper (see Appendix B) with recommended ranges of ROE and RORB using the IRC accepted CAPM and the DCF methodologies. Comparables from US electric utility industry have been selected and appropriate adjustments have been made for differences in economic, financial, and political risks of operating in Dominica vs. the U.S.

The Commission has no objection to, in fact it endorses, the CAPM/DCF methodologies for determining cost equity. The difficulty in identifying suitable proxies for Dominica will be the challenge and the Commission is prepared to consider recommendations from DOMLEC in this regard. Included in this would be issues such as country risk. This was not mentioned in the Consultation document as country risk was not considered a factor in the methodology proposed by the Commission. It is

DRAFT

agreed that, if comparable countries to Dominica are not used as proxies then the element of country risk will have to be considered.

The Commission does not accept that an adjustment for company size is a relevant parameter to form part of the risk assessment for DOMLEC's cost of capital. The IRC will use two concepts to justify its position- that of the 'going concern' and that of the 'natural monopoly theory'.

DOMLEC has been operating in one form or the other as the electric utility in Dominica for over 60 years and to date there has never been any expressed concerns as to DOMLEC's viability as a going concern for its shareholders. Importantly, the company's audited financial statements for the past 8 years (these are all that have been available for review), makes no statements or concerns which suggest that DOMLEC is not a going concern. Suffice it to say, in all of the utility's financial statements available to and studied by the IRC there have been no suggestions that;

1. the company's size has curtailed its growth and has provoked doubt as to its viability

2. because of its relatively small size operating in a small country it is more risky than a larger company operating in a large country – (relative scale being the issue).

It is unquestioned that DOMLEC plays a critical role in the country's economic development.

It is clear that DOMLEC, under new ownership since 2004 by WRB Enterprises and Dominica Social Security, has been satisfied and has harvested all necessary benefits from being the sole generator, transmitter and distributor of energy in Dominica to over 32 000 customers.

Dominica's economic development is inextricably linked to DOMLEC's ability to supply efficient electricity services as the monopoly provider of these services in the State. As a regulated monopoly DOMLEC has the opportunity to reap the benefits of a single provider to a growing consumer base.

DOMLEC is de facto a natural monopoly and will continue to enjoy the benefits so derived by virtue of the Commissions decisions relating to the introduction of competition in the electricity sector in Dominica where it has said that it is not feasible to introduce a competitive market in transmission and distribution.

Risk is relative and in a competitive environment a firm's ability for success and viability is dependent on consumers' choice. In a regulated environment, there is no risk associated with consumer choice and the monopoly service provider

DRAFT

enjoys certain privileges and “guarantees” that negates the perception of risk. The riskiness therefore of the monopoly electricity service provider in Dominica is agnostic of its size.

The fact is that the company is regulated within a clearly established legal and regulatory framework and thus its size is not a factor in an assessment of its risk.

On Page 28, the IRC says that the cost of equity (ROE) should be what investors would expect to earn with comparable investments. DOMLEC agrees. However, in Consultation #3 on Page 30, the IRC suggests that DOMLEC should perhaps have to return “excessive profits”. DOMLEC strongly objects to this concept. Either a mutually agreed range of Return on Rate Base (RORB) should be determined or there should be no range and just an agreed “target” return for initial rate setting purposes. In the former case, if the actual return exceeds the top end of the range rates will be adjusted downwards and conversely, if the actual return is below the lower end of the range it will trigger an adjustment upwards in the rate. In the latter case, with no agreed range of RORB, the risk to DOMLEC of having no lower limit to its return must be balanced by the reward of having no upper limit on RORB.

Also, it should be remembered that the cost of equity is an expected return only, and in any given year, the actual return could be significantly different. For example, ROE may be very low in years affected by hurricanes or other natural disasters. The IRC suggests comparing the ROE to other utilities in the Caribbean; again, one would need to find comparable companies, since the ROE for an affluent island (e.g., the Cayman Islands, Barbados) would not be appropriate for Dominica.

It is also important to note that due to the hybrid test year approach being recommended, adjustments need to be made for any debt issued in the forecast portion of the test year, or even during the first few months of the rate effective period. Also, given DOMLEC’s expanded capital investment plans and commensurate financing costs, there needs to be a standard that allows for the test year to be adjusted to account for cost of debt for the entire rate effective period rather than being constrained to just the first few months. The exact standard needs to be determined based on further discussions with the IRC.

DOMLEC should be reminded that the whole objective of the forecast is to enable recognition of expected costs (which include debt) that are known and reasonable. With regard to ROE, the Commission is disinclined to endorse a regime which appears to guarantee a rate of return. It is inclined to fixing the target rate of return only and providing DOMLEC with the

DRAFT

opportunity to meet or exceed that rate of return during the three year tariff period. The Commission's challenge will be to ensure that in trying to maximize the return DOMLEC does not compromise on quality of service both in the technical sense and the softer customer service. This creates an environment for DOMLEC to eke out efficiencies the benefits of which over the long term will be passed to consumers at tariff reviews.

Page 30, Government Imposed Obligations
DOMLEC is in general agreement with the principle of treatment for any Government Imposed Obligations. However, the threshold amount for determination if the imposition is material or not should be reduced to a cumulative sum of EC$100,000. Additionally, any such charge that is due to a Government Imposed Obligation must appear as a separate line item on customer's bills.

The Commission had proposed $500,000 as the threshold based on a view that an imposition becomes material if its impact represents approximately 1% of revenues (in this case the approximately level of revenues excluding fuel surcharge for 2008). The Commission considers this reasonable but it is disposed to hearing DOMLEC's analysis and justification for the level ($100,000) that it has proposed.

The Commission sees no merit in displaying recovery of such an obligation as a line item on the bill as it will disappear at the next annual review as it is incorporated in to the general revenue requirement.

Page 31 – 32, Regulatory Fees
DOMLEC is in agreement with the proposed treatment of Regulatory Fees. Again, this charge must appear as a separate line item on customer's bills.

The Commission supports any initiative that contributes to improving and increasing transparency in public undertakings and therefore philosophically it has no difficulty with the proposal to display regulatory fees on the electricity bill. There must however be some logic to actions such as this and while it would make sense to show the fees as line item if it were computed as a fixed percentage of the customers billing (similar to VAT, say) there is no merit in doing so if in fact the fee is a fixed amount to be recovered as an expense through rates. In the latter case, the Commission would insist that regulatory fees be shown as a discrete line item in the company's accounts and included as such in the Income/Expense statements published with audited financial statements.

DRAFT

The Commission therefore will give direction on this at such time that the Cabinet agrees on the regime for regulatory fees.

Page 33 - 35, Tariff Design
DOMLEC notes that for the purposes of the first filing, the rate design shall remain the same as that currently in use. DOMLEC also wishes to emphasize that the cost-of-service study that the IRC says it will require before the second tariff application is not a trivial exercise. DOMLEC would like the IRC to recognize that such a study is very likely to show that residential and small commercial customers should actually be paying higher rates than at present. This conclusion, if borne out by the study, would, we believe, be problematic. We request that this issue be carefully considered and that we meet to discuss the approach in much greater depth prior to undertaking this study.

The Commission notes DOMLEC's concerns regarding the outcome of a cost-of-service study but is of the view that it is these very concerns which make the study necessary. Decisions on rates must be taken on an objective and policy driven basis. DOMLEC should be as concerned or interested in the cost drivers of its business and for economic efficiency to seek to structure rates so that users pay the economic cost for the service provided. On the other hand if the socio-economic-political environment is such that rate balancing is not feasible, the Commission would wish to understand the areas and levels of cross subsidies.

The IRC also suggests interruptible rates and net metering as ways to lower rates for consumers. In DOMLEC's view, neither of these programs will benefit the average consumer. Instead it is only the large or relatively well-off consumers that stand to gain from such programs. With regard to interruptible rates, in general, these only make sense from the utility's perspective when it can negotiate such rates with large consumers, whose removal from the network will make significant differences to capacity requirements. Interruptible rates need to correspond to lower costs than DOMLEC achieves by not having to use its least efficient (highest cost) generation. However, among residential consumers (which the IRC seems to have in mind), most customers like this idea until their service is interrupted. Thus, it is not clear that such a program will work well, unless DOMLEC puts the telemetry in place to force the shutoffs, and that will require additional capital investment that the IRC will need to approve.

With regard to net metering, that term applies to what DOMLEC would pay for customers who generate their own power on site (e.g., through renewables) and feed it back into the grid. Net metering can be viewed as an "extreme" form of

DRAFT

energy conservation, in that it is possible for the customer to have either a net zero energy consumption or a net negative energy consumption (energy export). However, being able to take advantage of this program will require substantial investment in on-site generation, and this type of investment can only be made by the more well-off consumers. Under a net metering scheme, a consumer actually consumes grid services (the fixed cost component of the energy rate) with the potential of not having to pay for these services. Therefore, if net metering is allowed to proliferate, the end result will mean that the utility company is forced to allocate the same fixed costs for grid services across fewer kWhs sold, thereby increasing the cost of service to those customers who cannot afford on-site generation. DOMLEC has suggested, in its Interconnection Policy which has been submitted to the IRC, that net metering be restricted to systems under 5kW peak installed capacity and that there must be a cap on the quantity of such systems that are allowed to interconnect.

The Commission apologises for the lack of clarity on page 34 (numbered paragraph 7) of the Consultation Document. It withdraws this paragraph.

Pages 35 - 36, Performance Standards
We have several comments on the Performance Standards:

- *The IRC's discussion of performance standards is focused on the idea of imposing penalties on DOMLEC for sub-standard performance. We feel there should be corresponding rewards for superior performance. We have included such a mechanism in the proposal for the fuel charge mechanism. Please see Appendix A.*
- *To support this balanced approach, there could also be a range of acceptable performance for some parameters, and not a hair-trigger basis for penalizing or rewarding DOMLEC.*
- *There should be a linkage between the loss reduction and capital investments. In particular, DOMLEC would like to point out that its Capital Investment Plan must be consistent with achieving these reductions, and the IRC should favor these types of investments in particular, assuming they are prudent.*
- *Performance standards should not apply in years when there is a major natural disaster.*
- *DOMLEC believes that the exact definitions of terms used in establishing the performance standards are extremely important and must be agreed in advance with the IRC.*

The Commission is sympathetic to the suggestions made by DOMLEC. The decision on Quality of Service Standards recognizes that under

DRAFT

force majeure conditions the Company may apply for a waiver of specific standards. A similar provision would be made to apply to performance standards.

Page 38 – Paragraph 1
DOMLEC requests clarification from the IRC regarding the statement that "At the beginning of years 2 and 3, the tariff will be adjusted by the point to point inflation rate recorded in the Dominican economy over the previous twelve months." DOMLEC assumes that the inflation adjustment would be applied to the non-fuel Revenue Requirement and thus impact Base Rate revenues only. DOMLEC also assumes that no adjustment would be made to the underlying costs used to establish the non-fuel Revenue Requirement in the original rate case.

The point to point inflation means the official inflation as reported by the Government's competent authority for the agreed twelve months. If the adjustment is due to be implemented February 1 each year for instance, DOMLEC and the Commission may agree to fix the 12 month period for inflation reporting as January – to December of the previous year.

The inflation will be applied to the non fuel rate only and no re-computation of the revenue requirement will be done although it would be adjusted for any Government Obligations imposed during the previous period

However, the opportunity exists in this process to refresh the sales forecasts for Year 2 and Year 3 and incorporate that update into the non-fuel Base Rate adjustment.

For example, if the sales forecast is unchanged then the non-fuel Revenue Requirement is adjusted by inflation and divided by the original sales forecast kWh resulting in the new non-fuel Base Rate. If the sales forecast is increased, then the non-fuel Revenue Requirement is adjusted by the inflation rate and then divided by the updated sales forecast, which because it is higher than the original sales forecast, results in a lower non-fuel Base Rate than would have resulted had the original sales forecast been applied. Conversely, if the updated sales forecast is lower than the original sales forecast, then the non-fuel Revenue Requirement is adjusted by the inflation rate and then divided by the updated sales forecast, resulting in a correspondingly higher non-fuel Base Rate than would have resulted had the original sales forecast been applied. The use of a refreshed sales forecast along with the inflation adjustment is consistent with the intent of

DRAFT

making rational adjustments in rates for material factors over which DOMLEC has no control.

The Commission agrees with DOMLEC's interpretation.

Pages 43 – End
In general, most of Sections B – D are generic templates and forms and will require substantial review between IRC and DOMLEC staff for applicability in the DOMLEC rate case environment once the main mechanisms of the Regime are fully developed and agreed to by parties.

Section 2.5, Pages 47 & 48
In DOMLEC's opinion, all these definitions require substantial additional work, fleshing out the specific meanings, particularly the use of "estimated data", the reconciliation requirements and the "13-month average". Greater detail and understanding of the IRC's intent is needed. DOMLEC requests that IRC and DOMLEC staff meet to provide this further necessary detail.

The Consultations will take place once the principles for the tariff regime have been determined.

Schedule B: Pages 66-68
DOMLEC requests that the IRC provide clarification regarding IRC intent and views on the treatment of Capital Work In Progress (CWIP).

Two common approaches for treatment of CWIP are in use in regulated cost of service regimes:

1. *Allowance for Funds Used During Construction (AFUDC)*
   *Under AFUDC, financing costs associated with CWIP are accumulated during the construction period and are added to the total capital investment that is placed into Rate Base when the asset is placed into service. AFUDC is commonly accrued at the WACC. The effect is to defer return to the utility on the capital and financing costs until the investment is operational and placed in rate base. The utility essentially advances the capital during the construction period and recovers the principle and the AFUDC through rates over the service life of the project. From an accounting perspective, assuming a $50 Million CWIP amount, the debt costs are booked at an after-tax rate, say at 9.5% (using a hypothetical 50:50 capital structure, an equity rate of 15%, debt rate of 5%, and corporate taxes at 20%). In this case, the AFUDC will be recorded on the asset side of the balance sheet at $4.75 Million ($50 Million*9.5%), other income increases by $3.75 Million, and interest*

DRAFT

expenses reduce by $1 Million. Earnings actually increase by $4.75 Million with no impact on cash for the utility.

2. *CWIP into Rate Base*
   *Under this approach, CWIP is placed into rate base as the capital is expended by the utility eliminating the creation of a deferred capital financing cost (AFUDC) that is added to the total capital cost that goes into rate base when the asset is placed in operation. This approach is very commonly used for large capital investments that may span several years and has the effect of reducing the rate shock of adding a large capital investment plus a potentially substantial deferred financing cost to rate base at a single point in time in the future. In other words, if the investment is a significant portion of the total rate base of the utility, it would be beneficial for both the utility and the rate-payers to use the CWIP mechanism to roll the investment into the rate base. From an accounting perspective, assuming a $50 M CWIP amount and a 10% pre-tax WACC, the rate increase would be $5 Million, there would be a $5 M cash increase on the balance sheet, and revenues on the income statement increase by $5 Million as well. (** Is the CWIP investment depreciated as well? I would think not as the asset has not yet begun performing)*

It is important to emphasize the need for CWIP for large capital investments, for example, geothermal plant investment, new diesel generation investment, or transmission investment. These investments will be significant percentages of the current total rate base of the utility. High level of capital investment coupled with the expected higher debt financing costs in the future (resulting from the global financial crisis and non-availability of tax free NBD debt) employing CWIP may actually lower costs for rate-payers.

There is no mention of AFUDC or CWIP-into-rate-base in earlier rate base section pages 22-27. The Schedule B is also not clear as to the treatment. DOMLEC would like to meet with IRC staff to discuss this in more detail and examine the potential benefits associated with rolling CWIP into rate base as opposed to using the AFUDC approach.

The Commission favours the CWIP approach where this is brought into the rate base annually but such "assets" will not be depreciated until the works is commissioned. The accounting treatment is well established and the Commission would anticipate no controversy in adopting this methodology going forward.

DRAFT