Driselle Ramjohn

Subject: FW: My Thoughts On The Proposed Tariffs

From: andre acres [mailto:andre_acres@hotmail.com]
Sent: Wednesday, 15 March 2023 9:10 am
To: RIC Office <ricoffice@ric.org.tt>; consultation <ricconsultation@ric.org.tt>; consultation <ricconsultation@ric.org.tt>
Subject: My Thoughts On The Proposed Tariffs

Good morning,

Below are my thoughts on the proposed tariff increases on kilowatt hours used by T&TEC customers, and it is directed to the following: the board of commissioners of RIC and top management of T&TEC. The hard copy version will be sent via mail in due course.

The broad formulae that is used in calculating the proposes Tariff is the following: operating & maintenance expenditure plus depreciation plus return on regulatory asset base minus other income. In the definitions, depreciation and return on regulatory base forms the regulatory asset base. Further, depreciation is calculated using the straight line method and return on the regulatory asset base is weighted Average Cost of Capital formulae given on page 38 on TTEC-Framework and Approach Price Review 2021-2026.

One issue with the model is that it double counts the cost of the capital item, The Regulatory Asset Base. Capital allowances is a government approved depreciation on a capital (RAB) and is an allowable expense while the straight line method is the RIC method of depreciating the same item and not an allowable expense. For example, lets say in the 2021 to 2026 T&TEC has an capital expenditure in that period which consist of transformers, poles, vehicles, building and 14 new substations, and which aggregates to TT $1 billion, all expenditure takes place on the 1 st January 2021, there is no residual and the useful life of the asset 10 years. Then, it means under capital allowances the cost of capital items is recovered at the end of the forth year on 31 st December 2024. However, under the straight line depreciation the cost of the asset is recovered on the 31 st December 2031. Therefore, at the end of 2031 there was an over estimation of capital for revenue requirement purposes of TT $ 1 billion.

Another issue I have is with the weighted average cost of capital. I was told in the RIC consultation that T&TEC is an organization that exist because of guarantee and not by shares. Thus, the organization has no shareholders and using a formulae to calculate a return on equity is a misnomer. Return on equity only becomes relevant when the company issue shares and the shareholders are private person who hold shares with an anticipation of getting return albeit the company has no obligation to pay any dividends. If there is not a favorable return on equity prospective person will not by shares. Hence, the weighted average cost of capital formulae collapse to the WACC of debt only (re is 0 and multiplying it by (1-g) will also give value of zero (see page 38). I do believe that the debt to equity ratio is still relevant because equity represent the amount of funds from T&TEC revenues streams which can be be used to fund capital expenditure plus anticipated funds from the government injected in the organization.

My issue with WACC is that interest expense is captured twice in the RIC's model. Interest expense on capital items is an allowable expense; it will be captured under operating expense under trading cost. Therefore, adding the return on the regulatory asset base only serve to factor in the same item twice when arriving at the tariff.

In addition, I have some definitional issues with respect to debt aspect of the WACC formulae. It goes as follows: what is the level of gearing? what is the risk free rate? Is it the LIBOR rate, is it a US rate, a local rate

or some other rate? what is the debt premium?, From there, I can critique the WACC formulae further and provide some alternative solutions.

I believe that to improve T&TEC efficient allocation of funds it need to provide additional ratios to RIC. The first ratio is cost of capital items supplied by local suppliers over the cost of the same capital item that could have been supplied to T&TEC if it was bought from the manufacturer directly. This ratio will give an indication on whether the local suppliers are over charging T&TEC. For example, if 1000 lamp pole cost TT 400 million (assuming all pole are homogeneous) by local suppliers and that same lamp pole cost TT 40 million from a manufacturing company in the United states (after calculating cost insurance freight, duties etc). Then a ratio of 10 is too high. This means if T&TEC purchase one pole from a local supplier it could have purchase 10 poles from manufactures with the same outlay. The second ratio deals with capital expenditure 2021 to 2026 on local purchases over total capital expenditure for the 2021 to 2026 period. Total capital expenditure 2021 to 2026 includes capital expenditure on local supplies 2021 to 2026 plus capital expenditure on foreign supplies that local suppliers could have supplied. This will give an indication if capital expenditure is concentrated more locally or not. If the first ratio is high and the second ratio is very small then abnormal profits by local suppliers will have a negligible impact on propose electricity increases.

If the two ratio mentioned are high then the RIC must have a regard to " the protection of consumer interest with regard to price" see page 2. It is believe citizens (real or imagined) that an oligopoly occurs among local suppliers. If this is the case, then, the RIC should only allow T&TEC rate increases that is close to the liberalized cost of capital. For instance, the entrance of Sir Freddie Laker Sky train in the late 1970's forced other air transport providers to be more efficient in their operating cost or leave the market; some inefficient air providers never went out of business because the British government pull the plug on Sky train. In local market, before Digicel, Cell phone calls from TSTT carried two cost. The person who received the phone call was charge by TSTT and the person making the call was charged by TSTT Another example, is the car sales market in the 1980's in Trinidad and Tobago. In that period, people had to pay in advance and wait in some cases years to get a car. However, allowing more firms to enter the car sales market forced some existing firms that adopted the model "pay now and wait later" to go out of business.

Rent is an operating expense and it is covered in the RIC model of rate increases. I would like to know how much is T&TEC rental cost for the 2021 to 2026 period? The number of rental contracts that will expire in the 2021 to 2026 period? Rental cost as a percentage of total operating cost?. If the rental cost is relatively high in relation to total operating cost, then RIC can make demands for T&TEC to reduce this percentage over time. Otherwise, consumers of electricity will be funding the land lords and not necessarily components that are essential to electricity distribution and transmission.

There are several ways T&TEC can reduce its rental cost. One, recommend to government that in T&TEC constitutive documents agents of the organization must not use rental as a first option and if renting is a must rental contract must not be longer that a prescribe period of time. I think rental contracts must not be more than five years. Two, T&TEC must provide justification why rental is more favorable than non renting. For example, renting a offices at TT 400,000 a month for 10 years does not make much sense if similar accommodation can be achieved through borrowing the funds from the debt market (bond market or loan market) at an interest of 20 million annually for 10 years installments is made up of portion of capital cost and a portion that is interest . In this example, T&TEC will have improved liquidity and cash flows in the route of purchasing its own property. Three, T&TEC must retain independent advisors to determine if actual rents paid is close to the market rate. Four, if rental contracts are due to expire in the 2021 to 2026 period, T&TEC will be required formulate strategies to reduce rental cost such as purchasing its own property, having payment machines in strategic places like malls, government offices open to the public. For instance, since Flow have installed payment machines, the staff have been redirected to core aspects relating to producing and maintaining output: internet service, cable service and phone service.

In the RIC consultation members of the audience have told RIC that the major culprits that are responsible delayed payment to T&TEC is government agencies themselves. I Agree with the RIC with respect remaining

silent on political decision; the RIC has no authority to dictate to government with respect to political decisions. However, there is one recommendation that the RIC can make to government. T&TEC is VAT registered and the method of calculating vat is based on the accrual basis. It is recommended that the RIC recommend to government to change T&TEC accounting method for VAT to be on a cash basis. This means VAT is calculated on the basis of actual revenues received. This means T&TEC will not incur interest and penalties on revenues that that are receivable and improved working capital (current assets minus current liabilities). For example, the Guardian reported in January 2021 that amounts owed to T&TEC was about TT 1.4 billion which consisted of TT $ 1.2 billion from government and TT $ 264 million from ordinary customer, 12.5 % of TT 1.4 billion is 175 million in VAT and interest and penalties on that figure will be significant.

Another proposal for the RIC to T&TEC is for the organization to change over the fleet of vehicles. The current fleet of vehicles uses either diesel or gasoline. However, government has reduced the fuel subsidy three times and there are a plans to liberalize the fuel retail market, making it uneconomical to use conventional vehicles. Some alternative are CNG, electric vehicle or hybrid.

In the RIC formulae for proposed tariffs, if T&TEC can generate other income this can help reduce the tariffs. I proposed that T&TEC increase other income in several ways. One, impose or increase rent on its pole. Currently TSTT and some internet providers uses T&TEC poles to hang their cables. If the rent of the poles are based on the market rate, then it will increase other income and pull down the proposed tariff. Two, T&TEC impose a late fee on bills over one month and over TT $ 1,500 on commercial bills only. I think the rate should be 2 percent of the electricity cost excluding VAT. Three, T&TEC take legal action against insurance companies of motorist that damages its infrastructure due to accidents. Four, T&TEC charge the installation cost and use of banners on its poles at market prices. Five, T&TEC rent out portion of their buildings at market prices. This includes snacks dispenser machines or ATMS. Six, for ordinary commercial customers, not residential customers T&TEC must have their debt factored. For instance, debt over six months T&TEC must be allowed to sells its debt to third parties who are more efficient in collecting debt.

Another recommendation is that T&TEC be incorporated. Under the shareholder agreement RIC will hold only one share valued at TT $ 1 while the government holds the majority shares that is over 100,000 shares. Currently, if the agents of T&TEC willfully put the company in bad contracts it is only the T&TEC or the government that can go after such persons. Any one else lacks the legal capacity to do so. However, because RIC will hold one share in the company they can force the T&TEC to go after rouge agents, so that it can recover cost of the agents due to willful actions or inactions. This will help to ensure that T&TEC funds are used effectively and agents of the organization will be extra precautious in discharging their duties which in turn will in a lower risk premium on debt and lower interest on debt whether it comes from loans or selling bonds. Hence, RIC will have two main tools; one that is suggestive and another that is prescriptive.

I do not believe that the RIC can justify rate increase because of the cost of electricity in other CARICOM countries is higher and consumption of electricity in Trinidad and Tobago is higher. The reason electricity cost may be higher in CARICOM may be due to small size of the population, so they do not benefit from economies of scale, transport cost of fuel is higher and the technology of producing electricity is outdated and inefficient by the power companies. Alternatively, the reason electricity consumption is lower in in CARICOM countries is that some of the properties in those countries utilizes both solar energy and traditional electricity (hybrid) which causes energy usage to be lower. Another reason is that Trinidad and Tobago is a relatively industrial country compared to CARICOM countries which are heavily reliant on remittances, tourism, off shore services, and selling crops. These industries are not electricity guzzlers. For example, with a factory electricity is required for air condition, lighting, computers and also to run the machines.

I humbly believe if RIC deal with items already mentioned that are responsible for the artificially high tentative Tariffs, it can greatly reduce future tariff for residential and commercial customers. A rate increase that is too high can result in customers stop using electricity (poor), customers reducing their energy consumption significantly or customers switching to alternatives electricity like solar. This means that T&TEC will not be able operating close to capacity utilization and enjoying economies of scale which results in lower

cost of operation. If T&TEC is operating significantly below capacity utilization, customers using T&TEC electricity will have to absorb more cost. lets assume under RIC propose rate increase the T&TEC over heads is TT 900 million over 2021 to 2026 period, there is no price discrimination (residential vs commercial rate for simplicity)and aggregate kilowatt hours of energy drop significantly relatively to the proportionate increases in tariff T&TEC will loose out in the 2021 to 2026, but it is the customers who will pay in the next rate increase period. For example, in 2009 Alutrint Limited and T&TEC was contracted to buy 720 MW from TGU for over a 30 year period. However, when the Alutrint Limited project was cancelled, T&TEC was contracted to buy all the power (take or pay). As a result, T&TEC is buying electricity that it does not use which means it is below capacity utilization. Also, The World Economic Outlook, the IMF, projected in October 2022 the Trinidad and Tobago economy to grow by 3.5 %. This growth will help to push T&TEC closer to its capacity utilization level. finally, T&TEC will get away with rate increases in the short run, however in the long run middle to upper customers will have a more elastic demand for electricity.

Regards,

Andre' Acres