

Summary of Responses and Discussion

This document sets out the summary of the public comment received from Bermuda Electric Light Company ("BELCO") on the Preliminary Report, Preliminary Decision and Order for the TD&R Licence and the Authority's response and analysis. Please note that the Authority has summarized certain comments and the Authority has omitted comments if the issue that they raise was already addressed in this document.

21. The Authority proposes to adopt the Proposed Order set out in Appendix A and enact the Proposed General Determination set out in Appendix B to this Preliminary Report and Preliminary Decision. The Authority invites interested parties to comment on the Authority's conclusions with respect to the responses to the Consultation Document, Preliminary Report, the Proposed Order and the Proposed General Determination.

Part I, Section 1 — Definitions.

BELCO provides comment on the following definitions as they are presently set out in the Updated Draft Licence:

"Affiliate": this definition contains a typo in that the word "means" is included twice, and in any event, BELCO suggests the following language to bring clarity: "means in relation to the Licensee any entity that the Licensee directly or indirectly Controls, is Controlled by, or is under common Control with."

Authority's Response: We will align this definition with the definition used in the Bulk Generation Licence.

"Condition": While BELCO believes that the inclusion of the words "including any Transitional Conditions..." is appropriate, it is noted that there is no provision in the Draft Updated Licence which actually makes the Transitional Conditions operative. In fact, there is no provision in the Updated Draft Licence which provides that the Licensee shall comply with any Conditions at all. BELCO suggests that such language be included. The word "term" may be changed to "Condition" in Condition 6.1(a) of the Updated Draft Licence.

Authority's Response: We agree with BELCO's position. We will amend Condition 6.1(a) so that it reads "the Conditions of this Licence, including any Schedules and Annexures to this Licence".

"Generation Unit": BELCO believes that the prior version of this definition included in the Initial Draft Licence was clearer, as it confirmed that Generation Unit did not include a distributed generation system. BELCO suggests that the language be reinserted.

Authority's Response: We will amend the definition of "Generation Unit" such that it reads: "means any plant or apparatus for the generation of electricity including a facility compromising one or more generation units. For the avoidance of doubt, a Generation Unit shall not include any distributed generation systems."

"Insolvency Event": When, in the First Round Response, BELCO commented that the definition misunderstands insolvency law in Bermuda given that the Bankruptcy

Act 1989 does not apply to the insolvency of companies, the point BELCO was making is that companies cannot be adjudged bankrupt. The Electricity Act 2016 (the "EA") contemplates that the TD&R Licensee will be a company. This definition ought to reflect the exhaustive winding up provisions of the Companies Act 1981.

Authority's Response: The Authority notes that the Companies Act 1981 or any other applicable law is subject to change and therefore references applicable law in subsection (f) of the definition.

"Merit Order": Condition 28.4 of the Updated Draft Licence indicates that merit order is to be understood as least cost ranking, but this definition and the Authority's response to BELCO's, as set out in the Summary, prioritize use of renewable resources whether or not least cost. The Authority states that the approval of this definition by the Minister responsible for energy (the "Minister") will amount to a ministerial direction on the prioritization of renewable resources.

BELCO makes three points on this definition and the related issues.

First, the differences between the definition and Condition 28.4 of the Updated Draft Licence create confusion and uncertainty. The inclusion of this language in the Updated Draft Licence presents one example of how text going beyond licence conditions intended under the EA undermines the seamlessness the Authority intends.

Second, merit order is generally understood to be least cost ranking (that is, economic dispatch). Any other order would subsidize the use of the superseding resource and would require BELCO to raise customer rates to pay the subsidy. While there may be policy reasons for imposing a subsidy that will increase rates, it should not be implemented via a licence condition. Rather, any subsidy should be implemented through a ministerial direction involving the submission of information to the Minister sufficient for him to make a thoughtful, transparent and considered decision, in accordance with Section 9 of the EA. The subsidy that could result for BELCO customers by not adhering to a normal merit order could be substantial. Such a price hike should not be imposed sub silentio via an ambiguous and inconsistent licence definition.

The Authority states that if the Minister grants his consent to all the conditions added in the licence then "Ministerial directions will be issued to this effect." The Minister's consent to approve the conditions of this licence under Section 26(3) of the EA does not amount to a ministerial direction and does not supply the necessary transparency for a subsidy decision under Section 9 of the EA. The Minister would not have the information needed to make an informed decision, e.g., to understand the impact of the subsidy on BELCO's customers. Further, Section 9 of the EA provides that, in resolving trade-offs, the Minister shall, "in addition to considering Government policy, consider the purposes of this Act, public comments, and any technical analysis given by the Authority." The Authority needs to provide technical analysis regarding impacts before such a subsidy can be assessed, and this process of determining trade-offs is not an appropriate part of the licensing process.

Third, to the extent that BELCO is required to invest in additional assets to compensate or support the prioritization of renewable energy sources, BELCO is of the view that it should be compensated for the costs of acquiring and operating those additional assets.

Authority's Response: Section 26(3) of the EA 2016 does not prescribe the form in which the Minister must provide consent when consenting to additional Conditions being included into a Licence which are not listed under Section 26(1)(a) of the EA 2016. In any event, the current definition of "Merit Order" provides that cost considerations will be taken "fully into account".

"Power Purchase Agreement": The Authority has incorrectly stated that BELCO has said that the definition is unclear and confusing. In the First Round Response, BELCO did not make any comment on this definition and has no issue with it. It is unclear, however, why the Draft Updated Licence includes a definition of power purchase agreement different than that contained in the EA. BELCO also notes that a third definition, which is unclear, is used in the bulk generation licence contemplated by the corresponding consultation. Such differences undermine the seamlessness that BELCO agrees the regulatory framework should contain. Seamlessness requires that the same definition be used in all contexts.

Authority's Response: The Authority agrees that the same definition should be used across the different licences.

"Relevant Assets": BELCO believes that the suggested percentage for this definition is so low that it would be administratively expensive and would, therefore, represent a burdensome obligation on the Licensee. To address the onerousness of the Condition as contemplated and also to bring clarity, BELCO suggests the following amendment: "means any asset which is necessary to enable the Licensee to comply with its obligations under the EA, RAA and this Licence and including those assets which form part of the Licensee's Grid System including any interest in land upon which such asset is situated and which has a value in excess of **5%** of the accounting value of **total** property, plant and equipment."

Authority's Response: In response to Bulk Generation Licence - Renewable Energy Roger Todd explained that the definition of "Relevant Asset" as drafted would not include an asset that remains relevant and in service after it has been fully depreciated. The Authority has updated the definition to remove a percentage based definition. It also allows the Authority to make an administrative determination setting forth a methodology to determining relevant assets.

"Renewable Energy": BELCO suggests that this definition mirror the one provided in the EA.

Authority's Response: We agree with BELCO's comment and will make the necessary amendment.

"Service Agreement": In the Updated Draft Licence, the definition provides that Service Agreement, "means an agreement as more particularly described in Condition 29.3." Condition 29.3 reads: "Within one month from the Commencement Date, the Licensee shall submit to the Authority for approval the form of Service Agreement used by the Licensee."

BELCO considers that the definition is circular and would suggest that it instead read: "means an agreement between the Licensee and the End-User as more particularly described in Condition 29."

Authority's response: We agree with BELCO and will make the necessary amendment.

Part I, Section 3.3 — Scope of the Licence (No Relief from Additional Obligations).

The proposed Condition provides that nothing in the licence shall relieve the Licensee of obligations to comply with any other requirement imposed by Law or practice to obtain any additional consents, permissions, authorisations, licences or permits as may be necessary to exercise the Licensee's right to discharge its obligations under the licence. BELCO asked for clarification as to the meaning of "practice." The Authority responded that this means "custom/practice of the market", and the Authority states that this may constitute an implied contractual term under English law.

Apart from the fact the licence to follow the Updated Draft Licence is to be construed in accordance with Bermuda law, any additional "consents, permissions, authorisations, licences or permits" that BELCO might need are governed by law and not by contract. The concept of implied terms in private contracts should not be confused with regulatory obligations. The term "practice" does not make sense within this regulatory context.

Authority's Response: For the sake of clarity, the Authority will delete "practice" and replace this with "Prudent Operating Practice".

"Prudent Operating Practice" means the practice of a Reasonable and Prudent Operator.

Part I, Section 4 — Term of the Licence.

In the Summary, the Authority noted that, "Section 28(2) of the EA provides that, unless provision to the contrary is made in the licence, a licence may be renewed. Therefore, the EA does not contemplate any automatic right of renewal." BELCO believes that the licence should provide for treatment of stranded assets in the event that a renewal is not granted.

Authority's Response: In practice, as long as BELCO continues to properly perform its functions as prescribed under the terms of this Licence, the Authority will have no reason to reasonably deny a renewal or extension request by BELCO. If, however, BELCO breaches the terms of this Licence such that there is a substantial adverse impact on both its customers and Bermuda as a whole, then it is not reasonable for BELCO to expect any payments in the event that its Licence is not renewed or extended. It is the responsibility of the Authority to ensure that the interests of end-users with respect to prices and affordability, and the adequacy, reliability and quality or electricity services are protected.

BELCO's responsibility is to make sure it does not get into such a position and its inability to get any monetary benefit for its assets in such circumstances serves as an incentive for BELCO to remedy its breach as soon as possible. It should also be noted that, in practice, the value of assets in the hands of an entity which has had its licence revoked is substantially reduced.

In his response to Bulk Generation Licence – Renewable Energy, Roger Todd stated that power generation infrastructure is typically designed for a nominal service life of 30 years and furthermore Section 28(1) EA provides for a licence term of up to 30 years. Accordingly, the Authority has amended Condition 3.1(a) to include a 30 year term.

Condition 7.4 — Information, Audits and Inspection (Potential Breach).

The Authority states that it is imperative that BELCO inform the Authority as soon as it becomes aware that it is in a position in which it may "potentially" breach any Condition, adding "especially if an insolvency event becomes possible."

BELCO agrees that it should have a duty to report any potential breach (or other event) that has a **material** impact on its ability to perform its licensed operations. BELCO does not, however, understand why the Authority refuses to incorporate a materiality limitation. The consequence of not so limiting a reporting duty is to add unnecessary compliance and reporting costs that will raise rates for BELCO customers for no beneficial reason.

Authority's Response: materiality is a very subjective concept and there will inevitably be a difference between what the Authority and the Licensee consider to be "material". As the regulator, it is for the Authority (and not the Licensee) to determine whether a potential breach has a material impact on the ability of the Licensee to perform its licensed operations. Please note, the Authority has an underlying duty to act reasonably when making its determination.

Condition 9.2(b) — Enforcement, Supervision and Revocation (Revocation of Licence).

BELCO requests that the Authority specify the provision of law that enables the Authority to revoke the licence in the event of an Insolvency Event affecting the Licensee.

Authority's Response: BELCO is implying that it can be insolvent and still continue to have in force its bulk generation licence. As a matter of fact, if an "Insolvency Event" affects a Bulk Generation Licensee, such Bulk Generation Licensee will not be able to properly perform its obligations under its Licence. In these circumstances, it is not reasonable that the Licensee should continue to hold its Licence. In fact, this provides the greatest incentive for BELCO/Licensees to act in such a way so as to retain its Licence. This is a very common and fundamental position incorporated into electricity generation licenses in multiple jurisdictions.

The Authority has a responsibility to ensure the adequacy and reliability of electricity supply in Bermuda and is therefore permitted to take actions against any Licensee that is unable to perform its obligations under the Licence (see Sections 6 and 14 of the EA 2016). Section 14(4)(c)(i) of the EA 2016 provides that the Authority may make administrative determinations, including for the suspension or revocation of licenses for the provision of electricity where, amongst other things, the purposes of the EA 2016 (Section 6) are not met.

Condition 9.4 — Enforcement, Supervision and Revocation (Involuntary Transfer of Assets).

Citing, in particular, Section 6 of the EA, the Authority apparently confirms that it contemplates seizure of BELCO assets without compensation.

Seizure of assets without compensation is unconstitutional, illegal and wholly unacceptable. By apparently confirming that the Authority contemplates such a possibility, the Authority also potentially raises the cost of capital, imposing higher prices on BELCO customers for no good reason. It may impede BELCO in obtaining financing at a reasonable cost for substantial capital investments when the regulator contemplates that it may seize those assets with no compensation to its owner and investors. Nowhere in Section 6 of the EA or any other provision of the EA is it provided that the Authority can so act, and the EA would be

unconstitutional if it did so provide. Again, BELCO urges the Authority to clarify its position and assure the market that it does not contemplate uncompensated seizure of BELCO's assets.

Particularly with respect to this Condition, BELCO repeats that it reserves its rights to pursue all remedies available to it in law if the Authority insists on inclusion of the Condition in its present form.

Authority's Response: Please refer to our comments under your response to Condition 9.2(b) above – the same principle applies.

Condition 11 — Accounting Requirements.

In response to BELCO's assertion in the First Round Response that it could develop segment reports of its accounts supplemented by additional management account details appended to BELCO's annual financial statements, the Authority stated as follows:

In relation to [BELCO's suggestion that it should be required to develop segment reporting of its accounts] above, the Authority does not agree that segment reporting of BELCO's accounts consistent with the requirements under IFRS alone will suffice. It appears that BELCO is also proposing to provide disclosure of its management accounts which are unaudited. If BELCO was to provide both of the above (IFRS segment reporting and management accounts) this may be sufficient but this will depend on the granularity with which management accounts are reported and this leaves a lot of discretion with BELCO. The Authority is of the view that some kind of external scrutiny over BELCO's accounts by requiring auditors to give an opinion on the accuracy of the accounts of BELCO Generation Business and BELCO **TD&R** Business will be more appropriate.

The Authority's comments with respect to this Condition are confusing. It seems that the Authority is willing to move toward a workable solution, but the relevant aspects of the Condition remain substantively the same.

BELCO had hoped that it could engage in a dialogue to better understand the way forward for Condition 11, but at an ex parte meeting held on 28 June 2017 attended by BELCO representatives, Paul Byrne, Partner of PricewaterhouseCoopers Ltd., BELCO's Auditor ("PWC"), and the Authority's staff at the Authority's offices (the "Meeting"), it was made clear that the Authority was only willing to hear from BELCO and was unwilling to engage in a dialogue to resolve the matter.

Condition 11 of the Updated Draft Licence continues to be unworkable for the reasons set out below.

During the Meeting PWC explained that, in Bermuda, the regulation of the electricity sector by the Authority in Bermuda could be analogous to the regulation of the insurance sector by the Bermuda Monetary Authority (the "BMA") which has in place a decades-old regulatory accounting framework (the "BMA Framework"). It was suggested that the use of a similar framework for the accounting regulation of the electricity sector may make sense and may offer a greater cost-benefit than the proposed requirements. Details of the specific₆

recommendations are mentioned below under the appropriate headings, but changes may be required to bring the balance of the Sub-Conditions in line with the entirety of the Condition.

BELCO notes that the Updated Draft Licence contains Transitional Conditions relating to Condition 11 and the Authority has invited BELCO to suggest other provisions it thinks ought to be included therein. BELCO notes, however, that the inclusion of these Transitional Conditions does not alleviate BELCO's inability to comply with unworkable Conditions when the transitional period is over. As such, Condition 11 must still be substantially amended.

Authority's Response: The Authority has included a Conditional Provision A1 in the Annex which suspends the application of Condition 11 until the final accounting methodologies, mechanisms and other determinations have been made by the Authority.

Condition 11.3 — Accounting Requirements (Specific Requirements).

This Condition requires the preparation of full financial statements and footnotes for each of the separate business lines. As 1) both businesses are operated by one legal entity, 2) revenues are billed in a single transaction to customers, 3) cash flows are operated for the legal entity as a whole, and 4) many employee and other expenses are incurred for the entity as a whole, separate business financial statements would only be possible after applying a substantial degree of allocation.

During the Meeting, PWC explained to the Authority the accounting treatment of separate businesses within the same legal entity under the BMA Framework. BELCO suggests that it will prepare a limited set of financial statements for the TD&R Business and Bulk Generation Business (as the same are defined in the Updated Draft Licence) that would include a balance sheet and income statement as well as footnotes which specifically provide information on the basis of allocation of assets, liabilities, revenues and expenses to the separate businesses. Those footnotes would be reconciled to the full set of annual financial statements. The statement of changes in equity, cash flow statement and statement of comprehensive income would be excluded, as these statements will relate to the legal entity as a whole as dividing them into separate businesses would not provide decision-useful information. Furthermore, all other footnotes and accounting policies would be excluded, as those footnotes are already included in BELCO's consolidated audited International Financial Reporting Standards ("IFRS") statements.

Authority's Response: See comment above as regards to the practical implementation of Condition 11.

Condition 11.4 — Accounting Requirements (Auditor's Report).

BELCO's external auditor could provide an audit report on the separate business financial information included in BELCO's limited financial statements.

BELCO notes that PWC has stated that an audit will only be feasible to the extent there is a documented and approved approach for separating the elements of BELCO into the separate businesses. This will require BELCO and the RA to agree on transfer pricing mechanisms for revenues, cost allocations methodologies and a determination as to the allocation of various

assets and obligations, some of which may relate specifically to a separate business and some of which relate to the legal entity as a whole.

BELCO notes that much of the above information is currently not maintained by BELCO, and a separation project would be a significant and time consuming undertaking. Such project would need to include: 1) consideration of the amount of additional resources needed to implement the separation, 2) additional resources needed to account for the separate businesses on an ongoing basis, 3) information technology implications in terms of ensuring that as much of the process as possible could be automated. BELCO also notes that there would be an impact in terms of ongoing audit costs relating to the above. In light of these realities, BELCO is grateful that the Authority has included relevant Transitional Conditions.

As explained by PWC during the Meeting, where financial information is prepared in accordance with a special purpose framework or regulatory basis of accounting, the related audit report would be restricted to the exclusive use of the Authority. This form of reporting currently exists in Bermuda under the BMA Framework. Financial statements are prepared on the basis of the Insurance Accounts Regulations 1980 or Insurance Account Rules 2016 on which auditors issue reports for the exclusive use of the BMA. As the BMA Framework is not an internationally recognized basis of accounting, the statutory financial statements and related audit reports that are produced are not published. PWC has suggested, and BELCO does recommend, that a similar approach be adopted with respect to the separate business financial information and related audit reports of BELCO.

Authority's Response: The Authority has included a Conditional Provision A1 in the Annex which suspends the application of Condition 11 until the final accounting methodologies, mechanisms and other determinations have been made by the Authority.

Condition 11.7(b)— Accounting Requirements (Publication of Accounting Statements).

Consistent with BELCO's above comments relating to Condition 11.4 of the Updated Draft Licence, and similar to the BMA Framework, the information to be provided in accordance with the revisions BELCO proposes here should be restricted to the exclusive use of the Authority.

BELCO believes that IFRS is designed to meet the needs of a very broad group of users. They include comprehensive accounting policies that explain their basis of preparation together with detailed footnotes. The segment reporting rules of IFRS are designed to present disaggregated information in line with the way that a business is run by the chief executive officer.

We do not believe that the general purpose user of the BELCO statements would require information additional to the IFRS financial statements. Furthermore, the information is prepared in accordance with the Condition, and is not necessarily designed to meet the needs of a broad group of users or be comparable to other entities' financial statements.

Authority's Response: The Authority cannot strictly restrict such information to its exclusive use, as the Authority is required to provide information to the Minister in accordance with the RAA. Further, the Authority's broader responsibilities under the EA and the RAA may require it to share certain information to other parties under certain circumstances.

Condition 12 — Availability of Resources.

Here, and generally throughout the Authority's responses in the Summary, the Authority posits that the monopoly status of the Licensee means that no condition imposed by the Authority could be discriminatory. Discrimination *can* occur against a monopoly if a condition, not imposed on any other entity, is unconnected to a potential abuse of the monopoly status. That there is only one TD&R licensee does not mean that there are no limitations on the Authority's power to impose conditions. The regulator should not micromanage a licensee's business simply because it is a monopoly. The regulator must have a logical reason to impose a condition and that reason must be related to the scope of the regulator's authority and the objective behind that authority.

When a regulator contemplates conditions that will impose significant costs on ratepayers, the regulator needs a coherent reason for taking such action. The subject of this Condition is availability of resources, and thus the goal of this Condition must be to ensure that the Licensee has adequate resources to perform its duties under its licence. This goal is ensured in many ways under the EA. There is no justification to impose additional costly duties on directors and controlling interest holders, and the Authority provides no explanation except "BELCO is a monopoly."

Authority's Response: We do not agree with BELCO's comment. In order to comply with its obligations under the EA, including with regards to ensuring the safety and reliability of electricity supply in Bermuda, the Authority needs to make sure that BELCO has sufficient financial resources to undertake its licensed activities.

In any event, the Authority will insert this Condition in all electricity licenses.

Condition 12.5 — Availability of Resources (Auditor's Report).

As explained during the Meeting, BELCO's external auditor audits its historical financial statements in accordance with IFRS and will audit financial statements for the Licensee as described in respect of Condition 11.3. The Auditor does not opine on capital structure, financing alternatives or forward projections and would not be in a position to provide an assurance report on prospective financial information. In any event, the Condition is not proportionate and does not meet its aims of ensuring that BELCO has sufficient available resources.

Authority's Response: Condition 12.5 requires the Licensee to use its best endeavours to procure the requested report. The Authority recognizes that there may be externalities that prevent the Licensee from procuring such report.

Condition 12.6, 12.7 — Availability of Resources (Controlling Interest Holder).

BELCO repeats here its comments made in the First Round Response and its above comments that the Condition can still be discriminatory to a monopoly. The Authority also focuses on only one aspect of BELCO's position on this matter — that it is discriminatory — but fails to address how it believes it appropriate for BELCO to procure anything from an independent, separate legal entity. The Condition imposes requirements on non-licensees that BELCO does not control and therefore cannot be a condition imposed on the Licensee.

Authority's response: BELCO is managed and operated by its Controlling Interest Holder and, therefore, the Authority requires this provision. The Authority maintains that the inclusion of

this provision is not discriminatory but is necessary for the Authority to ensure that BELCO continues to be able to perform its obligations under the TD&R Licence.

Condition 13 — Prohibition of Cross-Subsidies.

In response to BELCO's comment that, until cost allocations are set, some costs under the shared services arrangements might be deemed cross-subsidies beneficial to BELCO and that BELCO's parent has had to provide subsidies in the past, the Authority states that:

There is no evidence to support the cost saving position proposed by Belco and, also a lack of past transparency, which needs to be addressed. However, the Authority has inserted a reference back to this Condition in the Transitional Provisions (see Annex below) which facilitates transitional arrangements until the Authority approves an accounting separation methodology in relation to BELCO's business.

First, BELCO notes that the Transitional Conditions mention Condition 13 but do not actually include substantive provisions.

Second, the statement that "there is no evidence" is a non sequitur, because this is not an adjudicatory proceeding, and BELCO has been given no notice and opportunity to provide such evidence.

Third, BELCO understands that the Authority wants to ensure that it has the tools necessary to impose transparency and maintain a level playing field in the competitive generation sector. A general prohibition as to cross-subsidies and development of transparent accounts are appropriate regulatory goals which BELCO supports. The immediate issue here is what language is appropriate for inclusion as a licensing condition. It does not make sense to include conditions that could raise costs to ratepayers by precluding assistance from BELCO's parent or prohibit a shared service arrangement that saves customers money.

BELCO suggests that Condition 13 be included in the Transitional Conditions for further development and that the language of Condition 13 recite the goals as noted above and the Authority's power to review shared services arrangements. The size and nature of Bermuda's electricity sector require shared services as a practical matter. The Authority should review and approve those services so that they result in least cost to Bermuda's ratepayers. Provisions allowing for such monitoring and approval can be included in Condition 13, but language that hampers the Licensee's ability to serve customers at reasonable cost should not. Further comment is included in the below section relating to the Transitional Conditions.

Authority's Response: The Authority has engaged appropriate consultants with extensive market experience – and has relied on their advice in framing these Licence conditions in the interests of electricity consumers in Bermuda. We have included a provision in the Transitional Provisions that the same arrangements that applied immediately before the Commencement Date shall apply until such time as the Authority has reviewed the current shared services arrangements and the Authority and the Licensee agree a separation methodology, and such methodology is agreed by the Authority by Administrative Determination and a practical timeframe for implementation is agreed. The Authority welcomes BELCO's positive remarks set out above as regards prohibition of cross-subsidies and the development of transparent accounts.

Condition 14.2 Service Standards & Performance Standards (Details to be provided).

In response to BELCO's comment that the language in this Condition would broadly require reporting of any voltage fluctuation, the Authority has modified Condition 14.2.

The textual changes made do not fix the problem. The language could still require BELCO to report any voltage fluctuation as a "detail" regarding a standard "it has failed to meet." BELCO cannot believe that the Authority wants massive reports of every voltage fluctuation, with the accompanying unnecessary costs to ratepayers such reporting would incur. Hence, this issue is simply a matter of finding language that meets the legitimate goal of obtaining reports that inform the Authority of ***material*** failures to meet standards. Insertion of a materiality limitation would achieve this result.

The Authority notes that, "Service standards and objectives will be agreed over time and there are also existing legal expectations that BELCO will perform at a fair level. Accordingly, the Authority has inserted a provision dealing with service standards in the Transitional Conditions at Annex 1 (see below)."

BELCO notes that there is a heading in the unnumbered Annex but no provision is included. As such, BELCO does not know what the Authority contemplates.

In any event, Transitional Conditions will not remove the obligations set out in the Conditions themselves and must be workable when they become operable even if they are not applied for some period. Further comment is included in the below section relating to the Transitional Conditions.

Authority's Response: The Authority has engaged several expert advisers and we are in agreement that these reporting obligations will not lead to BELCO's customers incurring great losses. Rather than there being a material increase in costs, the Authority believes there will be a material benefit to BELCO's customers from such reporting requirements. In order for the Authority to perform its function as the regulator, it is important that it is made aware of whether or not a Licensee is complying with its services and performance standards. BELCO TD&R is receiving its tariff on the basis of a set of services that it is providing. Therefore BELCO TD&R should be obliged to tell the regulator when it is not meeting those service standards and it is for the regulator to assess such impact on customers and decide if BELCO TD&R non-compliance is material or not.

Condition 14.7 — Service Standards & Performance Standards (Consequences for Non-compliance).

While the Authority has addressed the basis upon which it believes that it can impose a penalty for failing to comply with a service standard, it has not addressed the basis upon which it can require the Licensee to pay compensation to customers for failure to comply with standards. BELCO suggests that the Authority has not answered that aspect of BELCO's comment because the Authority cannot so require the Licensee. BELCO further requests that Condition 14.7(b) be removed from the Updated Draft Licence.

Authority's Response: the obligation to pay compensation to customers is consistent with Section 6(e) EA 2016 that the purpose of the Act is to "protect the interests of end-users with respect

to...the adequacy, reliability and quality of electricity service". The Authority believes that the obligation to pay compensation acts and an incentive for Licensees take more care in ensuring that its service and performance standards are met.

Condition 14.8 — Service Standards & Performance Standards (Tariff Reviews).

In response to BELCO's comment that language providing that service standards shall be considered in tariff reviews is not a licence condition, the Authority states: "This should appear in both the Licence and the General Determination. The Licence must contain such provision to allow the Authority to perform its duties in accordance with the Law."

First, a statement as to what the Authority will do in a tariff review is not a licence condition.

Second, either the EA provides the Authority with the power to review service standards in tariff reviews or it does not. If it does, this will be reflected in the general determination required under Section 35(1) of the EA. If it does not, then the Authority cannot expand its powers beyond that provided by law. Hence, it is incorrect to state that the licence must contain this language for the Authority to perform its duties in accordance with the law.

Authority's Response: It is imperative and absolutely necessary that the Authority has the power to review service standards in tariff reviews because, ultimately, the retail tariff (ie the price at which BELCO TD&R charges customers) is based on the services BELCO TD&R is providing.

Condition 15 — Disposal of Relevant Assets.

With respect to Condition 15.1, BELCO notes that "control" has now been lowercased but suggests that it remains necessary for the Authority to provide a different definition of the word "control" in the context of this Condition. Although the Authority has effectively disassociated the definition from this Condition, the similar definition set out in the Regulatory Authority Act 2011 now applies and also does not make sense in the context of this Condition.

Authority's Response: It should be obvious to BELCO whether or not it is in control of any of its assets. We cannot specify every circumstance that will occur in the future. These words must be given their plain, common sense meaning. The regulator must be able to know when the Licensee is disposing of assets/is not in control of assets which are necessary to secure the security of electricity supply in Bermuda.

Condition 16.5 — Restriction on Use of Certain Information (Precautions).

BELCO welcomes the Authority's recognition that many individuals will be involved in both the TD&R and Bulk Generation aspects of BELCO's operations but suggests that the newly included language again fails to recognize that BELCO is but one legal entity. While there are separate lines of business within BELCO, separate "businesses" are not actually operated. Employees, agents, consultants and other individuals will never be engaged by one of the businesses. These persons will be engaged by the single legal entity, BELCO. The second sentence is redundant, as the first sentence seems to sufficiently and clearly address the Authority's aim. Furthermore, the second sentence is unclearly drafted and is a logical impossibility. It currently states that, "any person, who works for both the Licensee's TD&R

Business and the Licensee's Generation Business, shall not disclose any Protected Information it receives in its capacity as employee, agent, and consultant of the Licensee's TD&R Business to the Licensee's Generation Business." Does that mean that a BELCO employee involved in both lines of BELCO's business cannot disclose information to himself or herself?

Authority's Response: We have amended this Condition so that it reads "any person, who works for both the Licensee's TD&R Business and the Licensee's Generation Business, shall not disclose any Protected Information it receives in its capacity as employee, agent, and consultant of the Licensee's TD&R Business to any other person in the Licensee's Generation Business and vice versa."

Condition 17 — National Disaster Contingency Fund.

In response to BELCO's comment that the cost of the fund must be recoverable, the Authority states: "The Authority may assess a range of cost recovery options, prior to any decision on the same."

The Authority's language is unclear. To the extent it suggests that the fund or a portion thereof will not be recoverable in rates, such would violate Section 35(2) of the EA and be confiscatory. Again, by making such suggestions, the Authority creates uncertainty and unnecessarily increases the cost of capital.

The Authority's position that it should remain opaque on this point is also inconsistent with its position as to Condition 14.8 of the Updated Draft Licence, noted above, that tariff review standards must be included in the licence. If what factors may be considered in a tariff review must also be included, then it follows that a provision acknowledging that the cost of the fund is recoverable in rates must also be included. Under Section 35 of the EA, BELCO is entitled to recover its reasonable costs of service. The obligation to contribute to a fund is a cost of service, and by raising the spectre that the Authority will not permit recovery of this cost, uncertainty is created and raises the cost of capital and costs for BELCO's ratepayers. Further, the asymmetrical inclusion of provisions aimed at reducing the Licensee's revenue when there are no corresponding provisions acknowledging revenue to which the Licensee is legally entitled, is, by definition, discriminatory.

Authority's Response: The Authority disagrees that this provision is discriminatory, as it is one of many considerations into the overall tariff setting methodology. Condition 17 sets forth that the National Disaster Contingency Fund will be funded from the Licensee's revenue and will be a consideration of the tariff setting methodology set by General Determination. The general determination process requires two rounds of public consultation, which will allow BELCO to provide feedback on the specifics of the methodology.

Condition 18.1 — Basis of Charges for Connection to Grid System (Statement to be Prepared).

If the Authority intends to insist that this Condition be included, it should be amended. It currently requires that within six months BELCO prepare a "statement, approved by the Authority." As a practical point, it is not within BELCO's power to provide an "**approved**" statement within six months because it cannot govern when the Authority will act to approve the statement.

Authority's Response: The Authority will work with BELCO to ensure that the statement is reviewed and approved in a timely manner.

Condition 20.2 — Requirement to Offer Terms.

This Condition provides that the Grid Connection Policy shall be the Bermuda Electric Light Company Limited Service Rules, but this reference is incorrect as the service rules do not wholly constitute the Grid Connection Policy. There is a practice in place governing grid connection, and within 30 days of the Commencement Date, BELCO will submit details on the same.

Authority's Response: Transitional Condition A4 provides that BELCO shall adhere to the BELCO Service Rules until the Authority approves the Grid Connection Policy.

Condition 22.2 — Grid Code.

Given that the Authority has not specified the timeframe during which BELCO is to submit the Interim Grid Code, BELCO suggests that it be required to submit it within 90 days from the Commencement Date.

Authority's Response: The Interim Grid Code is defined as the standards which the Licensee applied immediately prior to the Commencement Date. Accordingly, the Authority does not believe BELCO requires 90 days from the Commencement Date to submit this. BELCO is required to submit this to the Authority within 10 days of the Commencement Date.

Condition 22.4 — Grid Code.

With respect to this provision, the Authority has stated that, "BELCO does not want to draft the interim Grid Code — it says this is onerous if the final Grid Code will take effect in 1 year in any event. BELCO says the Licence should not set out principles by which the Grid Code should be developed."

BELCO did not make any such comment in relation to this provision or the Interim Grid Code and believes that perhaps the Authority conflated other comments made in connection with the Grid Connection Policy. BELCO believes that this misattribution highlights how overworked and cumbersome Conditions 18 through 22 of the Licence are.

BELCO notes that the Authority has said that, "As regards any interim Grid Code, this could simply be reference to BELCO's current arrangements under the Transitional Conditions prior to agreement of the final Grid Code in 12 months' time." As only a header is provided in the draft Annex included in the Updated Draft Licence, however, it is unclear what is contemplated.

In the First Round Response, BELCO noted that the Condition set out in the Initial Draft Licence provided that the Grid Code must provide for optimal supply, transmission, distribution and storage planned, organised and implemented in accordance with the Integrated Resource Plan (the "IRP"). It was further noted that the Grid Code is required within 12 months yet the EA does not require the Authority to request the IRP from BELCO for up to two years from its commencement date.

In its response, which has been summarized under the incorrect provision (at page 39 of the Summary), the Authority has said that:

While the drafting of exact specifications of the Grid Code would be facilitated by knowledge of IRP scenarios, the Grid Code can still be drafted at the level of access and charging principles / methodologies without specifying the exact nodes and types of energy mix. Therefore, whilst an IRP would be useful, the agreement of a Grid Code is not constrained by the lack of an agreed IRP.

If the Authority is now dismissing the need for an approved IRP when developing the Grid Code, then the Updated Draft Licence text should not still provide that the Grid Code must be designed to adhere to the IRP. The Grid Code cannot be designed to adhere to the IRP if there is no approved IRP. BELCO agrees that a Grid Code is not dependent upon the approval of any particular IRP, and so Condition 22.4(d)(i)(B) should be removed. Alternatively, the Condition should be amended to provide that BELCO shall be required to comply with the IRP to the extent that one exists.

Authority's Response: We agree with BELCO and will remove Condition 22.4(d)(i)(B).

Condition 24.1 — Obligation to Enter into Power Purchase Agreements.

In response to BELCO's comment that it cannot contract with itself, the Authority has changed the text of Condition 24.2.

While the new language leaves questions as to the meaning of the term "substantially similar" the general concept that generation from third party providers should not be treated disparately from BELCO generation absent a rational basis makes sense. BELCO understands the language "substantially similar" to mean this, and, if its understanding is correct, agrees.

While the Authority has amended Condition 24.2 to take into account that BELCO cannot enter a power purchase agreement with itself, Condition 24.1 must also be amended to reflect the same.

Authority's Response: We agree and will make this amendment.

Condition 26 — Retail Tariff & Restriction on Licensee's Revenue (Natural Disaster Contingency Fund).

BELCO repeats here its comments made in the First Round Response.

Condition 26.5 — Retail Tariff & Restriction on Licensee's Review (Persistent Failure).

In the First Round Response, BELCO commented that a process should be developed for determining what constitutes persistent failure; that the subject of this condition should be treated as a general determination and not a license condition; and that while performance incentives and reductions in revenue might be included in a tariff methodology, rates cannot be confiscatory. The Authority responds that "persistent failure/breach" is a recognized term in English law and is best ascertained in individual cases, "especially given BELCO's monopoly

position in Bermuda," and that Sections 35(2) and (3) of the EA refer to achieving service standards set by the Authority under general determination.

The lack of clarity as to the term "persistent failure/breach" raises due process notice issues, exacerbated by the Authority's reference to BELCO's "monopoly" status (suggesting discriminatory intent and treatment). Nothing in Section 35 (2) and (3) of the EA permit confiscatory rates. While the position under English law is persuasive, it is not binding. Finally, since the Authority acknowledges that this subject matter is to be addressed in a general determination, its inclusion in the Updated Draft Licence as a condition is inappropriate and does not make sense.

Authority's Response: the Authority disagrees with BELCO. The terms "persistent failure" and "persistent breach" are recognised terms under English law and are applied as such in the context of this Licence. In any event, the Authority has a duty to act reasonably in determining what it believes to constitute a "persistent breach" and/or a "persistent failure".

Condition 29.3 — Duty to Offer and Supply under Service Agreements (Approval).

BELCO welcomes the revision of Condition 29.3 but notes that the timeframe for the submission of the form of service agreement — one month — is provided in the Summary but not in the Second Round Consultation Document. In any event, given all of the obligations imposed on the Licensee, BELCO suggests that two months would be a more reasonable timeframe for compliance.

Authority's Response: The Authority agrees and will make this amendment.

Condition 34 — Indemnification (Third Party Claims).

In response to BELCO's comment that indemnification of the Authority is not supported in law or industry practice but that, if such a provision is included, it should provide that BELCO shall indemnify the Authority only regarding injury or death for which BELCO has been deemed finally liable in a court of law, the Authority states that it: "is not operating any asset. If any person/customer suffers property damages, injury, death as a result of some action of BELCO but brings an action against Authority, BELCO ought to indemnify Authority *[sic]* for all costs in relation to such claims."

The Authority still cites no legal precedent for this Condition. It additionally appears that the Authority may be asserting that BELCO must pay the Authority's legal costs if anyone sues it no matter how frivolous the claim. Furthermore, if injury or death ensues from some Authority-mandated action that, for example, creates a safety hazard, it is unclear why BELCO should be liable.

Authority's Response: this indemnification language was also used in the Bermudan telecoms licenses and is therefore a generally accepted licence condition in Bermuda. In any event, it is an internationally accepted practice to keep the regulator indemnified against these claims.

Condition 36.2 — No Abuse of Dominant Position (Actions Available to Authority).

As a result of BELCO's comments on this Condition in its First Round Response, the Authority has amended the Condition. Rather than referring to Section 26(1)(f) of the EA, however, the

Condition should refer to Condition 26(1)(e) of the EA. Condition 36.2 provides that, if the Licensee abuses its dominant position, the Authority shall be entitled to take those actions set out in Section 26(1) of the EA. Section 26(1) of the EA is the provision under which the Authority can require the Licensee to comply with remedies, but it does not itself set out any actions. This provision therefore requires rewriting.

Authority's Response: We agree with BELCO that reference should be made to Section 26(1)(e) of the EA 2016 and we will make this change.

Condition 38 — Insurance Requirements.

BELCO prefers the alternative insurance Condition, as it addresses the concerns BELCO expressed in the First Round Response. BELCO currently follows Prudent Operating Practice as it does not insure overhead cabling and poles given limited market availability and cost considerations. BELCO suggests the following language to complete Condition 38.1(a)(i):

- (i) fixed assets (buildings and their contents, machinery, stock, fixtures, fittings and all other personal property forming part of the Transmission System and Distribution System) against risks of physical loss or damage including substations but not including cabling, lines and poles for their full replacement value;

BELCO also suggests that "reputable insurance companies" be defined.

Authority's Response: we do not propose to define "reputable insurance companies" as the term is clear and is to be read literally.

Annex — Transitional Conditions

Throughout the Summary, in response to certain of BELCO's concerns raised in the First Round Response, the Authority has indicated a willingness to impose Transitional Conditions that would absolve BELCO of its obligations to comply with particular Conditions during a transitional period. While the inclusion of Transitional Conditions make sense and may be helpful, it must be remembered that the Conditions themselves do not necessarily become workable simply because they do not apply for a particular period. The Conditions themselves require amendment, even if that means that headings are simply provided for those Conditions with the substance replaced with empty brackets until more appropriate conditions are considered, drafted and approved.

The Authority indicates that it is considering adding Transitional Conditions to the Updated Draft Licence in respect of the following matters:

1. Accounting Separation Requirements
2. Prohibition of Cross-subsidies
3. Service Standards
4. Consumer Protection
5. Grid Connections
6. Tariffs

BELCO repeats its comments made above that the Licence should clearly provide that the Licensee is required to comply with the Conditions (which, as defined, includes the Transitional Conditions).

As headings and no substantive provisions have been provided in the draft Annex, BELCO does not know what the Authority contemplates including in respect of Sections A2, A3, A4 and A5 of the Annex and awaits the Authority's guidance.

BELCO provides the following comment on Sections A1 and A5 of the Annex.

A1 ACCOUNTING SEPARATION REQUIREMENTS AND PROHIBITION ON CROSS SUBSIDIES

Given the comments made above, BELCO suggests the following wording:

Notwithstanding the provisions of Condition 11 and Condition 13, the Licensee shall not be obliged to comply with the provisions of Condition 11 and Condition 13 until such time as:

- (i) the Authority and the Licensee agree the methodologies, mechanisms and other actions to be taken to enable the Licensee to comply with Conditions 11 and 13.
- (ii) any such methodologies, mechanisms and other actions are approved by the Authority by Administrative Determination; and
- (iii) the Authority and the Licensee agree a practical timeframe for the implementation of the methodologies, mechanisms and other actions that will enable the Licensee to comply with Conditions 11 and 13.

Authority's Response: This is fine.

A5 TARIFFS

With respect to A5, BELCO suggests that, during the transitional period, the Condition will provide that the Authority will employ the rate-setting methodology adopted by the Energy Commission in its directive dated 31 March 2016 adjusted to remove the proviso that assets funded by debt be excluded from the rate base.

BELCO believes that this proviso is inconsistent with the allowed return which was based on the Energy Commission's weighted average cost of capital analysis. If the methodology is not adjusted, it will be difficult for BELCO to obtain a credit rating and lower its cost of capital through debt financing

BELCO anticipates future discussions with the Authority on a tariff methodology that will be consistent with the EA and facilitate the necessary financing required for the replacement and upgrade projects necessary to maintain Bermuda's high standards of reliability.

Authority's Response: The Authority is in the process of developing its own tariff methodology, which will be consistent with the EA and may or may not be consistent with that used by the EC.

