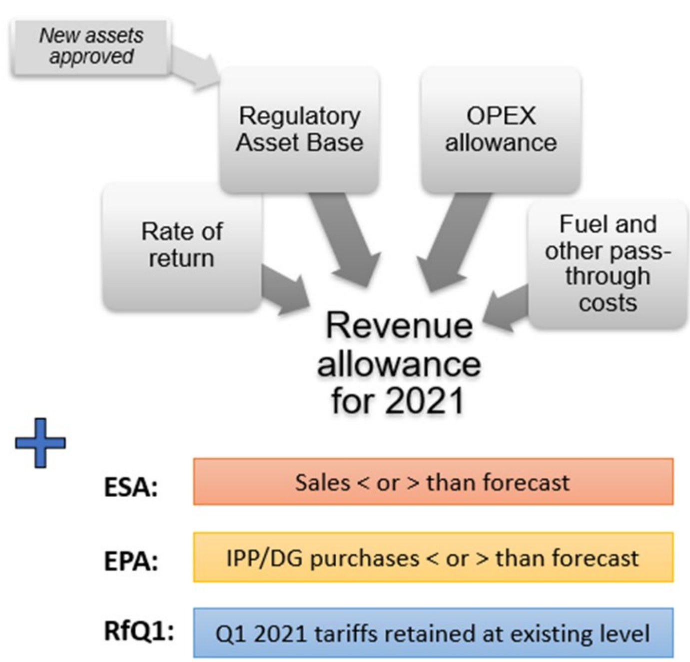
Retail Tariff Review Public Report

The methodology to calculate and approve Retail Tariffs in Bermuda

The current Retail Tariff methodology was published by the Regulatory Authority (the "RA") in October 2018. This rigorous methodology reflects best international practices and incorporates feedback raised by members of the public and industry stakeholders in response to an RA consultation . In summary, this methodology indicates that retail tariffs should be derived from a **revenue allowance** applied for by BELCO and reviewed, possibly adjusted, and validated by the RA. The main factors that make up this revenue allowance, which are scrutinised by the RA are as follows and as illustrated in Figure 1 below:

- The allowable **rate of return**: this allows BELCO to recover the cost of financing new investments;
- The **regulatory asset base**: this represents the inventory of all generation, transmission, and distribution assets owned by BELCO, including new investments applied for by BELCO;
- The **allowance for operational costs (OPEX)**: this includes a range of items from salaries, through to vehicles and lubricants for power plants;
- **Fuel costs projections;**
- **Costs projections with respect to purchasing power** from third parties, such as Tynes Bay power plant and customers with solar panels; and
- **Adjustments** such as the Energy Sales Adjustment and the Energy Purchase Adjustment to align variances noted between actual and forecasted balances.

Figure 1: Components of the revenue allowance



There are **distinct revenue allowances for the Bulk Generation (BG) and Transmission, Distribution, and Retail (TD&R) Business Areas** of BELCO. The revenue allowance for the Bulk Generation business area is recovered by the Transfer Price (transferred from the BG Business Area to the TD&R Business Area). Under this methodology it is anticipated that in the future, revenue allowances should be set in advance for a period that could range between 2 and 5 years. Prior to the end of each period, a new review takes place to set new allowances for the next period.

The RA's initial intention was to conduct a comprehensive review for their second Retail Tariff review this year, considering a longer rate review period of two to three years. However, the impacts of the Covid-19 pandemic on costs, consumption, and revenues from the Regulatory Authority Fee (the "RAF"), resulted in the RA choosing a one-year review period for this year. The current review can be considered as an interim review, primarily seeking to minimize rate disruption, and to provide economic relief for customers during the Covid- 19 pandemic, with no change to the tariff structure, while continuing to ensure the effective and efficient implementation of the Retail Tariff Methodology[1].

The procedure to decide on BELCO's revenue allowance and new Retail Tariffs

The process to review and approve BELCO's revenue allowance for 2021 has followed these key steps:

1) The RA requested BELCO to submit its initial revenue allowance application (received on 17th November 2020).
2) The RA undertook a detailed review of BELCO's initial application and sought further clarification and additional information through a series of information requests.
3) BELCO submitted its final revenue allowance application.
4) Final review and adjustments to BELCO's revenue allowance by the RA, issuance of an Order setting BELCO's revenue allowance for 2021, and request that BELCO produce Retail Tariffs to align with the revenue allowance.
5) BELCO submitted its final Retail Tariffs for approval.
6) RA's final review of BELCO's proposed retail tariffs and publication of an Order setting BELCO's retail tariffs for 2021.

Level of revenue allowance approved for 2021

BELCO submitted a final tariff application which included revenue requirements (i.e. "applied-for" revenue allowance) of BMD $212,983,186 for 2021, before deferrals. Figure 2 below shows a breakdown of the main components of BELCO's submission. [2].

[1] Retail Tariff Methodology https://www.ra.bm/documents/retail-tariff-final-report-decision-order/?wpdmdl=13336&refresh=5dd5dc4e63dfa1574296654
[2] net of "other revenues" deducted from the revenue allowance

Figure 2: Breakdown of 2021 Revenue Allowance by Business Area Before Deferrals

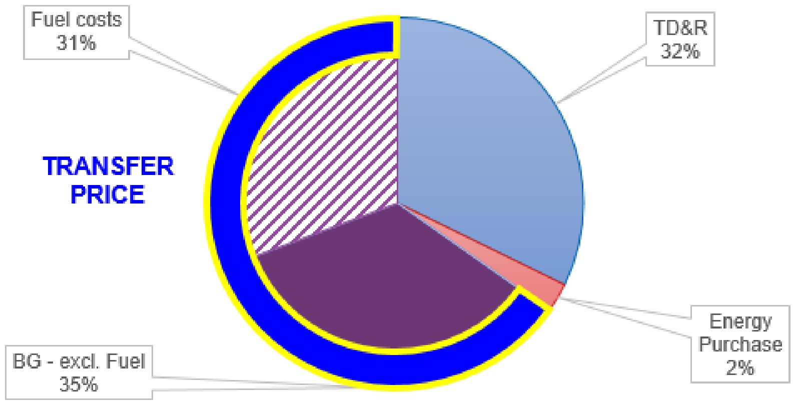


Figure 2 also demonstrates how BELCO's Revenue Allowance is split between revenue categories within their final submission. The following key observations can be made from BELCO's submission:

- Energy purchases accounted for 2% of the overall revenue requirements;
- Fuel is roughly a third of the total revenue requirements;
- Overall, roughly two thirds of the revenue requirements relate to BELCO Bulk Generation, while a third relates to BELCO TD&R; and
- The Transfer Price accounts for 66% of the revenue requirements when fuel is included.

BELCO observed that the level of Revenue Allowance applied for, would need to increase existing electricity rates, which BELCO recognised was not desirable to do in the current context.
As such, BELCO offered to defer recovery of a share of total revenue allowance (BMD $13,477,034 in total) to future review periods. Thus, BELCO proposed a revenue allowance for 2021, net of deferrals (also referred to by BELCO as "capped allowance") of BMD $199,506,153.

However, the RA set the level of Allowed Revenue for 2021 at BMD $ 211,432,019. This means a decrease of approximately BMD 1.6 million to the Allowed Revenue applied for by BELCO. The main observations that have led to this conclusion are summarised below.

- An independent review of BELCO's cost of equity calculations indicated that it was reasonable to decrease the allowed rate of return from 8% (current level and as applied for by BELCO for 2021) to 7.5%.
- After the review of BELCO's OPEX Allowance for 2021, the RA decreased the allowance by BMD 0.33 million in comparison with BELCO's application.
- A review of BELCO's capital budget in 2020 and 2021 prompted the RA to remove BMD $13 million from the 2021 capital budget. This was attributable to "staggered overspent" on the 2020 capital budget allowance, and assets not deemed prudent to include in the regulatory asset base due to insufficient justification.

Methodology to calculate the new retail tariffs in Bermuda

The methodology to set the 2021 Retail Tariffs was set to address the following key principles:

1) The Retail Tariff structure (meaning the nature and definition of tariff components charges including the facilities charge, the energy charge, and the demand charge) should remain the same as that in place in 2020;

2) The new Retail Tariffs should enable BELCO to recover a maximum of BMD $198.0 million (i.e. the revenue allowance set in Order #20210507 published on 7th May 2021;

3) The new Retail Tariffs should be set with the intent of having an even impact within the customer groups; and

4) There should be a decrease in Retail Tariffs for all customers and the average rate reduction should be comparable across all customer categories.

The process of adjusting the Retail Tariffs to achieve the Allowed Revenue has drawn on actual consumption and billing data provided by BELCO covering the 12-month period from the 1st January 2021 to 31st December 2021.
The selected methodology:

- delivers a reduction in average tariff to all customer groups;
- retains the current ratios between the different Retail Tariffs within the tariff (such as the facility charge, the energy charge, and the demand charge), which will limit the range of impacts on customers with different consumption levels;
- allows for the transparent reflection of the full cost of fuel to be recovered through the Fuel Adjustment Rate (FAR); and
- further encourages energy efficiency across all customer groups.

Figure 3 represents the estimated variation in Retail Tariffs, by customer group, between the existing Retail Tariffs and the new Retail Tariffs approved by the RA. It indicates that the new tariffs are expected to yield a weighted average reduction in retail tariffs (across all customer groups) of 1.6%.

Figure 3: Weighted Average Bill Impact from May to June 2021 by Customer Class (including and excluding FAR and RAF)