

**RESPONSE OF THE BARBADOS LIGHT & POWER COMPANY LIMITED  
TO THE INTERVENORS' CLOSING SUBMISSIONS**

BARBADOS

NO.02/09 BL&P - RADJ

**THE FAIR TRADING COMMISSION**

**IN THE MATTER** of the Utilities Regulation Act, Cap. 282 of the Laws of Barbados;

**IN THE MATTER** of the Utilities Regulation (Procedural) Rules, 2003;

**IN THE MATTER** of the Application by The Barbados Light & Power Company Limited for a Review of Electricity Rates pursuant to section 16 of the Utilities Regulation Act, Cap. 282 of the Laws of Barbados.

<b>THE BARBADOS LIGHT &amp; POWER COMPANY LIMITED</b>	<b>APPLICANT</b>
<b>A N D</b>	
<b>BARBADOS ASSOCIATION OF RETIRED PERSONS INC.</b>	<b>INTERVENOR</b>
<b>BARBADOS SMALL BUSINESS ASSOCIATION</b>	<b>INTERVENOR</b>
<b>BARBADOS ASSOCIATION OF NON GOVERNMENTAL ORGANISATIONS</b>	<b>INTERVENOR</b>
<b>BARBADOS CONSUMERS RESEARCH ORGANISATION INC.</b>	<b>INTERVENOR</b>
<b>DR. ROLAND R. CLARKE</b>	<b>INTERVENOR</b>
<b>MR. ERROL NILES</b>	<b>INTERVENOR</b>
<b>MR. DOUGLAS TROTMAN</b>	<b>INTERVENOR</b>
<b>CANBAR TECHNICAL SERVICES LTD.</b>	<b>INTERVENOR</b>
<b>SENTINEL GROUP CARIBBEAN INC.</b>	<b>INTERVENOR</b>

**INTRODUCTION**

1. Pursuant to the ruling of the Electricity Panel of the Fair Trading Commission ("FTC") made on October 23, 2009 during the course of the hearing of the Application for a Review of Electricity Rates ("Application") by The Barbados Light and Power Company Limited ("the Applicant"), the Intervenor

permission to file written Closing Submissions, within five (5) business days after receipt of the last set of transcripts from the FTC. The Electricity Panel also gave the Applicant permission to respond to the Intervenor's written Closing Submissions.

2. On October 27, 2009, the Applicant received a copy of the written Closing Submissions of Dr. Roland Clarke from the FTC. On November 12, 2009, the Applicant received copies of additional written Closing Submissions from the FTC by the following Intervenor's:
  - (a) Public Counsel on behalf of the Barbados Association of Retired Persons Inc. (BARP) and the Barbados Small Business Association (BSBA);
  - (b) Barbados Consumer Research Organisation, Inc. (BARCRO);
  - (c) Canbar Technical Services Ltd.; and
  - (d) Barbados Association of Non Governmental Organisations (BANGO);
  
3. The Applicant has examined the written Closing Submissions of the Intervenor's along with the closing submissions made by Mr. Errol Niles, Mr. Clyde Mascoll and Mr. John Campbell outlined in the transcript of proceedings, and has come to the conclusion that save and except for certain issues raised in the submissions by Dr. Clarke, Mr. Mascoll, Mr. Gibbs-Taitt and BANGO, the other issues raised by the Intervenor's have been adequately dealt with in the evidence presented on behalf of Applicant and in the Applicant's written Closing Submissions.
  
4. The Applicant now therefore responds to the following issues which have been raised:
  - (i) by Dr. Clarke:
    - (a) Use of local data in establishing the Return on Equity;
    - (b) Returns on the local stock exchange;
  
  - (ii) by Dr. Clarke and Mr. Mascoll:
    - (c) Inclusion of Deferred Income Tax Credit and Deferred Manufacturers' Allowance in the Weighted Average Cost of Capital ("WACC"),

- (iii) by Mr. Mascoll and Mr. Gibbs-Taitt:
  - (d) Exclusion of street lights from Rate Base;
- (iv) and Mr. Mascoll and BANGO:
  - (e) Increasing the first band of Domestic Service (DS) Tariff.

#### **(A) USE OF LOCAL MARKET DATA**

5. At paragraphs 5 and 6 of his Closing Submissions, Dr. Clarke raises the question of why local market data was not used in establishing the Return on Equity. Dr. Clarke also states that Mr. Camfield did not say categorically that local data could not be used and questions why Mr. Camfield did not use his "special analytical procedures" in order to facilitate the use of local data.

#### **Applicant's Response**

6. The Applicant has clearly set out in its Application the reasons for not employing local market comparisons in the determination of the Return on Equity. At paragraph 21 of the Memorandum on Rate of Return, under the heading "Cost Of Equity: Barbados & Caribbean Comparisons" the Applicant states as follows with regard to the Barbados Equity Market:

*"While a number of investment opportunities are present in Barbados, many of these are not exchange-traded financial assets, which means that the investment community as a whole cannot readily gauge and, through regular purchase and sale of shares, value the underlying business assets. In addition, the Barbados equity market is a developing market and, as evidenced by the Barbados Stock Exchange, is very thinly and intermittently traded. Generally speaking, the Exchange does not yet represent a sufficiently liquid market to readily reveal the underlying value of assets to investors. In summary, capital valuation methods cannot be readily applied to Barbados's equity market with a sufficient and full level of confidence to adequately gauge the underlying cost of equity. So, while the Company had access to a review of the local equity market, this*

*review was used for comparative purposes only because of the above limitations.”<sup>1</sup>*

7. This position has also been similarly described by Mr. Camfield in his Affidavit<sup>2</sup> and during the course of his oral evidence<sup>3</sup>.

#### **(B) RETURNS ON THE LOCAL STOCK EXCHANGE**

8. At paragraph 6 of his Closing Submissions, Dr. Clarke references Table T of the Affidavit of Mr. Robert Camfield, stating that “the Barbados Stock Exchange’s cumulative realized historical return between 1990 to 2006 is 5.82%” and suggests that this should be treated as the Return on Equity for the local market and used in the computation of WACC.

#### **Applicant’s Response**

9. The 5.82% shown in Table Q (and not Table T) is not the Return on Equity for companies represented on the local market. As stated by Mr. Camfield in his Affidavit – *“The analysis calculates annual market returns for the market indexes (without recognition of dividends), and the statistical variance of market returns ...”*.<sup>4</sup> Specifically, it is the cumulative realized return on all historical observations of the overall index for the Barbados Exchange.
10. Table Q was used to arrive at values for sovereignty risks, utilizing statistical variation for all exchanges (not Barbados alone) with reference to the U.S. statistical variation (standard deviation of the statistical distribution) as shown towards the bottom of the table.
11. The Rate of Return for the local market was provided by the Applicant for 2007. At paragraph 22 of the Memorandum on Rate of Return under the heading “Results of Local Market Comparison”, the Applicant references information

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<sup>1</sup> Pages 183-184, *Application* (Volume 1), FTC Document No. 1

<sup>2</sup> Pages 550 and 649, *Application* (Volume 3), FTC Document No. 3

<sup>3</sup> *Transcript of Proceedings* Days 6 and 7, Wednesday, October 14, and Thursday, October 15, 2009.

<sup>4</sup> Pages 571 and 668, *Application* (Volume 3), FTC Document No. 3

which was taken from the Review of Local Market Returns 2007 prepared by Signia Financial Group Inc. The Applicant states:

*"For the purpose of general comparison, the review of 20 listed companies on the local market showed an average ROE of 13.50% for the year 2007, with a range from a low of 3.1% to a high of 32.65%."*<sup>5</sup>

12. The Applicant attaches Schedule 1 from a report prepared by Signia showing the Return on Equity for companies listed on the Barbados Stock Exchange for the years 2006, 2007 and 2008. It is submitted that this Schedule clearly indicates that Returns on Equity for the Barbados market have been much higher than the 5.82% and comparable to the Return on Equity requested by the Applicant.
13. Furthermore, at paragraph 23 of the Memorandum on Rate of Return under the heading "Caribbean Utility Comparisons" the Applicant provided what information was available regarding the returns for Caribbean utilities.<sup>6</sup> The Applicant also noted the limitations in using these comparisons directly, but it can be seen that these are at similar or higher levels to the return being requested by the Applicant.
14. The Applicant maintains that its request for a Return on Equity of 13.5% and an overall Return on Rate Base of 10.48% is fair and reasonable.

**(C) INCLUSION OF DEFERRED INCOME TAX CREDIT AND DEFERRED MANUFACTURERS' ALLOWANCE IN WACC**

15. Dr. Clarke in his submissions suggests that the calculation of the WACC should include a cost rate of zero for both Deferred Investment Tax Credit and Deferred Manufacturers' Allowance.
16. Mr. Mascoll in his closing submissions suggests that the Rate of Return should be reduced to reflect a lower cost for deferred credits and allowances. He

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<sup>5</sup> Page 184, *Application* (Volume 1), FTC Document No. 1

<sup>6</sup> Pages 184 - 185, *Application* (Volume 1), FTC Document No. 1

further raises the issue of the intent of tax law regarding treatment of the Investment Tax Credit and Manufacturers' Allowance. He suggests that these should be included in the WACC at the cost of debt (5.25%) and not at the policy-based weighted average cost of capital of 10.61% as shown in the Application.

### **Applicant's Response**

17. The Applicant submits that Mr. Camfield has dealt with this issue adequately in his evidence by explaining that there were good reasons for the inclusion of these components, namely that it was the intent of the tax policy that these should be an incentive to the Applicant to encourage investment and that this benefits the consumer in that it increases cash flow. Consumers also benefit via the rateable pass-through of these tax credits. He has also explained their cost rates. Please note in particular the transcript of proceedings for Day 6, Wednesday, October 14, 2009 at pages 535-536 and Day 7, Thursday, October 15, 2009 at pages 631- 633. In addition, in response to interrogatory no. 25 of FTC Interrogatories Series #1<sup>7</sup>, Mr. Camfield stated,

*"Barbadian business entities are accorded incentives to induce incremental capital investment, where such incentives translate into higher returns than would have otherwise been obtained. Under cost-based regulation, the decrease in taxes, resulting from the tax credit provisions of the tax code, flow directly to retail consumers and, stated in nominal terms, have no impact on the returns to capital. Hence, no benefit is realized by BLPC under a regulatory policy that does not recognize the inclusion of DTCC balances in capital structure, and where such balances are costed at the appropriate rate of return. Accordingly, BLPC and FTC must include DTCC in the regulatory capital structure and apply a cost rate that is no less than the WACC, stated on a traditional basis. Such an approach is necessary in order to satisfy the intent of the relevant provisions of Barbadian tax law."*

18. It is also submitted that since investment in the assets of the Applicant is underwritten by both debt and equity, it is appropriate to recognize the cost of

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<sup>7</sup> FTC Document No. 29

both debt and equity in the cost rate applied to balances of deferred investment tax credits and manufacturers' allowance, not the cost of debt in isolation. This combined debt and equity cost rate is the weighted average cost of capital, stated on a policy basis (10.61%). This is the approach that has been taken by the Applicant.

#### (D) EXCLUSION OF STREET LIGHTS FROM RATE BASE

19. Both Mr. Mascoll and Mr. Gibbs-Taitt on behalf of the BARCRO submit that the Rate Base should be reduced by the exclusion of street lights since the Applicant is proposing not to receive any target returns from this category.

#### Applicant's Response

20. As the Applicant has stated in paragraph 1 of its Memorandum on Rate Base, it has only included in its Rate Base plant which it has determined to be "used and "useful".<sup>8</sup> Street lighting is an important social service provided for security and safety purposes for the benefit of the entire country. As such the Applicant submits that street lights provide a valuable benefit to consumers, are used and useful, and therefore should be included in the Rate Base. The inclusion of street lights in the Rate Base is a common practice.

#### (E) INCREASING FIRST BAND OF DOMESTIC SERVICE (DS) TARIFF

21. Mr. Mascoll and BANGO suggest that the first band of Domestic Service bills should be increased from 0 – 100 kWh to 0 – 150 kWh or 0 – 250 kWh.

#### Applicant's Response

22. The Applicant submits that the issue of the range of the first band of the Domestic Service tariff was raised with Mr. Stephen Worme during his cross-examination. The implications of raising the limit were provided by Mr. Worme. Please note in particular the transcript of proceedings for Day 10, Tuesday, October 20, 2009 at pages 938-939 and Day 11, Wednesday, October 21, 2009 at page 1008.

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<sup>8</sup> Pages 113, *Application* (Volume 1), FTC Document No. 1





23. In response to the suggestion that there should not be an increase in the rates in the band of 0-250kWh, the Applicant submits that this would not be a fair approach as the cost burden would have to be shifted to the customers in the higher bands who are already paying a higher rate than their cost of service. The Applicant would also like to refute the claims made by BANGO that it has accepted that the elasticity of electricity usage is zero at least for low income customers. The Applicant maintains that it has sought to minimize the impact of any rate increase on the small DS customers without overburdening larger customers and to encourage energy conservation amongst its customers generally by maintaining the inclining block rate structure.
24. In the circumstances, the Applicant submits that the 0 – 100 kWh band is a reasonable choice.

**DATED NOVEMBER 20, 2009**

