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PLEASE QUOTE OUR REF.

Our Ref: B-R74

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14 March 2018

Regulatory Authority
1st Floor, Craig Appin House
8 Wesley Street
Hamilton HM 11

Attention: Jozelle Escolastica

Dear Sirs,

Re: Response to Consultation Document: Comments on Regulatory Accounting Instructions for Electricity Sector

This letter provides the response of Bermuda Electric Light Company Limited ("BELCO") to the consultation document entitled, "Consultation: Regulatory Accounting Instructions General Determination for Electricity Sector" issued on 23 February 2018 (the "Consultation Document"). The questions posed in the Consultation Document are addressed in turn below using the numbering set out therein, but BELCO reserves all rights and remedies available to it, now and in the future, to provide additional and/or complementary submissions in relation to the subject matters contained herein and/or otherwise to modify and amend its position as set out herein.

29. Interested parties are invited to comment on the Regulatory Accounting Instructions for the electricity sector.

Overriding Caveat

BELCO believes the proposed instructions set out in Annex 1 of the Consultation Document (the "Instructions") provide a reasonable basis for enhanced transparency with respect to BELCO's costs and profitability levels, and BELCO understands and supports the benefit such transparency provides to the formation and understanding of customer rates. Further, BELCO believes that this transparency can be achieved without undue burden to licensees, provided that the Instructions are only applicable from January 2018, are applied in a practical way and are applied solely to material matters.

BELCO's responses to the questions set out in the Consultation Document are subject to the above overriding caveat.

Competition in Electricity Generation

The Regulatory Authority (the "Authority") has stated that accounting separation is required, in part, to promote competition among electricity generators, but BELCO questions the capacity of the information sought in the Instructions to promote competition from independent power producers. In fact, BELCO believes the public's understanding of the cost of alternative sources of generation could become distorted given that the cost structure of a portfolio of generation units built under a vertically integrated, regulated cost-of-service model with a strict obligation to serve is not comparable to the cost structure of one generating unit selling energy through a power purchase agreement. As such, we believe the information gleaned from compliance with the Instructions will need to be disseminated by the Authority with care.

Conflicts Between Licences and Instructions

BELCO is also concerned about discrepancies between the obligations set out in the Instructions and those set out in BELCO's transmission, distribution and retail ("TD&R") licence (the "TD&R Licence") and bulk generation ("BG") licence (the "BG Licence" and together with the TD&R Licence, the "Licences"). For instance, the substance of the auditor's reports required under Condition 11.4 of the TD&R Licence and Condition 22.4 of the BG Licence differs from that stipulated in the Instructions. The Licences require that the auditor shall state whether the accounting statements prepared in accordance with Condition 11 of the TD&R Licence and Condition 22 of the BG Licence, "**have been properly prepared in accordance with [those Conditions]** and give a true and fair view of the revenues, costs, assets, liabilities, reserves and provisions of, or reasonably attributable to, the Separate Business to which the statements relate." Conversely, the Instructions provide that the auditor is to give a specific statement that, "The regulatory accounts have been properly prepared **and comply with the regulatory accounting instructions** for the electricity sector of Bermuda issued by the Regulatory Authority of Bermuda."

BELCO trusts that the Authority recognizes that, as per Condition 6.2 of the TD&R Licence and Condition 5.2 of the BG Licence, the Instructions, being a General Determination, shall take precedence in instances of irreconcilable conflicts with the Licences.

Auditor's Assurance

BELCO wishes to share with the Authority the feedback received from its auditor, PricewaterhouseCoopers Ltd. ("PWC") with respect to the assurance statement sought in paragraph 7 of the Instructions (the "Assurance").

PWC has indicated that the Assurance is inconsistent with International Standard on Auditing 800 (Special Considerations – Audits on Financial Statements Prepared in

Accordance with Special Purpose Frameworks) (the "Standard"). As such, PWC has stated that the following alternative language reflects the Standard:

"In our opinion, the financial statements of Bermuda Electric Light Company Limited are prepared, in all material respects, in accordance with the regulatory accounting instructions for the electricity sector of Bermuda issued by the Regulatory Authority of Bermuda."

30. In particular, the Authority welcomes responses in relation to the questions outlined in the table below.

1. Do you agree that the accounts of the bulk generation and TD&R licensed business units should be separated from each other, from the accounts of the unregulated business units of the licensee (if applicable), and from the accounts of related parties?

BELCO agrees with the usefulness of accounting separation (as defined in the Instructions) of the BG and TD&R licensed business units from each other and from unregulated business units and related parties.

2. Do you agree that, for every licensed business unit, the elements that need to be reported include operating costs, revenues, current assets and current liabilities, and fixed assets?

BELCO believes that reporting separately the main balance sheet and income statement elements of each licensed business unit provides an appropriate level of transparency.

3. Do you agree with the three-tier approach to allocating all operating costs and revenues to the individual business unit?

BELCO generally agrees with the three-tier approach to allocation of costs and revenues.

4. Do you agree that assets should be allocated to the regulatory accounts of their main user, where the main user should make a transfer charge to any other business unit that also uses that asset?

BELCO believes that assets should be allocated to the regulatory accounts of their main user and that shared assets should either be allocated on the basis of shared usage or that the main user should charge a market-based levy for such usage depending on which approach is more practical. The Authority ought to be cautious about the potential for market-based costs to destroy the existing synergies inherent in a vertically integrated utility that benefit ratepayers.

5. **Do you agree that current assets and current liabilities should be allocated to the business units in line with the principles of cost and revenue allocation?**

BELCO agrees that current assets and current liabilities should be allocated in line with the principles of cost and revenue allocation.

6. **Do you agree that long-term liabilities should be allocated to business units only if they are directly associated with a particular business unit, or are collateralised with assets that are associated with particular business units?**

BELCO agrees that long-term liabilities should be allocated only if they are directly associated with a particular licensed business unit or collateralized with their assets and otherwise should be shown as unallocated liabilities. In particular, legacy costs related to environmental remediation and post-retirement benefits should either be left unallocated or allocated to the TD&R accounts to avoid distorting the generation cost structure for liabilities and costs that relate to periods prior to 1 January 2018.

7. **Do you agree that the licensee should comply with the IFRS in relation to the capitalisation policy in everything but capitalisation of interest—i.e. that the licensee should not capitalise interest?**

BELCO believes that it is appropriate to use international financial reporting standards ("IFRS") as the basis for accounting policies in general because they provide an internationally recognized methodology subject to significant due process. Using IFRS with minimal deviation also ensures that the external accounts and the separated regulatory accounts are consistent with each other, eliminating confusion.

In relation to capitalized interest, BELCO believes that a return on capital ought to be earned for assets under construction and that this can be achieved either by including assets under construction in tariffs or through an allowance for funds used during construction (i.e. capitalized interest). We believe that the treatment of interest for accounting separation should follow the tariff methodology for assets under construction.

8. **Do you agree that the cost model of asset valuation is an appropriate methodology to use in the preparation of regulatory accounts?**

BELCO agrees that the cost model is an appropriate methodology to use for asset valuation.

9. **Do you agree that only pre-agreed economic asset life assumptions should be used?**

Rather than agreeing economic asset life assumptions on an arbitrary basis, BELCO believes that the asset life assumptions should be based on IFRS. IFRS provides the appropriate standard for determining asset lives because it requires management to base asset lives on fundamental economic and technical considerations as they change from time to time. We do not object to advising the Authority when circumstances change.

10. **Do you agree that, as far as is practical and proportionate, transfer charges and transactions with related parties should be valued at arm's length?**

BELCO agrees that, as far as is practical and proportionate, transfer charges and transactions with related parties should be valued at arm's-length (as arm's-length is more particularly described in the Instructions). BELCO believes that a cost-based approach, rather than competitive tendering, from which market rates would be gleaned, is the most appropriate approach in relation to corporate services.

11. **Do you agree that, for every licensed business unit, the licensee should provide a breakdown of operating costs and revenues by internal transactions, external transactions with related parties, and external transactions with independent parties?**

BELCO does not object to providing details of internal and related-party transactions where material but questions the value of this information if all transactions are undertaken on an arm's-length basis.

12. **Do you agree that third-party transactions need to be disclosed in the notes to the regulatory accounts?**

BELCO does not object to providing details of non-core third party transactions where material.

BELCO looks forward to the publication of a general determination in connection with this public consultation.

Yours faithfully,



Denton Williams
Chief Operating Officer