

Minimising the Impact of Rising Fuel Prices - LUCELEC's Perspective

The past 12 months has seen unprecedented increases in crude oil prices on the international market resulting in the price paid for fuel by LUCELEC increasing from \$7.07 to \$13.14 per gallon (an 86% increase). These increases have been reflected also in the fuel cost adjustment factor (fuel surcharge) charged to customers. The escalation for the period April to June, 2008 has been particularly steep, resulting in an increase of approximately 12 - 15% in the average customer electricity bill. It should be noted that rising fuel and electricity prices are not unique to Saint Lucia and virtually every utility company worldwide that depends on fossil fuels for production of electricity is facing the same challenge.

LUCELEC's approach to this present crisis has been taken in the context of the Company's corporate social responsibility philosophy and the critical role that the Company sees itself playing in the development of the country, as the sole supplier of electricity. This corporate social responsibility philosophy is built into our mission, vision, and strategic business plan. Our operations are structured such that we consider the interests of society by taking responsibility for the impact of our activities on customers, suppliers, employees, shareholders, communities and other stakeholders, as well as the environment. For LUCELEC, this extends beyond the obligation to comply with the law. We voluntarily take steps to improve the quality of life for employees and their families as well as for the society at large. And we have been working assiduously over the years to ensure that Saint Lucia is supplied with a safe, reliable, cost-effective and competitively priced electricity supply that is accessible to all those in Saint Lucia who want it.

We see our success as inextricably linked to the success of customers and the country. In short, we care. Therefore, the Board and Management of LUCELEC are very concerned about this current fuel and energy crisis and have been actively exploring and pursuing various options for minimising the impact of rising fuel prices on electricity rates, our customers and the country.

However, despite the public pressure to bring some immediate relief to customers, these options and their implications for the various stakeholders need to be carefully considered so that whatever actions that are eventually agreed upon in the short, medium and long term are viable and sustainable. Due caution needs to be exercised to ensure that arbitrary interventions which may in the end have major negative impacts on the customer, the Company, the Government and the country are avoided.

A delegation from the Company met with the Cabinet of Ministers and has submitted a brief identifying the available options and their likely impacts. Some of the more sustainable options presented include intensifying customer education in areas of efficient energy use to encourage customers to implement energy conservation measures, expediting action on all initiatives for generation expansion using alternative technologies and renewable or sustainable sources, reviewing and expanding tax and other concessions for renewable energy and energy efficient

products, and the development and implementation of a broad energy policy which sets out targets for energy conservation, demand reduction, reduction of emissions, percentage of power derived from renewable and/or sustainable sources, etc., through which some of these initiatives may be implemented.

Some of the options will require varying actions at different levels - from the Government of Saint Lucia, the LUCELEC Board of Directors, the management and staff, and the customer. One thing is clear though, it certainly cannot be 'business as usual'.

LUCELEC has always operated ethically and in accordance with the requirements of the Electricity Supply Act and best practice in corporate governance. We welcome any initiatives by the Government to implement the various checks and balances enshrined in the Electricity Supply Act to satisfy *customers* that our operations are within the law and above board. We also recognise that amendments and refinements to the Act are required from time to time, and are committed to working with the Government to improve the regulatory, technical, financial and other requirements of the Act.

Finally, LUCELEC would like to assure customers that we remain committed to maintaining the most cost effective tariffs to customers. To this end, we expect to be able to initiate action shortly on the following options, which LUCELEC has been investigating and preparing for the past several years but which were only marginally economically viable when oil prices were less than US\$100 per barrel.

- The conversion of our existing generators that currently utilize light fuel oils (diesel) to use cheaper heavy fuel oils. This should be completed within the next 15 months.
- Seek assistance from, and work with, Government to resolve the issues associated with the utilization of Saint Lucia's geothermal resources given that LUCELEC has agreed on terms to buy the electric power that can be generated from this source. This energy source is much cheaper and more environmentally friendly than fossil fuels.
- Seek assistance from, and work with, Government to expedite the confirmation and acquisition within the shortest possible time, of the most appropriate sites for the establishment of wind farms and a major petroleum coke project to utilize the very cheap waste from the process of petroleum refining.

These options will result in the use of cheaper fuels for the generation of electricity, reduce the dependence on fossil fuels, and ultimately the price to customers. With the appropriate support, LUCELEC will see these projects through within the shortest possible time.

We trust that the foregoing has helped to clarify some of the issues associated with producing electricity in Saint Lucia and the rising price of fossil fuels. We look forward to your patience, understanding and cooperation as we seek to continue

working towards providing Saint Lucia with a safe, reliable, cost effective and competitively priced electricity supply.

Remember though, the most immediately significant measure for minimising the impact of rising fuel prices - the efficient use and conservation of electricity - is in your hands.

Thank you.

Having put forward this general statement on the Company's position in relation to rising electricity costs, we wish to provide responses to some specific questions or issues that have been either asked of the Company or raised in various public fora in recent weeks.

Why have electricity rates risen without warning?

Electricity rates have NOT risen without warning. The base tariff for electricity has not changed. What customers are seeing reflected in their higher than usual bills is the higher than usual fuel surcharge arising out of record world market prices for oil and other fossil fuels, the extent of which has caught everyone off guard.

Over the last ten years the cost of one kilowatt hour (kWh) unit of electricity has increased from an average of 51.3 cents in 1998 to 84.2 cents at June 2008 or an average of 6.4% per annum. Fuel is the most significant item of cost in the production of electricity. At present, fuel comprises 89% percent of the direct operating costs in the production of electricity as compared to 45% ten years ago.

What is the Fuel Surcharge Cost Adjustment?

The fuel surcharge is a cost recovery, rate balancing mechanism enshrined in the Electricity Supply Act (ESA). When the price paid for fuel by LUCELEC goes up the fuel surcharge increases; when the price paid for fuel by LUCELEC goes down the fuel surcharge decreases. It is a mechanism employed by many electric utility regulators worldwide to manage the volatility in the price of oil (i.e. the frequent, almost daily fluctuations in the price of oil) on the world market.

How is the Fuel Surcharge Cost Adjustment calculated?

The formula for the calculation of the fuel surcharge is enshrined in the Electricity Supply Act. The total number of Imperial gallons of diesel fuel used at all the Company's generating stations in Saint Lucia during the calendar month immediately preceding the calendar month during which meters are read:

- (a) multiplied by the current price less the base price in cents; and
- (b) divided by the total units sold in Saint Lucia during the calendar month immediately preceding the calendar month during which meters are read.

The current price means the average price LUCELEC paid for fuel in that month. The base price means the average price paid for fuel by LUCELEC in the previous year. See sample calculation below.

Line 1: Current price of fuel (June 2008)	-	EC\$13.1444 per gallon
Line 2: Average price for 2007 (Base Price)	-	EC\$7.1862 per gallon
Line 3: Amount of fuel used (June 2008)	-	1,524,307 gallons
Line 4: Cost of 1,524,307 gallons at EC\$ 13.1444 per gallon (Current Price) = Line 3 x Line 1 = EC\$20,036,141		
Line 5: Cost of 1,524,307 gallons at EC\$ 7.1862 per gallon (Base Price) = Line 3 x Line 2 = EC\$10,953,975		
Line 6: Current cost of fuel less cost at base price = Line 4 - Line 5 = EC\$9,082,166		
Line 7: Electricity sales (June 2008) = 26,231,781 units		
Fuel Surcharge Cost Adjustment = (Line 6 ÷ Line 7) x 100 (convert to cents) = 34.6 cents per unit		
= 9,082,166 ÷ 26,231,781 x 100 = 34.6 cents per unit		

This calculation is done every month and printed in the newspapers as required by law.

Isn't LUCELEC double billing customers by making them pay for electricity and pay for the fuel as well?

No. The rate or tariff that is paid by customers is calculated in two parts. The first part is the base tariff for each respective group of customers which comprises primarily what is termed non-fuel costs, that is, all other costs involved in producing electricity. It includes a component of fuel costs based on the average cost of fuel in the prior year. The base tariff is adjusted in February of each year to reflect the average price of fuel in the prior year, according to a formula in the law.

The second part is the fuel surcharge, which is where the difference in the average price for fuel paid by LUCELEC in the prior year and the current price is reflected. The two parts are added to make up the rate that each group of customers pay each month. The fuel surcharge is adjusted monthly as calculated above. If LUCELEC did not have to pay for fuel the cost of selling a unit of electricity would be reduced by 52% to 40.4 cents, but fuel is not free and Saint Lucia, and by extension LUCELEC, has no control over the price. LUCELEC makes absolutely no profit, directly or indirectly, from the price and/or quantity of fuel that it uses. In fact, the high cost of fuel tends to reduce demand for electricity and this has the effect of reducing revenues and ultimately profit levels.

Why doesn't LUCELEC absorb some of the Fuel Surcharge?

Apart from the law not making provision for this, fuel expenses are an operating cost and as with any other inputs has to be recovered or the business would fail.

Why is LUCELEC 'guaranteed' a profit?

LUCELEC is not guaranteed a profit but the Electricity Supply Act makes provision for a target rate of return. There are several reasons for this which are associated with the nature of an electric utility. The law places universal service obligations on LUCELEC. That means LUCELEC is required to provide electricity to virtually anyone who wants it, regardless of whether it is economical or profitable to do so. In the normal course of business, companies can choose where and when they expand. In that way, they can control capital and operating costs. LUCELEC does not have that

freedom. LUCELEC is required to not only meet the demand for electricity, but also to maintain an acceptable level of reserve capacity.

The electric utility business is also very capital intensive. This means that equipment and facilities are expensive and operating and maintenance costs are extremely high. It takes a very long time (up to 20 years) to recover investments.

An electric utility that is struggling to make ends meet benefits no one. The country depends on a safe, reliable, and cost effective source of electricity not only for use by domestic, commercial and industrial customers, but also to attract foreign direct investment. If LUCELEC made no profits for 2007, for example, the cost of a unit of electricity would be reduced by approximately 10% or 8.3 cents for 2008, the shareholders would have received no returns on their investment (dividends), and there would be no further investments in future expansion and/or in other initiatives in Saint Lucia that would be necessary for the country's growth. Then LUCELEC would struggle to maintain a safe and reliable supply of electricity next year.

Finally, the target rate of return that the law makes provision for controls or limits LUCELEC's rate of return (or profits), there is no 'guaranteed' profit per se. Shareholders make a return on their investments (which encourages investments to improve plant, equipment and service) but at the same time ensures that the most cost effective price to customers is maintained, such that if LUCELEC exceeds the maximum rate of return (in layman's terms, makes more profit than allowed), then 50% of the 'extra' is given back to customers as a rebate and the shareholders keep the other 50%. This serves as an incentive to encourage LUCELEC to strive for efficiency improvements in their operations, but at the same time ensuring that customers benefit from these efficiency improvements.

Does LUCELEC read every meter?

LUCELEC makes every effort to read every meter at the scheduled time each month. There are a few instances where obtaining a meter reading may not be possible because of inaccessibility due to fenced or locked compounds and ferocious dogs. In such circumstances an estimate, based on historical consumption patterns is made until access to the meter is obtained. Our records indicate that on average we read 99.3% of the meters on the system monthly.

What if LUCELEC makes a mistake in its meter reading?

Meter reading data is entered electronically. This minimises the potential for errors. However, if an error is made, the affected customer should contact LUCELEC immediately to have the situation rectified. In any event, meter reading errors generally balance out when the next reading is obtained and the subsequent bill is issued.

Is LUCELEC stalling the development of alternative (wind, geothermal) energy sources?

Absolutely not. In fact, LUCELEC has done all that it can and that has been required of it to either initiate or facilitate the development of alternative energy sources. Responsibility for any delays in that regard **does not** rest with LUCELEC. LUCELEC is itself frustrated by the lack of movement on these initiatives since a fundamental part of the Company's operational and business strategy is to provide the most cost effective price for electricity to our customers, and this includes exploring renewable sources.

What is LUCELEC doing to minimise the impact of rising fuel prices on customers?

LUCELEC has and continues to improve operational efficiencies and productivity to ensure that the non-fuel costs are kept to a minimum. In fact, LUCELEC's non-fuel costs have remained relatively flat (approximately 40.4 cents per kWh) for the last 10 years, a significant achievement, considering inflation and other factors over that period. Few companies can claim such a performance. This ensures that any increases in tariffs are related purely to fuel costs.

LUCELEC is also working to expedite all its initiatives for generation expansion using alternative technologies and renewable or sustainable sources (including conversion of the existing Wartsila generating equipment to use cheaper Heavy Fuel Oils (HFO), the development of a wind farm, working with potential geothermal energy developers and burning relatively cheap petroleum coke). It should be noted that in terms of maintaining the most cost effective tariffs to customers, some of these options were not economically viable until the price of oil climbed above US\$100 per barrel.

Is there anything that customers can do to minimise their electricity bills?

Yes. Customers can practice energy conservation measures and use technologies such as solar water heaters and other energy efficient appliances to keep their consumption of electricity down. LUCELEC has launched a public awareness campaign identifying some very practical ways that customers can reduce electricity consumption. We encourage customers to practice these measures.