



**LESOTHO ELECTRICITY AND WATER AUTHORITY**

**LEWA's DETERMINATION OF LESOTHO ELECTRICITY  
COMPANY'S (LEC'S) TARIFF APPLICATION FOR 2017/18**

**April 2017**

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### **DETERMINATION OF LESOTHO ELECTRICITY COMPANY'S (LEC'S)**

#### **(Pty) Ltd**

#### **APPLICATION FOR A TARIFF INCREASE FOR 2016/17**

### **1. DECISION**

Based on the available information from the written and oral submissions by various stakeholders during public consultation process, reasons, facts and evidence provided, and LEC's response to both LEWA and public comments, the Lesotho Electricity and Water Authority (LEWA) Board, having met on 07 April, 2017 decided as follows:

- a) That the Lesotho Electricity Company (LEC) be allowed revenue of M 856.29 million for the 2017/18 Financial Year;
- b) That the energy and maximum demand charges for all customer categories be increased as shown in Table 1 and Table 2 below:

Table 1: Approved LEC Energy Charge for 2017/18

| Customer Categories | 2016/17 (old) Energy Charge (M/kWh) | Approved percentage change (%) | Approved Energy Charges (M/kWh) | Adding Customer Levy @M0.0423/kWh | Adding Rural Electrification Levy @M0.02/kWh large customers and @M0.035/kWh for others (M/kWh) | Final Approved Energy Charge (M/kWh) | 2016/17 (old) Energy Charges including levies (M/kWh) | Final Tariff Percentage increase (%) |
|---------------------|-------------------------------------|--------------------------------|---------------------------------|-----------------------------------|---|--------------------------------------|---|--------------------------------------|
| Industrial HV       | 0.1796                              | 3.6%                           | 0.1861                          | 0.2284                            | 0.2484  | 0.2484                               | 0.2419  | 2.7%                                 |
| Industrial LV       | 0.1989                              | 3.6%                           | 0.2061                          | 0.2484                            | 0.2684  | 0.2684                               | 0.2612  | 2.8%                                 |
| Commercial HV       | 0.1796                              | 3.6%                           | 0.1861                          | 0.2284                            | 0.2484  | 0.2484                               | 0.2419  | 2.7%                                 |
| Commercial LV       | 0.1989                              | 3.6%                           | 0.2061                          | 0.2484                            | 0.2684  | 0.2684                               | 0.2612  | 2.8%                                 |
| General Purpose     | 1.4688                              | 3.6%                           | 1.5222                          | 1.5645                            | 1.5995  | 1.5995                               | 1.5461  | 3.5%                                 |
| Domestic            | 1.2994                              | 3.6%                           | 1.3467                          | 1.3890                            | 1.4240  | 1.4240                               | 1.3767  | 3.4%                                 |
| Street Lighting     | 0.7376                              | 3.6%                           | 0.7644                          | 0.8067                            | 0.8417  | 0.8417                               | 0.8149  | 3.3%                                 |

Table 2: Approved LEC Maximum Demand (MD) Charge for 2017/18

| Customer Categories | 2016/17 (old) Maximum Demand Charge (M/kVA) | Percentage Change (%) | Approved Maximum Demand Charges (M/kVA) |
|---------------------|---|-----------------------|---|
| Industrial HV       | 253.0338                                    | 3.6%                  | 262.2392                                |
| Industrial LV       | 295.5498                                    | 3.6%                  | 306.3019                                |
| Commercial HV       | 253.0338                                    | 3.6%                  | 262.2392                                |
| Commercial LV       | 295.5498                                    | 3.6%                  | 306.3019                                |

The figures in Tables 1 and 2 exclude VAT

- c) The short-term contract between LEC and EDM should be reviewed with a view to procure more power from Eskom;
- d) The current charges for connection, wiring testing, wiring re-testing, survey, re-survey, licensing for wiring, meter testing and house extension remain the same for the financial year 2017/18; and
- e) The effective date for the approved tariffs is 10 April 2017.

## 2. INTRODUCTION

The Lesotho Electricity and Water Authority (LEWA) is a statutory body established to regulate the Electricity Supply Industry (ESI) and Urban Water and Sewerage Services (UWSS). Amongst other things, LEWA is empowered to regulate prices charged to consumers of electricity and water. Consequently, every service provider that is licensed to carry out a regulated activity must when necessary, lodge an application to LEWA for any proposals for electricity and water prices. Tariffs proposed by the licensed entity in the application become effective three (3) months after filing unless the Authority issues a notice of modification or a counter proposal, within the period. Consistent with international best practices on regulation, an application filed with the Authority is subjected to public participation processes so that inputs from consumers and interested stakeholders can also be considered when assessing the application. In line with the requirements of the law, LEC has been submitting its applications for

tariff reviews over the years and assessment thereof has consistently included consideration of the application, evidence, facts and public inputs.

### **3. LEC TARIFF APPLICATION**

#### **3.1. Overview of the Application**

The Authority received an application (the Application) for a Tariff Review from LEC (referred to as the Company or the Applicant in the document) on 09 January, 2017.

In its Application, LEC stated that one of its licence conditions prescribed that it had to submit an application to the regulator when it needed to increase tariffs. The Application stated that LEC had tabled revenue requirement alongside the tariff levels proposed per customer category, expected to yield the required revenue that is needed to provide reliable and safe electricity to the economy. It further stated that the application was necessitated by the increase in bulk supply tariffs from EDM and ESKOM and inherent increase in the company's operational costs.

The Application stated the following as the Company's cost drivers:

- The Imported Power costs;
- Expenditure costs;
- Depreciation costs and
- Return on assets costs.

#### **3.1.1. Achievements**

The Application mentioned that as at December 2016, LEC had experienced a significant absorptive capacity of 72% in terms of utilising the allowed revenue. It highlighted that a number of strategic activities that had sourced financing through the last financial year's tariff application had reached their final stage while some were still in progress. Below in Table 3, is a list of projects, their status as at December 2016 and their estimated costs:



Table 3: List of LEC projects, their status and costs

| Project   | Purpose  | Status as at December 2016 | Estimated Cost        |
|---|--|----------------------------|-----------------------|
| <p><b>1. Enterprise Analysis</b></p>  | <p>To review the organization's ways of working, identify areas of improvement and develop a plan of how LEC will function in the future. The outcome of the project is expected to be a regulation compliant structure based on efficient business processes.</p> | <p>At final stage</p>      | <p>M 5.9 Million.</p> |
| <p><b>2. Network upgrading and improvement</b></p>  | <p>To address ailing network by improvement and upgrading of the systems</p>   | <p>At final stage</p>      | <p>M 35.2 Million</p> |
| <p><b>2.1 Maintenance of 132/33kV 40MVA Mazenod 1 transformer</b></p>   | <p>To maintain continuous power supply</p>   | <p>At final stage</p>      | <p>M 4.3 Million</p>  |
| <p><b>2.2 The Mazenod substation upgrading that included</b></p> <ul style="list-style-type: none"> <li>a) Transformer 1 Mazenod 132/33kV 40MVA Maintenance</li> <li>b) civil &amp; structural works</li> <li>c) connection of second 132kV line between Mabote &amp; Mazenod,</li> <li>d) Connection of 132/33kV 40MVA transformer at Mazenod; and</li> <li>e) Connection of 132kV and 33kV electrical equipment.</li> </ul> | <p>To address load growth and curb frequent trips caused by overloading</p>  | <p>At final stage</p>      | <p>M 30.9 Million</p> |
| <p><b>3. Replacement of two transformers on the Maputsoe substation.</b></p>  | <p>To increase capacity to cater for the future demand</p>   | <p>Planning</p>            | <p>M16 Million.</p>   |

| Project   | Purpose   | Status as at December 2016 | Estimated Cost |
|---|---|----------------------------|----------------|
| 4. Replacement of mini- substations in Maseru town  | To cater for the supply of electricity in the growing trends in the construction sector | In progress                | M 3.2 Million  |
| 5. Specialised services on the maintenance of circuit breakers  | To boost reliability of supply  | In progress                | M 5.4 Million  |
| 6. Upgrading of conductors and replacement of decayed poles in Butha Buthe, Leribe, Mafeteng, Mophale's Hoek and Quthing. | To boost system reliability   | At final stage             | M 3.8 Million  |

### **3.1.2. Challenges**

The Application also highlighted the Company's challenges as follows:

#### **A. Vandalism**

The impact of vandalism can be associated with loss of material, business, lives and damage to electrical property. For 2015/16, the cost associated to vandalism was estimated at M 1.3 Million. To this end, in order to address the losses, the Company had begun awareness and sensitisation campaigns, and would continue to hold workshops meant to enhance strategies for curbing vandalism.

#### **B. Extreme weather conditions**

The climate and topography of the country remained a challenge to the reliability of electricity supply in the country. In the current financial year, one of the many cases resulting from extreme weather conditions required restoration costs amounting to M2.5 million.

#### **C. Security of Supply**

The local electricity production (from 'Muela Hydropower Plant) covered 66% of the energy requirement while 44% percent was imported from Eskom (South Africa) and EDM (Mozambique). The document also mentioned that the imported electricity prices had been, hiked. The Application also highlighted that there was an urgent need to embark on local generation to protect Lesotho from high imported energy costs.

#### **D. Exchange rate exposure**

As a result of the South African Rand losing value against the US Dollar, LEC had experienced a significant increase in prices of electricity for bulk supply purchases from EDM as they are denominated in United States of America dollar (USD). In 2015/16, LEC had lost total revenue amounting to M17 Million as a result of the exchange rate that prevailed as opposed to the projected exchange rate of M11/USD.

To curb the risk, LEC was in negotiations with other future providers which were perceived to be cheaper in a medium to long term.

### 3.1.3. Way forward

The Application presented a summary of strategic projects with an estimated cost of more than M 52 Million which were envisaged to be covered by the following years' tariffs. It mentioned that these projects and others were meant to arrest network challenges in the medium to long term.

### 3.2. Tariff Methodology

The Application stated that the tariff setting is based on revenue requirement for a single year. The revenue requirement encompassed the relevant costs incurred by the business, plus an allowed investment return and depreciation. The projected costs were based on a forecast for the Financial Year under review.

### 3.3. The Cost Drivers

The following were mentioned as some of the main cost drivers:

#### A. Imported Power

The Company forecasted the bulk supply purchases cost amounting to M 432 792 158 for 2017/18 which is 1.6% higher than the figure approved for 2016/17. LEC forecasted total bulk supply costs as shown in Table 4 below.

Table 4: 2017/18 LEC's Bulk Supply Purchases Forecasts

| Intake Point        | Energy Purchases (KWh) | Amount (Maloti)       |
|---------------------|------------------------|-----------------------|
| MHP (Muela)         | 519 187 043            | 57 963 991.37         |
| ESKOM               | 268 636 680            | 237 623 966.59        |
| EDM                 | 97 500 000             | 137 204 200.00        |
| <b>TOTAL ENERGY</b> | <b>885 323 723</b>     | <b>432 792 157.96</b> |

## B. Expenditure

Components of the expenditure cost category of the revenue requirement were outlined as reflected in Table 5 below:

*Table 5: Expenditure Cost Components*

| <b>Expense Items</b>            | <b>Costs (Maloti)</b> |
|---------------------------------|-----------------------|
| Generation, fuel and lubricants | 1 725 999.96          |
| Maintenance and repairs         | 44 552 750.00         |
| LEWA licence fee                | 4 800 000.00          |
| Operating expenses              | 100 951 025.28        |
| Staff remuneration              | 162 746 654.87        |

Operating expenses, maintenance and repairs, were cited in the Application as mostly driven by sales, inflation, increased number of customers and network expansion. Salaries, were forecasted to increase by 10% in order to align with regulation requirements, and to be able to embark on a retention strategy that would benchmark employees' salaries with the best practices in the market. In addition, LEWA's licence fee was forecasted to increase by 4%.

## C. Return on Assets

The Application mentioned that at the beginning of 2016/17, LEC asset base registered M 2.6 billion compared to the M 2.5 Billion that was registered in 2015/16 after asset valuation. Regulated Asset Base (calculated from assets financed solely by LEC) amounted to M 1.4 Billion. In consideration of the prevailing economic situation in the country, LEC stated that it has requested M 100 467 621 instead of the estimated figure of M174 467 641.

## D. Depreciation

The Application mentioned that for 2017/18, forecasted depreciation cost was M116 439 203. The depreciation figure translates into a 16% increase compared to the previous financial year figure of M100 005 205.

### 3.4. Revenue Requirement

The application stated that the estimated revenue requirement for 2017/18 was M 964 475 432. The increase, according to the application was mainly attributed to the anticipated power purchase costs increases from both Eskom and EDM. The cost components of revenue requirement are as shown in Table 6 below:

Table 6: Cost per Component of Revenue Requirement

| Cost Component             | Proposed Cost (Maloti) | Composition in percentage (%) |
|----------------------------|------------------------|-------------------------------|
| Bulk purchases             | 432,792,158.00         | 45                            |
| Operating Expenditure      | 268,497,680.00         | 28                            |
| Depreciation               | 116,439,203.00         | 12                            |
| Maintenance Costs          | 44,552,750.00          | 5                             |
| Diesel for Semonkong       | 1,726,000.00           |                               |
| Return on Assets           | 100,467,641.00         | 10                            |
| <b>Revenue Requirement</b> | <b>964,475,432.00</b>  | <b>100</b>                    |

The Application stated that the revenue requirement was expected to be financed by a nominal increase of 16.9% on both energy and maximum demand. The proposed energy and maximum demand tariffs were as stated in Table 7 and Table 8 below respectively:

Table 7: Proposed Energy Charges

| Customer Category | Proposed tariffs (M/kWh) |
|-------------------|--------------------------|
| Industrial HV     | 0.2100                   |
| Industrial LV     | 0.2325                   |
| Commercial HV     | 0.2100                   |
| Commercial LV     | 0.2325                   |
| General Purpose   | 1.7173                   |
| Domestic          | 1.5192                   |
| Lighting          | 0.8624                   |

Table 8: Proposed Maximum Demand Charges

| Customer Category | Proposed tariffs (M/kVA) |
|-------------------|--------------------------|
| Industrial HV     | 295.84                   |
| Industrial LV     | 345.55                   |
| Commercial HV     | 295.84                   |
| Commercial LV     | 345.55                   |

### 3.5. Other Provided information

The Application also included the following information:

- Sales Revenue and Demand Forecasts;
- Operating Expenses;
- Audited accounts;
- Management Accounts;
- Projected Maximum demand
- Bulk supply forecasts
- Cost allocation basis

## 4. PUBLIC CONSULTATION SESSIONS

Following the approval of the timelines for the processing of the Application, the Authority publicised the application and requested that written inputs be forwarded to LEWA by close of business on 01 February, 2017. In line with the Lesotho Electricity Authority Tariff Filing and Review Procedure for Electricity and Water, the Authority identified data gaps and communicated them in writing to LEC on 01 February, 2017. The Company provided the required clarifications and additional information, albeit not sufficient, on 21 March, 2017.

Three public hearings were held on 3 February 2017, 17 February, 2017 and 3 March, 2017 in Mophale's Hoek, Hlotse and Maseru respectively. LEC, stakeholders, Catholic Commission for Justice and Peace (CCJP), Lesotho Chamber of Commerce and Industry (LCCI), Leribe Business Forum (LBF), Consumer Protection Association (CPA), Nien Hsing Group and Lesotho Industrial Employers Association (LIEA) made presentations before the Pricing and Tariffs Committee of the Authority. Summarily, the presentations outlined some clarifications sought with respect to the information

provided on LEC's application and during the presentation, and recommendations to both the Board and LEC.

#### **4.1. LEC's Presentation**

In its presentation, LEC stated that it is a regulated state owned entity that received no subventions from the Government except that it undertook electrification projects for the Government. LEC highlighted that it had presence in all the regions of the country (in ten districts). The Company stated that it operated small generation plants in Mants'onyane and Semonkong. The regulated entity's composite licence covered transmission, distribution and supply of electricity.

The Licencee pointed out that its capital costs did not form part of the tariff. The company pointed out that bulk suppliers of electricity were 'Muela, EDM and ESKOM. The presentation stated, among others, the following as LEC's business characteristics:-

- Business with long term focus
- It is a vertically integrated network energy business

##### **4.1.1. Challenges**

In its presentation, LEC stated the following as its challenges:

- a. Third party contracts (of which LEC is a price taker) for the provision of the goods and services such as the undermentioned:
  - Stock materials (copper or aluminium price volatility)
  - Security costs (related to labour code which is roughly increasing annually by between 8% to 10%);
  - Fuel increases (as a result of Organisation of the Petroleum Exporting Countries (OPEC) output reduction and price increase); and
  - Bulk purchases;
- b. Independent Power Producers, which did not offer competitive prices following approval of Energy Policy;
- c. Antiquated equipment:- Old infrastructure needed to be replaced as finding its spare parts was becoming almost impossible;



- d. Extreme weather:- LEC infrastructure was affected by strong wind and heavy snow as a result of climate change;
- e. Exchange rate exposure:- EDM bulk purchases exposed LEC to foreign exchange risk; and
- f. Vandalism: this results in loss of material, business and lives.

#### **4.1.2. Strategic Achievements**

Amongst others, LEC stated the following as its achievements:

- a. Road shows undertaken to build relations throughout the ten districts;
- b. 2015/16 Financial Statements were audited in time;
- c. Improved absorptive capacity; and
- d. Improved Asset Register.
- e. Embarkment on negotiations of 20MW solar farm to be installed at Ha Ramarothole;
- f. Undertaking of the continuing feasibility studies for generation at Senqu, Seaka, Makhaleng and Monontsa.

#### **4.1.3. Future Planned Works**

As a way forward, LEC stated the following, among others, as its future planned works:

- a. System improvement on Ha Matšooana line in Thaba Tseka, 11kV feeders at Hlotse, Mokhotlong & Butha-Buthe and Moruthoane feeder to upgrade conductor & replace rotten poles is planned at M12 million;
- b. Maintenance works, critical spares and consumables for entire LEC network is planned at M 6.5 million to minimise unplanned outages;
- c. Upgrading of Litsoeneng substation to support new villages load eg Maphutseng;
- d. Upgrading of Leloaleng and new Mt Moorosi substation;
- e. Refurbishment of 33kV line from Mazonod to Thaba Tseka and 33kV line from M/Hoek to Quthing;
- f. Maintenance of Mabote transmission transformers and transmission lines at M 3.5 million;

- g. Replacement of dilapidated switchgear at SW12 that supply Lerotholi Polytechnic, Limkokwing & surrounding areas is planned at M 5 million; and
- h. Replace old 132kV Lejone and Pitseng circuit breakers to curb nuisance power trips that affect Liqhobong and Kao mines is planned at M 5 million.

#### **4.1.4. Revenue requirement**

In the presentation, LEC mentioned that the tariff must recover the required revenue for the year. It presented the components of the revenue requirement as stated under 3.4 above.

#### **4.2. Issues Raised by various Stakeholders**

The groups' presentations pointed out the following as LEC's limitations and weakness:

- LEC did not present the Company's 5 year plan;
- It stated that the infrastructure was old and costly but expenditure was more on new equipment than on old infrastructure maintenance;
- It did not compare expenditure against revenue for new installations;
- It did not present creditors status and debt collection strategies;
- Efficiency gains and their trends analysis were not presented;
- Strategies to leverage on efficiency gains were not presented;
- Running Semonkong mini-hydro plant cost was too high;
- Regarding rural electrification project, LEC did not show how much was spent and recovered, how the projects were maintained and their sustainability strategy.

During all the public hearings that were held, stakeholders, through group discussions and individual presentations, raised a number of issues that needed to be addressed by the Company. These included:-

- a. Ensuring consistent supply that was resilient to wind and rain as unreliable supply adversely affects all customers.
- b. Putting in place measures to prevent illegal connections;
- c. Ensuring that its infrastructure was protected against vandalism;
- d. Ensuring that the emergency number was answered;

- e. Introducing pro-poor tariff system in order to enhance service access by vulnerable groups such as the poor, orphans, old aged, unemployed and low income earners;
- f. Improving on information dissemination strategies especially on planned interruptions of supply;
- g. Embarking on feasibility studies regarding solar and wind generation; and
- h. Extending the network so that customer number increased, which would result in increased revenue.

The group representatives made the following recommendations for LEC to:

- Make long term plan of at least 5 years;
- Install prepaid meters for large users to reduce costs;
- Manage debt in collaboration with stakeholders;
- Increase portfolio of income streams;
- Stagger the proposed increase;
- Embark on cost reduction or saving programs within the Company;
- Look into modalities to address the issue of pioneer developers;
- Adopt differential tariffs to consider time of use and locations; and
- Use mobile networks' facilities such as cell phones to notify people of the planned power cuts or outages.

The groups' representatives also mentioned that because of the prevailing economic environment, the proposed tariffs would not be affordable. They pointed out that persistent tariff increase may result in people resorting to other sources of energy, and that would affect LEC's revenue negatively. The representatives also mentioned that, for all the years, LEC had presented similar reasons when applying for tariff adjustment but there had been no change in the quality of its service delivery. They pointed out that LEC had never upgraded its systems with the allowed tariff increase. They also indicated that the drivers of tariff increase were fluctuating but LEC's tariff was continually increasing. They advised LEC that persistent tariff increases may result in revenue drop instead of an increase as demand would decline. They also advised LEC to embark on a study on electricity usage (especially in the rural areas) to ascertain if forecasted demand reconciled with the actual demand. The study would assist LEC to determine if electricity tariffs were affordable. They also proposed that the utility should revert to other sources of electricity generation (solar, water and wind)

within the country in order to cut the bulk supply costs. They recommended a tariff increase in the range of 0% to 7%.

CCJP opined that customers connected via rural electrification levy should not be made to pay levies since they are presumed to be 'poor'. The organisation further indicated that consumers were not even aware of the electrification levy charge. CCJP recommended the introduction of a pro-poor band to cater for low income earners and that such a band be subsidised by the affluent groups. LEWA was urged to closely monitor LEC in order to prevent the Company from exploiting its monopolistic position. According to CCJP a 16.9% request in tariffs could not be justified and that displayed exploitation of LEC's monopolistic position. It recommended that:

- LEWA should suspend the tariff review process and seek a new mandate to carry out the Company's forensic audits; and
- LEWA should enforce compliance to allowed revenue requirements

In its presentation, CPA observed that whilst increase in coverage was appreciated, LEC should supply its customers with reliable and cost effective electricity. It also highlighted that ESKOM and EDM supply accounted for 34% of bulk purchases not 44% as stated in the Application. CPA pointed out that the dollar exchange rate could no longer be given as a reason for the increase in tariffs as EDM supply accounted for only 36% of the imported supply and the dollar exchange rate had been on a steady decline over 2016/17. It also stated that as a result of spiralling costs of services provided due to LEC, unemployment rate was likely to increase. According to CPA, poor economic performance and the economic growth that does not translate into welfare improvement of the lower class of the society, will result in the poor not affording the increase.

CPA highlighted that there was need for adjustment of tariffs as the 9.4% increase that was used as a basis for last year increase was nullified. It stated that the requested increase of 16.9% had no basis as neither ESKOM nor EDM had made equivalent increases. It also stated that such increase would adversely affect industries, schools, students and the economy as a whole. CPA recommended that the proposal should be denied based of the following:

- LEC should adjust the demand accordingly;

- Lack of robust analysis of the likely effects of the requested tariff on the affordability by customers; and
- Unemployment was swelling.

Lesotho Industrial Employers Association (LIEA) stated that any increase on electricity tariff would be a heavy load on the already battered industry. LIEA pointed out that Lesotho's expensive electricity rendered products from this country uncompetitive compared to product from countries with government subsidy for industries electricity usage. The Association mentioned that increased tariffs would be directly reflected in the end pricing of the products and thus rendering products expensive and not competitive. LIEA also declared that as a result of not being competitive, more businesses would close down and more Basotho would lose their jobs. LIEA maintained it did not support a 16.9% increase because of what was afore mentioned and the fact that projected inflation would not exceed 6.3%

Lesotho Textile Exporters Association (LTEA) mentioned that it represented 20 manufactures of textile and apparel that employed approximately 32 300 workers. It stated that the requested increase was not consistent with the 2017 inflation of approximately 6% projected in Macro Poverty Outlook for Lesotho – Report Number: 108890 published by the World Bank.

LTEA pointed out that if LEC could be granted a tariff increase above the prevailing inflation rate, pressure would be put upon members' enterprises who were struggling to maintain orders in a highly competitive global environment. LTEA mentioned that if proposed tariffs would be allowed, significant burden would be imposed on its members especially those in manufacturing of textiles and laundry operations. It also highlighted that activities of LTEA member firms sustain many other formal and informal sector businesses in Lesotho, and a tariff increase of that magnitude would fuel inflationary pressures within the country. LTEA also requested more time for consultation with members and preparation of inputs in future tariff increase applications.

FORMOSA in its presentation advocated for multi-year tariff review as that would allow it adequate time to plan ahead. It stated that the double digit annual adjustments may result in firms or investors deciding to relocate to countries with favourable business climate. It further mentioned that there were challenges that needed Lesotho to be

pro-active to avoid getting into the crisis stage of disinvestment. Formosa also stated that LEC with its request to hike tariffs was not helping Lesotho to retain the competitive edge it had over other countries. It finally recommended that LEC should adopt use of discounted tariffs and/or differential tariffs.

LCCI pointed out that a great portion of the LEC costs was from bulk purchases. It stated that EDM contract to supply LEC addressed the issue of 2008 load shedding and LCCI hence proposed that the EDM contract should be terminated as it had become a cost burden. LCCI further mentioned that terminating the EDM contract would cut down on wheeling costs. It also advised LEC to take advantage of the current ESKOM excess capacity by negotiating a better PPA with ESKOM for Maseru intake point.

LCCI stated that NERSA allowed ESKOM 2.9% increase for 2017/18. The organisation also advised LEC to include the benefit of Mants'onyane generation facility in the Application. It also stated that LEC did not align its tariff requests to regulatory requirements.

LCCI also highlighted that losses were a very important parameter in tariff determination, as well as the audited data in determining revenue outturn. It stated that LEC estimated the depreciation amount yet regulation stipulated that it should be calculated. It made the following recommendations:

- The regulator must enforce compliance;
- Multi-year tariff to be considered, to enable informed business investment decision by the private sector; and
- A capped 6% increase to be allowed.

### **4.3. Analysis of Public Hearings**

In all three (3) public hearings that were conducted, stakeholders generally opposed an increase in tariffs. It was evident that the stakeholders were recommending that the shareholder should play a major role in facilitating and financing expansion of electricity services in the country. Recommended increase in line with inflation was an indication that electricity tariffs should increase based on costs of living considerations, amongst other things since such a criteria was considered fair and just to all. Electricity was still considered as an essential ingredient for the creation of

employment and growth of the economy in the country. Targeted subsidies in society were also considered important in order to ensure continued access by those who cannot afford. Finally, stakeholders were fully aware of development in electricity prices in the SADC region, in particular the Republic of South Africa. Reliable, quality service and effective customer care were considered as pillars of efficiently run electricity utility by stakeholders. Good governance and accountability were considered as critical for end-users to appreciate and support the utility in overcoming its challenges in service provision. A long-term outlook in designing electricity pricing mechanisms was also key for both households and businesses in planning their future electricity costs.

## **5. Analysis of LEC's Application**

### **5.1. LEC's Costs and Required Revenues**

The LEC's revenue requirement is made up of the following major cost items:

- a. Bulk Supply Purchases;
- b. Repair and Maintenance (including fuel and oil for generation);
- c. Operating Expenses;
- d. Labour Costs;
- e. Depreciation; and
- f. Return on Investment

#### **5.1.1 Bulk Supply Purchases**

Whilst LEC had not provided the Authority with detailed information regarding forecasted bulk supply costs for 2017/18, it appeared its estimated M452.79 million<sup>1</sup> was adequate. This was due to the fact that power imports from Eskom had only increased by 2.2%<sup>2</sup> for 2017/18. There was also high likelihood of LEC securing increased notified maximum demand from Eskom as it (Eskom) had excess capacity after completing the construction of some of its generation facilities. Furthermore, LEC

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<sup>1</sup> The budget was confirmed by LEC at public consultation meeting on the 3 March 2017.

<sup>2</sup> This was announced by National Energy Regulator of South Africa, NERSA, on the 23 February 2017

is directed to renegotiate its power purchase agreement with EDM so as to eliminate costs related to exchange rate, wheeling and imports monitoring from EDM by Eskom.

Furthermore, LEC is advised to participate in the regional (SAPP) power market in order to reduce costs on imports from EDM. The Company should have recruited the Power Trading Officer as was directed by the Authority so that it participates in a competitive regional energy market.

LEC has not been monitoring bulk supply costs on a quarterly basis contrary to LEWA's 2011 'Pass-Through Charging Principle for Bulk Supply Tariffs and Procedure for Implementation Mechanism'. The Company has been using almost all its cost of sales budget, which consists of bulk supply expenses, fuel for mini-hydropower plant, and repair and maintenance budget, for bulk supply costs. LEC had not been under or over recovering in bulk supply costs as the budget for repair and maintenance was considered as part of bulk supply costs contrary to the pass-through principle approved by the Authority in December 2011. As shown in Table 9 below, repair and maintenance budget was used for the purchase of power since 2013/14.

*Table 9: Bulk Supply Costs Regulatory Clearing Account since 2013/14 until 2016/17*

| Item  | Financial Years Since 2013/14 until 2016/17 |                       |                       |                        |
|---|---|-----------------------|-----------------------|------------------------|
|   | 2013/14 in Maloti (M)                       | 2014/15 in Maloti (M) | 2015/16 in Maloti (M) | 2016/17* in Maloti (M) |
| Audited Bulk Supply Costs, inclusive of repair and maintenance and fuel for mini-grid | 278,279,816.00                              | 298,941,464.00        | 353,331,930.00        | 440,000,000.00         |
| Actual Bulk Supply Costs  | 256,905,530.00                              | 285,261,749.00        | 339,076,016.70        | 426,050,644.00         |
| Allowed Bulk Supply Costs Budget  | 200,000,000.00                              | 265,996,627.15        | 321,218,495.00        | 367,218,878.00         |
| Audited Repair and Maintenance, and Fuel Budget                                       | 21,374,286.00                               | 13,679,715.00         | 14,255,913.30         | 13,949,356.00          |
| Allowed Repair and Maintenance Budget   | 17,134,200.00                               | 22,525,200.00         | 31,409,071.00         | 31,409,071.00          |
| Audited Budget on Repair and maintenance  | (4,240,086.00)                              | 8,845,485.00          | 17,153,157.70         | 17,459,715.00          |

\* Unaudited data



It would therefore not be logical for the Authority to compensate LEC for under-recovery in bulk supply costs as the Company has not implemented the pass-through principle and it has not suffered any financial loss in the process. Since LEC has, for reasons not explained, failed to comply with regulatory directives regarding bulk supply monitoring, LEWA shall, effective from the next tariff application consider introducing punitive measures for continued non-compliance. To use regulatory allocation for maintenance and repairs on bulk costs is an indication that LEC gives little or no regard to LEWA's directives.

#### **5.1.2 Repair and Maintenance (including fuel and oil for generation)**

LEC proposed a budget of M44.55 million for repair and maintenance, and fuel and oil for diesel generator at Semonkong mini-hydropower plant for the financial year 2017/18. This constituted a 42% increase compared to the approved budget<sup>3</sup> for 2016/17. The justification for 42% increase in this budget had not been provided and until such time the Company had submitted its preventive maintenance schedule to the Authority, increases of this magnitude would not be feasible. Again, as it had been shown in Table 7 above, the repair and maintenance budget had not been used for its purpose. The Authority, therefore, approved that in 2017/18, M16.86 million, be included as the budget for repair and maintenance and 1.73 million for fuel and oil. As was the case with the 2016/17 tariff determination, LEC should submit its preventive maintenance programme to the Authority for consideration and approval, including implementation monitoring.

To use regulatory allocation for maintenance and repairs on bulk costs is an indication that LEC gave little or no regard to LEWA's directives. The least LEC could have done was to approach the Authority and seek approval for any changes to the approved allocations. Reliability of supply had also been one of the major concerns of customers and stakeholders during public hearings and LEC should vigorously maintain and repair its network as expected. Any future changes, without approval, will compel the Authority to penalise LEC.

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<sup>3</sup> LEC had not included repair and maintenance budget in its revenue requirement of M819.54 million for 2016/17.

### 5.1.3 Operating Expenses

LEC proposes a budget of M100.95 million for 2017/18 and this constitutes a 14.7% increase compared to 2016/17 approved budget. Whilst LEC will exceed the approved budget for 2016/17, the Company would maintain the budget for 2016/17 in 2017/18 as it would have implemented programmes that were going to be initiated in 2017/18.

Based on indexation formulae that takes into account annual inflation, growth in sales and increase in customer connections, LEC's budget for operating expenses is M101.69 million, 0.8% increase compared to what LEC proposes. LEC is therefore allowed a budget of M101.69 million for operating expenses in 2017/18.

The approved budget is based on connection growth of 5% and sales increase of 12.8%, as shown in Table 10 below, and average inflation rate of 6.6%.

Table 10: Energy Sales (kWh), Connections and Revenue per kWh

| Item                         | Projected Actuals in 2016-17 in Maloti (M) | Projected in 2017-18 in Maloti (M) | Increase in Percentage (%) |
|------------------------------|--|------------------------------------|----------------------------|
| Energy Sales (kWh)           | 694,998,169.13                             | 784,453,929.73                     | 12.87%                     |
| Connections                  | 203,776                                    | 213,971                            | 5.00%                      |
| Total Revenue                | 737,913,007.49                             | 856,287,655.90                     | 16.04%                     |
| Revenue (M) Required per kWh | 1.0617                                     | 1.0916                             | 2.81%                      |

The average tariff increase will be 2.81% instead of 16.7%<sup>4</sup> stated by LEC while the Company's revenue will increase by 16.04% compared to 2016/17 Financial Year.

### 5.1.4 LEC's Labour Costs

For 2017/18, LEC proposes labour costs of M162.75 million and this represents a 10% increase compared to 2016/17 wage bill for the Company. The proposed increase is not in line with approved labour costs indexation formulae which consists of half growth

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<sup>4</sup> This increase is based on LEC's revenue requirement of M964.48 million

in connection and average annual inflation rate. Based on these two variables (average annual inflation rate of 6.6% and half growth in connection of 2.5%), LEC's labour costs will be increased by 9.1% compared to 2016/17, to M161.42 million for 2017/18.

The Company should maintain improved staff productivity, which increased from one staff per 350 connections in 2016/17 to approximately one staff per 389 connections in 2017/18. This is commendable as the Company is nearly close to achieving a target of one staff per 400 connections.

### **5.1.5 Depreciation Charge**

The depreciation charge proposed by LEC is M116.44 million and this is 16% higher than the figure approved in 2016/17. Contrary to LEWA's Regulatory Accounting Guidelines, approved in September 2012, LEC's proposed figure includes depreciation charges for assets to be developed in 2017/18 financial year.

Despite, the Company's presentation on the use of depreciation funds during public hearings, the Authority is still unable to monitor progress in LEC's efforts to replace old equipment in its network. Some projects<sup>5</sup> appear green fields and it is not clear how they form part of replacing obsolete infrastructure in LEC's network. In line with both Regulatory Accounting Guidelines and Charging Principles for Electricity and Water and Sewerage Services, LEC is allowed a depreciation charge of M100.01 million, the same charge as approved in 2016/17. To date, LEC has not submitted a proof that a 'Depreciation Account' has been established.

### **5.1.6 LEC's Return on Investment**

LEC's proposed return on its asset of M174 467 641.00 is based on the regulatory asset base of its entire assets irrespective of their respective financiers. This blanket approach implies that LEC should earn a return even from assets financed by customers, donors and the Government of Lesotho (GoL). This approach is not consistent with best practice in which returns should go to the financiers. For GoL financed assets, the Authority is consulting with relevant authorities because it is

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<sup>5</sup> The construction of a 33kV line from Metolong to Berea and this costs M10 million.

expected that if LEC earns a return, it should in return declare dividends to Government.

Based on LEC's asset register which classifies assets by categories and their financiers, the Company had an asset value of M3.23 billion of which M2.93 billion had been financed by GOL and customers. LEC's financed assets therefore only value M0.3 billion. Based on depreciation charge of M29.46 million and WACC of 12.2%, LEC would be entitled to a return of M32.86 million instead of M174.47 million for the financial year 2017/18. However, due to the fact that the submitted asset register was still work in progress<sup>6</sup>, the Company will be allowed half of its entitlement.

## **5.2. LEC's Adjusted Revenue Requirement**

Adjustments made in 5.1 above lead to the revenue requirement shown in Table 11 below.

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<sup>6</sup> This has been confirmed in LEC's response in data gap.

Table 11: LEC Revenue Requirement in 2017-18 Financial Year

| Cost Items   | Approved in 2016/17 in Maloti (M) | Revised forecast in 2016/17 in Maloti (M) | Variance between Approved and actual in 2016/17 in Maloti (M) | Projected LEC Costs for 2017/18 in Maloti (M) | Adjusted Costs for 2017/18 based on the approved costs in 2016/17 in Maloti (M) |
|--|-----------------------------------|---|---|---|---|
| Cost of Sales  | 400,293,949.00                    | 446,031,937.00                            | - 45,737,988.00   | 479,070,908.00                                | 471,376,753.53  |
| Bulk Purchases                                       | 367,158,878.00                    | 413,877,637.00                            | -46,718,759.00  | 432,792,158.00                                | 452,792,158.00  |
| Repairs and maintenance                              | 31,409,071.00                     | 30,920,293.00                             | 488,778.00  | 44,552,750.00                                 | 16,858,595.53   |
| Diesel and oil                                       | 1,726,000.00                      | 1,234,007.00                              | 491,993.00  | 1,726,000.00                                  | 1,726,000.00  |
| Operating Expenditures                               | 340,783,340.51                    | 355,055,825.00                            | -14,486,427.49  | 384,936,883.00                                | 368,480,547.07  |
| Labour   | 147,951,504.43                    | 148,078,049.00                            | -126,544.57   | 162,746,655.00                                | 161,417,342.08  |
| Depreciation   | 100,005,205.00                    | 100,648,594.00                            | -643,389.00   | 116,439,203.00                                | 100,005,205.00  |
| Other expenses                                       | 88,010,761.08                     | 101,727,255.00                            | -13,716,493.92  | 100,951,025.00                                | 101,685,172.98  |
| LEWA License   | 4,815,870.00                      | 4,631,927.00                              | 183,943.00  | 4,800,000.00                                  | 5,372,827.00  |
| Sub-total (Cost of sales and operating expenditures) | 741,077,289.51                    | 801,117,762.00                            | -60,224,415.49  | 864,007,791.00                                | 839,857,300.60  |
| Return on Asset                                      |                                   | 35,830,716.00                             | -35,830,716.00  | 100,467,641.00                                | 16,430,355.30   |
| Financing costs                                      | 14,240,022.73                     |   | 14,240,022.73   |   |   |

| Cost Items                                  | Approved in 2016/17 in Maloti (M) | Revised forecast in 2016/17 in Maloti (M) | Variance between Approved and actual in 2016/17 in Maloti (M) | Projected LEC Costs for 2017/18 in Maloti (M) | Adjusted Costs for 2017/18 based on the approved costs in 2016/17 in Maloti (M) |
|---|-----------------------------------|---|---|---|---|
| LEC's Total Required Revenue (excl. levies) | 755,317,312.24                    | 836,948,478.00                            | -81,815,108.76  | 964,475,432.00                                | 856,287,655.90  |

#### A. Tariff increase

In order to achieve the adjusted required revenue indicated in Table 11 above, the average tariff increase would be 2.81% and the tariffs would be increased as indicated in Table 12 and Table 13 below.

Table 12: Approved LEC Tariff Levels for 2017/18 by the LEWA Board

| Customer Categories | 2016/17 (old) Energy Charge (M/kWh) | Approved percentage change (%) | Approved Energy Charges (M/kWh) | Adding Customer Levy @M0.0423/kWh | Adding Rural Electrification Levy @M0.02/kWh large customers and @M0.035/kWh for others (M/kWh) | Final Approved Energy Charge (M/kWh) | 2016/17 (old) Charges including levies (M/kWh) | Final Tariff Percentage increase (%) |
|---------------------|-------------------------------------|--------------------------------|---------------------------------|-----------------------------------|---|--------------------------------------|--|--------------------------------------|
| Industrial HV       | 0.1796                              | 3.6%                           | 0.1861                          | 0.2284                            | 0.2484  | 0.2484                               | 0.2419   | 2.7%                                 |
| Industrial LV       | 0.1989                              | 3.6%                           | 0.2061                          | 0.2484                            | 0.2684  | 0.2684                               | 0.2612   | 2.8%                                 |
| Commercial HV       | 0.1796                              | 3.6%                           | 0.1861                          | 0.2284                            | 0.2484  | 0.2484                               | 0.2419   | 2.7%                                 |
| Commercial LV       | 0.1989                              | 3.6%                           | 0.2061                          | 0.2484                            | 0.2684  | 0.2684                               | 0.2612   | 2.8%                                 |

| Customer Categories | 2016/17 (old)<br>Energy Charge<br>(M/kWh) | Approved<br>percentage<br>change (%) | Approved<br>Energy Charges<br>(M/kWh) | Adding Customer<br>Levy<br>@M0.0423/kWh | Adding Rural<br>Electrification Levy<br>@M0.02/kWh large<br>customers and<br>@M0.035/kWh for<br>others (M/kWh) | Final Approved<br>Energy Charge<br>(M/kWh) | 2016/17 (old)<br>Charges<br>including<br>levies (M/kWh) | Final Tariff<br>Percentage<br>increase (%) |
|---------------------|---|--------------------------------------|---------------------------------------|---|--|--|---|--|
| General Purpose     | 1.4688                                    | 3.6%                                 | 1.5222                                | 1.5645                                  | 1.5995   | 1.5995                                     | 1.5461  | 3.5%                                       |
| Domestic            | 1.2994                                    | 3.6%                                 | 1.3467                                | 1.3890                                  | 1.4240   | 1.4240                                     | 1.3767  | 3.4%                                       |
| Street Lighting     | 0.7376                                    | 3.6%                                 | 0.7644                                | 0.8067                                  | 0.8417   | 0.8417                                     | 0.8149  | 3.3%                                       |

Table 13: Approved LEC Maximum Demand Charges for 2017/18 by the LEWA Board

| Customer Categories | 2016/17 (old) Maximum Demand Charge (M/kVA) | Approved Percentage Change (%) | Approved Maximum Demand Charges (M/kVA) |
|---------------------|---|--------------------------------|---|
| Industrial HV       | 253.0338                                    | 3.6%                           | 262.2392                                |
| Industrial LV       | 295.5498                                    | 3.6%                           | 306.3019                                |
| Commercial HV       | 253.0338                                    | 3.6%                           | 262.2392                                |
| Commercial LV       | 295.5498                                    | 3.6%                           | 306.3019                                |

\*The figures in Table 12 and Table 13 exclude VAT.

The above tariffs would enable the utility to generate M856.29 million from its customers. This is shown in Table 14 below.

Table 14: LEC 2017/18 Total Revenue Based on the Approved Tariffs

| Customer Categories | Approved LEC Energy Charge (M/kWh) | Approved Maximum Demand Charge (M/kVA) | Forecasted Energy Sales (kWh) | Forecasted Maximum Demand (kVA) | Total Revenue to LEC in Maloti (M) |
|---------------------|------------------------------------|--|-------------------------------|---------------------------------|------------------------------------|
| Industrial HV       | 0.1861                             | 262.2392                               | 231,776,341.51                | 397,804.00                      | 147,461,228                        |
| Industrial LV       | 0.2061                             | 306.3019                               | 44,936,834.25                 | 196,483.00                      | 69,446,222                         |
| Commercial HV       | 0.1861                             | 262.2392                               | 90,243,832.21                 | 225,327.00                      | 75,887,005                         |
| Commercial LV       | 0.2061                             | 306.3019                               | 60,515,597.36                 | 172,878.00                      | 65,427,309                         |
| General Purpose     | 1.5222                             |  | 104,774,310.11                |                                 | 159,491,133                        |
| Domestic            | 1.3467                             |  | 250,377,104.29                |                                 | 337,175,914                        |
| Lighting            | 0.7644                             |  | 1,829,910.00                  |                                 | 1,398,845                          |
| <b>Total</b>        |                                    |  | <b>784,453,930</b>            |                                 | <b>856,287,655.90</b>              |



## **6. LEC's Annual Performance Review**

While LEC's annual compliance would be reviewed at the end of the year, based on information gathered during inspections and monthly reporting formats, there are incidences of unreliable power supply reported during public consultations. In some cases, the power cuts are unannounced and that affects both economic and social activities of the society at large.

Furthermore, LEC has not been able to comply with the following regulatory instruments and tariff decision directives of the Authority:

- a. The LEA Act, 2002, as amended, in respect of providing regulated accounts for its businesses:** This is despite the Company establishing a telecommunications company that it claimed it has been properly ring-fenced from the electricity supply businesses;
- b. Lesotho Electricity and Water Regulatory Accounting Guidelines:** The guidelines clearly stipulate how the Company/licensee should treat RAB, depreciation and construction capital work in progress;
- c. Lesotho Electricity and Water Charging Principles for Electricity and Water and Sewerage Services:** The principles guide the licensee on the preparation and submission of tariffs to the Authority. These principles allow for multi-year tariffs that many stakeholders have requested to be considered moving forward. The Principles are supplemented by the Tariff filing and Review Procedure which stipulates the minimum and the type of information that should accompany tariff application to the Authority;
- d. Lesotho Electricity and Water and Sewerage Services Revised Pass-through Principle for Bulk Supply Tariffs and Procedure for Implementation Mechanism:** This principle is aimed at ensuring that LEC is constantly monitoring its bulk supply costs so as to ensure that any necessary interventions are known and acted upon timeously. LEC's inability to comply with this principle make it hard for the Authority to do necessary adjustments to its bulk supply costs;
- e. LEC's Composite license:** In terms of the license, LEC is tasked with procuring power in an economic and competitive manner. However, LEC has maintained the unaffordable EDM power sales agreement despite availability of less expensive power in South Africa on the basis that Eskom is untrustworthy. There is no

supporting information on this claim as Eskom had supplied Lesotho power needs for all the three supply points for over twenty (20) years now; and

- f. **The establishment of 'Depreciation Account':** The account is aimed at ring-fencing depreciation funds with the view of ensuring they are used for capital maintenance. Despite LEC reporting on the use of these funds during public hearings, it has failed to prove to the Authority that the appropriate account has been established and report on its activities on a quarterly basis.

## **7. LEC'S FINANCIAL PERFORMANCE**

LEC's major financial ratio analysis is detailed below. The information used is for 2015 and 2016 (audited financial statements) as well as the management accounts for the period ended 30 September 2016.

### **7.1. Profitability**

According to the Audited Financial Statements for the year ended 31<sup>st</sup> March 2016, LEC's gross profit was M324 million which represents 47.8% of the sales. This sufficiently covered all the operating costs amounting to M312 million and a profit after tax of M18 million was realised as compared to a profit of M36 million in 2015. The sales for 2016 have increased by 6% while the operating expenses increased by 4% (M12 million) as compared to 2015. Management accounts for the period ended 30 September 2016 shows a loss of M29 million while the projected year end operating profit is M7.3 million. The projections for 2017/18 shows a profit of M5.3 million. This shows a deterioration in LEC's financial performance.

### **7.2. Liquidity**

The idea behind this is that a company should have enough current assets that give a promise of 'cash to come' to meet future commitments to pay off its current liabilities. Obviously, a ratio in excess of one (1) is ideal. Both the current and quick ratio shows are an indication of the company's liquidity position.

**a. Current ratio (Current Assets/Current Liabilities)**

The current ratio of LEC as at March 2016 was 1.5 while March 2017 projections stand at 0.83. This is below the recommended threshold. It suggests that LEC may have a problem in settling short-term obligations.

**b. Quick ratio (Current Assets less Inventory/Current Liabilities)**

The quick ratio as at 31 March, 2016 stands at 1.3 as compared to projections for the year ended 31 March, 2017 at 0.8. This implies that with the exclusion of inventories LEC's ability to settle its short term liabilities would go further down to 0.51 which is way below the recommended threshold.

**c. Cash generated from operations**

The Cash Generated from Operations measures the company's ability to finance its long term investing obligations. LEC's position in this regard was very weak as in the year ended 31 March, 2016 it was not able to generate sufficient cash flows, funds from the previous financial year were used to finance capital items. The projections for 2017 show further weakened results as the opening cash flow in March 2016 was M133 million and the projected closing cash and cash equivalents for March 2017 is M40 million.

### **7.3. Gearing Ratio**

The capital gearing is a measure of the proportion of the company's capital that is debt. The LEC's gearing for 2016 has slightly decreased by M0.8 million compared to 2015. That means long – term debt is 3.7% of Equity. The management accounts projections for the year ending 31 March 2017 show a gearing of 3.5% (decrease of M1.2 million from March 2016). The degree of borrowing may have a negative impact on the liquidity and the return on investment of an entity. In a healthy financial situation interest cover (**Profit before tax / interest costs**) is expected to be more than 3 times. In the case of LEC the interest cover on projections for the year ending 31 March 2017 the cover stands at will be 3.5 times.

In conclusion, some of LEC's financial measurements show a deterioration in both the profitability and liquidity ratios. Though interest cover has decreased from 28 times to 3.5 this is however still within the recommended threshold. Finally, LEC'S Financial

Statements for the year ended 31 March 2016 have been given an except for opinion which means that there were some accounting elements which have not been treated accurately/need to be corrected.

## **8. ISSUES RAISED DURING PUBLIC HEARINGS**

Stakeholders in all three public hearings raised issues of which some were responded to by LEC. Some issues were on governance and funding for the public utility. Amongst issues that could not be responded to by the utility were the following:

- a. **Increased generation capacity:** Whilst the current approved Energy Policy was clear that the country should at least be able to meet its base load demand from local generation, stakeholders were of the view that the entire electricity demand for the country should be met by local generation. It is however not clear from the policy perspective whether the country should be self-sufficient in electricity supply.
- b. **The role of shareholder:** Stakeholders have requested that LEC should be funded by Government and that tariffs should also be subsidized. It may be necessary for Government to define a clear framework in which the utility will be funded and the Government expectations thereof. This should include a clear statement on the dividend policy by the shareholder regarding returns made by the utility.
- c. **Social/subsidy Policy:** The Government should consider subsidizing old age, orphaned, disabled and unemployed. This issue was also raised in 2016/17 public consultations meetings and the Authority was in the process of commissioning cost of service study, to amongst others, address the pro-poor pricing mechanism
- d. **Employment creation and economic development:** Utilities services should be priced such that they enhance Lesotho competitiveness in the manufacturing sector as the sector relies extensively on reliable and efficient electricity supply. The reduction in GDP growth associated with electricity price increases is likely to result in a number of jobs being compromised.
- e. **Infrastructure Development:** LEC should collaborate with institutions like Lesotho National Development Corporation (LNDC) when it plans its infrastructure development so as to enhance their economic sustainability and contribution to employment creation and economic development.

- f. Governance of State-owned utilities:** Government should consider putting in place an efficient, robust and transparent governance structure for its utilities. The governance charter should address issues such as appointment of directors, their remuneration, etc.
- g. Multi-year tariff structure:** A multi-year tariff structure should be considered as it enables predictions on the future costs of electricity. Again, it has strong incentives for the utility to control costs.

## **9. CONCLUSIONS**

Based on the available information from the written and oral submissions by various stakeholders during public consultation process, reasons, facts and evidence provided, and LEC's response to both LEWA and public comments, the LEWA Board has found justification for M964.48 million revenue requirement not in line with LEWA's Regulatory Principles and Guidelines. LEWA Board therefore concludes as follows:

- a.** The requested 16.9% increase in energy and demand charges, requested by LEC generates M965.86 million. In order to meet its revenue requirement of M964.48 million, energy and maximum demand charges would need to increase by 16.7%.
- b.** LEC's revenue requirement is M856.29 million and in order to achieve this revenue requirement tariffs will increase by 3.6%.
- c.** Since 2013/14, LEC has not been applying the Pass-Through Charging Principle for Bulk Supply Tariffs and Procedure for its Implementation Mechanism. Therefore LEC is not entitled to bulk supply under-recoveries it incurred during that period as repair and maintenance budget was used to finance the shortfall.
- d.** LEC's repair and maintenance budget has been largely used for payment of bulk supply costs. This has not resulted in severe power cuts reported by the Company. However, there could be a backlog in repair and maintenance that might need to be addressed in future.
- e.** The Company's return on assets was based on the entire LEC's assets irrespective of their financiers. The correct LEC's return on its assets is therefore M32.86 million instead of M174.47 million proposed by the Company.
- f.** The Company's operating expenses and labour costs are not in line with approved LEWA formulae which consists of increase in connections, sale growth and

average annual inflation rate. Based on the formulae, LEC's operating and labour expenses are M101.69 million and 161.42 million, respectively.

- g. LEC's staff productivity ratio has not reached a set target of one staff per 400 connections. It is currently at one staff per 389 connections and this was an improvement compared to 2016/17 ratio which was 1:350.
- h. LEC's depreciation charge of M116.44 million is not based on used and useful assets. It is therefore not calculated in line with LEWA Regulatory Accounting Guidelines which say 'construction work in progress (CWIP) for an asset shall not be included in the RAB until the asset is in use'. LEC's depreciation charge is therefore maintained as M100.01 million, the same as allowed in 2016/17 financial year.
- i. The short-term contract between LEC and EDM should be reviewed with a view to procure more power from Eskom. This will result in relatively reduced imports costs of power as EDM costs are 40% more expensive compared to Eskom.

## 10. APPROVAL

A. The Board therefore approved that the LEC tariffs should be increased as shown in Table 15 and Table 16 below.

Table 15: Approved LEC Tariff Levels for 2017/18 by the LEWA Management

| Customer Categories | 2016/17 (old)<br>Energy Charge (M/kWh) | Approved percentage change (%) | Approved Energy Charges (M/kWh) | Adding Customer Levy @M0.0423/kWh | Adding Rural Electrification Levy @M0.02/kWh large customers and @M0.035/kWh for others (M/kWh) | Final Approved Energy Charge (M/kWh) | 2016/17 (old) Energy Charges including levies (M/kWh) | Final Tariff Percentage increase (%) |
|---------------------|--|--------------------------------|---------------------------------|-----------------------------------|---|--------------------------------------|---|--------------------------------------|
| Industrial HV       | 0.1796                                 | 3.6%                           | 0.1861                          | 0.2284                            | 0.2484  | 0.2484                               | 0.2419  | 2.7%                                 |
| Industrial LV       | 0.1989                                 | 3.6%                           | 0.2061                          | 0.2484                            | 0.2684  | 0.2684                               | 0.2612  | 2.8%                                 |
| Commercial HV       | 0.1796                                 | 3.6%                           | 0.1861                          | 0.2284                            | 0.2484  | 0.2484                               | 0.2419  | 2.7%                                 |
| Commercial LV       | 0.1989                                 | 3.6%                           | 0.2061                          | 0.2484                            | 0.2684  | 0.2684                               | 0.2612  | 2.8%                                 |
| General Purpose     | 1.4688                                 | 3.6%                           | 1.5222                          | 1.5645                            | 1.5995  | 1.5995                               | 1.5461  | 3.5%                                 |
| Domestic            | 1.2994                                 | 3.6%                           | 1.3467                          | 1.3890                            | 1.4240  | 1.4240                               | 1.3767  | 3.4%                                 |
| Street Lighting     | 0.7376                                 | 3.6%                           | 0.7644                          | 0.8067                            | 0.8417  | 0.8417                               | 0.8149  | 3.3%                                 |

Table 16: Approved LEC Maximum Demand Charges for 2017/18

| Customer Categories | 2016/17 (old) Maximum Demand Charge (M/kVA) | Percentage Change (%) | Approved Maximum Demand Charges (M/kVA) |
|---------------------|---|-----------------------|---|
| Industrial HV       | 253.0338                                    | 3.6%                  | 262.2392                                |
| Industrial LV       | 295.5498                                    | 3.6%                  | 306.3019                                |
| Commercial HV       | 253.0338                                    | 3.6%                  | 262.2392                                |
| Commercial LV       | 295.5498                                    | 3.6%                  | 306.3019                                |

\*The figures in Table 15 and Table 16 exclude VAT.

B. The 2016/17 charges for connection, wiring testing, wiring re-testing, survey, re-survey, licensing for wiring, meter testing and house extension remain the same for the financial year 2017/18.

## 11. EFFECTIVE DATE

The effective date for the approved tariffs is 10 April 2017.

## 12. COMMUNICATION

The decision of the LEWA Board has been communicated to the applicant, LEC, by a letter dated 07 April 2017, and to the general public through press conference, press release and via print and electronic media on the same date.

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Date: 16/06/2017

**CHAIRPERSON OF THE LEWA BOARD**