



LESOTHO ELECTRICITY AND WATER AUTHORITY

In the matter regarding a

**DETERMINATION OF LESOTHO ELECTRICITY COMPANY (Pty) Ltd's
APPLICATION FOR A TARIFF INCREASE FOR 2014/15**

1. DECISION

Based on the available information and analysis of the application, written and oral submissions from stakeholders during public consultation process, reasons, facts and evidence provided, the Lesotho Electricity and Water Authority (LEWA) Board, at its meeting held on 11 April, 2014, decided and resolved as follows:

- a) That the Lesotho Electricity Company (LEC) be allowed a revenue of M676.10 million for 2014/15 Financial Year.
- b) That the energy and maximum demand charges for all customer categories be increased as shown in Tables 1 and 2 below.

Table 1: Approved LEC Energy Charges for 2014/15

Customer Categories	Old Energy Charges (M/kWh)	Approved percentage change	Approved Energy Charges (M/kWh)	Adding Customer Levy @M0.030/kWh	Adding Rural Electrification Levy @M0.02/kWh large customers and @M0.035/kWh for others (M/kWh)	Final Approved Energy Charge (M/kWh)	Old Energy Charges including levies (M/kWh)	Final Tariff Percentage increase
Industrial HV	0.1347	12.4%	0.1514	0.1814	0.2014	0.2014	0.1801	11.8%
Industrial LV	0.1491	12.4%	0.1676	0.1976	0.2176	0.2176	0.1945	11.9%
Commercial HV	0.1347	12.4%	0.1514	0.1814	0.2014	0.2014	0.1801	11.8%
Commercial LV	0.1491	12.4%	0.1676	0.1976	0.2176	0.2176	0.1945	11.9%
General Purpose	1.1011	12.4%	1.2378	1.2678	1.3028	1.3028	1.1615	12.2%
Domestic	0.9741	12.4%	1.0950	1.1250	1.1600	1.1600	1.0345	12.1%
Street Lighting	0.5530	12.4%	0.6216	0.6516	0.6866	0.6866	0.6134	11.9%

Table 2: Approved LEC Maximum Demand (MD) Charges for 2014/15

Customer Categories	Old Maximum Demand Charge (M/kVA)	Approved Percentage Change	Approved Maximum Demand Charges (M/kVA)
Industrial HV	189.7000	12.4%	213.2433
Industrial LV	221.5700	12.4%	249.0686
Commercial HV	189.7000	12.4%	213.2433
Commercial LV	221.5700	12.4%	249.0686

The figures in Tables 1 and 2 exclude VAT.

- c) The current charges for connection, wiring testing, wiring re-testing, surveying, re-surveying, licensing for wiring, meter testing and house extension shall remain the same for the financial year 2014/15 until LEC applies for the review of the charges to the Authority for consideration and approval.

2. THE APPLICANT

Lesotho Electricity Company (Pty) Ltd (hereinafter referred to as LEC) is a Government owned company established in terms of the Lesotho Electricity Company (Proprietary) Limited (Establishment and Vesting) Act 2006, wherein the assets, liabilities, rights and obligations of Lesotho Electricity Corporation were vested in the new company, which was duly registered in terms of the applicable laws governing companies. The company was subsequently issued with a Composite Electricity Licence in terms of Section 50 of the Lesotho Electricity Authority Act 2002, as amended, to conduct transmission, distribution and supply of electricity businesses.

3. THE APPLICATION

3.1 Overview of the Application

The Authority received an application for a Tariff Review from LEC on 23 January, 2014. 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 14 February, 2014. The Company provided the required clarifications, albeit inadequate, together with additional information on 25 February, 2014.

In its Application, LEC stated that one of its licence conditions prescribes that it must submit an application to the regulator when it needs to increase tariffs. The Application outlined the proposed revenue requirement and the tariff levels for all LEC's customer categories needed to yield the revenue. The Application pointed out that the tariff increases were driven by increased bulk costs from both Electricidade de Moçambique (EDM) of Mozambique and Eskom of South Africa, and increased operating costs of the company.

The Application stated that:

- a) LEWA was continuously emphasizing compliance with Quality of Supply and Service Standards (QoSSS) and adoption of efficiency improvements by the Company;
- b) LEC was faced with new risks and challenges due to aging infrastructure, including decreased network efficiency resulting from increased failure rates, and high maintenance costs;
- c) The Company was required to submit a tariff review application estimating forecasted demand and identified resources to meet it, at least once a year¹ to the regulator;
- d) Costs that were to be recovered from the tariff are bulk purchases, operations, maintenance and other compliance related costs;
- e) In order to allocate costs transparently, the Cost Allocation Manual² was followed for the proposal under review;
- f) The costs among business units would then be separated into direct and indirect costs;
- g) For 2014/15, LEC was faced with capital investment programme for refurbishment that was estimated to cost M135.00 million;
- h) Sourcing funds for the capital investment becomes a challenge as most commercial banks have a lending period of not more than 10 years and the return on assets allowed to LEC can only allow it to take up loans if they were repaid beyond 20 years;
- i) Due to less cost reflective tariffs, lenders' interest in owning the electricity infrastructure was low and they are mainly concerned with the borrower's ability to pay;
- j) The tariff setting methodology was based on single year revenue requirement;

¹ The enabling law, LEA Act of 2002, as amended, does not make it mandatory for LEC to make annual applications for tariff increases.

² The Manual was not available when the Authority asked for a copy for information and further action.

- k) The multi-year tariff application would only be considered by LEC once the single-year process was fully established; and
- l) The revenue requirement was based on overall level of costs incurred by the Company.

The Applicant also mentioned that technological and economic changes in Lesotho are expected to challenge and transform the Lesotho Electricity Supply Industry (ESI). The changes are attributed to the following:

- a) Lack of funding for capital projects;
- b) Increasing customers base;
- c) Technological advancement;
- d) Regulatory environment;
- e) Demand Side Management (DSM)³;
- f) Government programs to electrify non-economic villages; and
- g) Growing economic growth trends.

In the light of the 40 years⁴ payback period for electrification projects in the country, LEC in 2014/15 would revert to new and diverse suppliers of capital such as sovereign fund managers and export credit agencies.

The Applicant also mentioned that the process of generation, transmission, distribution and supply of electricity has associated costs and generally, in order for the electricity supply industry to be sustainable, average tariff levels must reflect the cost of supply. In the financial year under review, LEC is compelled to consult stakeholders regarding introduction of Time of Use tariff (TOU) as a demand side management initiative.

LEC further suggested that it should be permitted to set prices that will generate enough revenue to cover maintenance and development of networks, customer service and provision of a reasonable rate of return. Tariffs that are set below the true cost of supply are described

³LEC mentioned that the programme needs to be implemented with other key stakeholders such as Government as it needs to be supported with enabling legislation, regulations and rules.

⁴During public hearings, LEC stated that it takes over 55 years to recover capital investments in electrification.

as the greatest hindrance to a viable, sustainable and growing power sector that is able to consistently meet customers demand and provide reliable supply.

3.2 The Drivers of Price Increases

The Applicant mentioned bulk purchases and operating expenditure for the Company's transmission and distribution businesses as the drivers of electricity tariffs increase. The increases were attributed to growth in demand of electricity, replacement of ageing network assets, enhanced reliability and performance standards.

3.2.1 Bulk Purchases

LEC stated that the bulk purchases prices trends were uncertain due to large scale expansion program and construction of generating plants in South Africa. Expected average ESKOM prices increase is 8.0% and natural growth of 6.0% on energy was applied. The Applicant further mentioned that EDM bulk tariff is expected to increase by 10.0%⁵ regardless of the projected exchange rate of M10.00 to \$1.00. LEC forecasted total bulk supply costs as shown in Table 3 below.

Table 3: LEC's Bulk Supply Purchases for 2014-15

Intake Point	Energy Purchases	Amount
Maseru Bulk	185,688,991.50	181,177,464.67
Clarens	89,674,940.00	60,324,903.11
Qacha'sNek	7,488,359.17	2,903,676.45
EDM	48,294,337.67	13,441,224.71
'Muela Hydro Power	505,321,462.08	63,371,226.31
Total	836,468,090.41	321,218495.26

⁵During public hearing LEC gave a figure of 12%.

3.2.2 Repair and Maintenance

LEC stated that the growth in capital expenditure results in increased costs associated with maintaining the increased asset base and a safe operating environment. The company's target was to inspect, maintain, test and repair electrical equipment to improve its reliability. In 2014/15, LEC would channel its resources towards preventive maintenance services. The revenue requirement included the critical system improvement programme which was part of the maintenance aspects of the business.

3.2.3 Staff Remuneration

LEC stated that operating expenditure was driven by growth in wages and staff numbers. It further stated its challenges as compliance with license conditions, connecting new customers and meeting load growth and a rising demand. In an attempt to address those challenges, it intended to reduce long working hours and reduce accidents; 36 positions would be filled in the 2014/15 financial year. LEC mentioned that faults crews would be formed to improve faults response time in 2014/15.

3.2.4 Return on Assets

The Application mentioned that the return on asset (ROA) figure was last revalued at M81.33 million whilst LEWA had instead allowed M12.00 million which translated into 577.7% under recovery from ROA. For 2014/15 LEC requested M79.76 million on ROA, which the Company suggested was lower than last year's request as capital works had been suspended due to cash flow problems.

3.2.5 Fuel and Fleet Management

LEC stated that fuel price trend translates into higher and unpredictable costs. LEC has forecasted M1.27 million on diesel for running Semonkong and Mants'onyane, M5.50 million for fuel of vehicles fleet and M2.00 million would be set aside for maintenance of the fleet. LEC has estimated M18.00 million to purchase 20 new vehicles and 20 new double cabs to replace old ones. It further mentioned that the M40.00 million capital repayments of proposed

vehicles was expected to earn a total interest of M10.99 million, with a monthly installment of M0.85 million for the next five years.

3.2.6 Connection Fees

LEC stated that in the last tariff review application, it had requested a suspension of the 50 metres threshold, where a customer pays a standard rate of M2, 000.00 but LEWA had not approved the request⁶. LEC pointed out that it subsidised the connection fees as the actual cost was M4, 000.00 per connection. LEC mentioned that it had forecasted 15000 new connections for 2014/15 and should all of them connect within 50 metres, LEC would have subsidised them by M30.00 million.

3.2.7 Revenue Requirement

LEC stated that for 2014/15 the total revenue required was estimated at M761.60⁷ million comprising cost of sales at M374.32 million, total operating expenses at M307.52 million and return on assets at M79.76 million. LEC requested 26.8% tariff increase for all customer categories on both energy and maximum demand charges.

4. APPLICABLE LAW

The legal mandate of the Authority to make a determination of tariff applications is derived from the LEA Act, as amended. In terms of the Act, Section 22(f) thereof, it is the function of LEWA to regulate prices charged to electricity consumers.

5. PUBLICATION OF THE APPLICATION

In terms of Section 24 (6) of the Act, the Authority is required to publish a notice in newspapers and other local media to allow electricity consumers and other interested stakeholders to comment on the reasonableness of the tariffs applied for. Accordingly, a public notice was issued on both the print and electronic media from 09 to 21 February 2014

⁶ LEC had earlier requested the Authority to approve the Connection Fee Policy which is the domain of the Government.

⁷ The LEC's revenue requirement based on its budget is M788.20 million.

for stakeholders to provide their comments. Stakeholders were given until 25 February, 2014 to submit their comments. It further requested stakeholders who had interest in making oral presentations before the LEWA Board to indicate in writing, so that appropriate arrangements could be made. At the close of that day (25 February, 2014), comments and indications to make oral presentation had been received from Lesotho Flour Mills Ltd, Forum of Electrical Practitioners Industry (FEPI), Lesotho Chamber of Commerce and Industry (LCCI), Consumer Protection Association (CPA), Nien Hsing, Transformation Resource Centre (TRC), Catholic Commission for Justice and Peace (CCJP), Maluti Mountain Brewery (MMB) and individual domestic customers.

6. PUBLIC CONSULTATION SESSION

The Authority held three public hearings on 27 February, 2014, 6 March, 2014 and 13 March, 2014 in Mokhotlong, Mphahle's Hoek and Maseru, respectively. In all the hearings, LEC made a presentation of its Application to the Board and stakeholders with the latter given the opportunity to present views and concerns, including recommendations. In response to the Application, FEPI, LCCI, CPA, Nien Hsing, TRC, CCJP, MMB and stakeholders⁸ made presentations to the Board, which requested clarifications on both LEC's application and presentation, and stakeholders' presentations.

6.1 LEC's Presentation

In its presentation, LEC stated that it was a regulated state owned entity and described its business as being characterized by the following, among others:-

- a) Competitive retail market ;
- b) Capital intensive;
- c) High fixed costs; and
- d) Use of imported capital equipment.

LEC further mentioned that the capital costs were not allowed in the tariffs and its customer base was increasing with low consuming customers. Its challenges were stated as

⁸ Participants at public hearings were afforded opportunity to organize themselves into groups and presented their views through their representatives, after LEC had made its presentation.

inadequate redundancy of the network, low returns in electrification, unavailability of long term funds, and network reinforcement and old equipment replacement requirements⁹ which were not allowed in the tariff.

LEC mentioned that the 'Muela effect of stabilising prices had started to diminish and as a result, long run marginal cost (LRMC) of electricity would be determined by ESKOM and EDM as they had become the marginal power suppliers. LEC also mentioned that ESKOM was undertaking new generation projects that resulted in tariff increase. The company required 50.0% capacity support from ESKOM and EDM.

The following reasons were stated as drivers for the requested tariff adjustment: -

- a) ESKOM and EDM tariffs' increases of 8.0% and 12.0% respectively, that translated into bulk purchases costs increase; and
- b) Increased operating costs due to increased number of customers, increased length of network and plans to improve customer service.

LEC mentioned bulk purchases costs, operating costs, depreciation and return on assets as determinants of its M762.00 million revenue requirement. The total revenue requirement comprises M374.00 million costs of sales, M308.00 million total operating expenses and M80.00 million returns on assets. The company finally requested 26.8% increase on energy charges for all customer categories and the same percentage on maximum demand charges. The proposed tariffs were as shown in the Tables 4 and 5 below.

Table 4: LEC Proposed Energy Charges for 2014/15

Customer category	Current Tariff-inclusive of Levies (M/KWh)	Proposed tariff-including of levies (M/KWh)	Cent increases	Percentage increase
Industrial HV	0.1347	0.1709	0.0362	26.8
Industrial LV	0.1491	0.1891	0.0400	26.8
Commercial HV	0.1347	0.1709	0.0362	26.8

⁹ The Authority always allows depreciation, repair and maintenance funds in tariff determination.

Commercial LV	0.1491	0.1891	0.0400	26.8
General Purpose	1.1011	1.3966	0.2955	26.8
Domestic	0.9741	1.2356	0.2615	26.8
Street Lighting	0.5532	0.7014	0.1484	26.8

Table 5: LEC Proposed Maximum Demand Charges for 2014/15

Customer category	Current Tariff-inclusive of Levies (M/kVA)	Proposed tariff-including of levies (M/kVA)	Cent increases	Percentage increase
Industrial HV	189.6973	240.6129	50.9156	26.8
Industrial LV	221.5725	281.0436	59.4711	26.8
Commercial HV	189.6973	240.6129	50.9156	26.8
Commercial LV	221.5725	281.0436	59.4711	26.8

6.2 Issues Raised by various Stakeholders

During the three public hearings that were held, stakeholders, through group discussions, raised a number of issues that needed to be addressed by the company. These include:-

- a) Increasing access to electricity might result in economies of scale, that is, unit cost for electricity was likely to remain low;
- b) Electricity prices should remain affordable as poor people, orphans, old aged, unemployed and low income earners might not afford the services;
- c) LEC's capital expansion programme should be funded by the Government as it is the only shareholder, not the customers;
- d) LEC should ensure reliability of supply as supply unreliability affects all customers negatively;
- e) LEC should explore other funding options;
- f) Availability of information on LEC's programmes is a challenge and the company needs to improve on information dissemination strategies;
- g) Lesotho as a country should be self-sufficient in electricity generation;

- h) Connection charges are expensive and this prohibits more people to be connected to the network;
- i) Energy savers are expensive and should be subsidised;
- j) LEC is a monopoly hence it does not have incentive to serve more customers;
- k) LEC should explore differential tariffs; and
- l) The company must have an asset maintenance plan.

In their presentations, large users of electricity (Maluti Mountain Brewery and Nien Nsing), Lesotho Chamber of Commerce and Industry (representative of small and medium enterprises), emphasized the need for LEC to explore efficiency gain measures before it can consider increasing tariffs. They contended that huge tariff increase would result in their unit production costs increasing and may be compelled to retrench staff/employees, adding to already high unemployment rate in the country. In a nutshell, high tariffs will weaken local industries' position against the ever increasing competition from other parts of the world. Large industries further argued that LEC's labour costs reflected a 'top heavy' structure and customers should not be made to suffer for the LEC's inefficiencies.

Representative of small and medium enterprises argued that they might struggle with 26.8% increase in electricity costs. LEC was requested to review its proposed increase so that the base for tariff increase in 2014/15 should remain reasonable.

Consumer advocate groups (Transformation Resource Centre (TRC), Consumer Protection Association (CPA) and Catholic Commission for Justice and Peace (CCJP)) presentations emphasized the need to ensure that electricity services should be affordable to the poor. They insisted that electricity provided essential services to the community and therefore it should be easily accessible. They further argued that Government should provide both consumption and connection subsidies to ensure that access to electricity is affordable.

6.3 Analysis of Public Hearings

In all three (3) public hearings that were conducted, stakeholders did not entirely oppose the proposed tariff increase. The stakeholders proposed tariffs' increases ranging from 0.0 % to 21.0%. However, more emphasis was put on quality and reliability of services. It was

observed that public consultation and participation in service delivery was helpful in making customers and other stakeholders accept reasonable tariff adjustments. As evidenced by the attendance of and participation by stakeholders groupings at the hearings, there is a growing appreciation by the public of the opportunities that public hearings provide. Stakeholders get an opportunity to interact with the service provider and are able to express their views, suggestions and recommendations regarding improved service delivery.

The Pricing and Tariffs Committee of LEWA requested LEC to clarify some issues during the public hearings.

In response to the Authority's requests for clarifications, LEC responded as follows:-

- a) **Use of Depreciation Funds:-** The company conceded that it has, in the past financial years, used depreciation funds for other purposes, contrary to the prescripts of LEWA's tariffs determination.
- b) **Rationale for Increasing Staff:-** Over the years, LEC has stated that it needs to align its increase in staff with growth in business. It has compared itself to the utilities in Swaziland, Botswana and Namibia. The company felt that a benchmark of 1 employee/400 connections was not easily attainable as it applies to utilities in developed countries.
- c) **Increasing Costs of Labour:-** The company needed to increase staff numbers in order to operate efficiently. The company will submit a Human Resource Plan to the Authority¹⁰.
- d) **Provision of Inconsistent Data:-** The company is working hard to improve its data submission to the Authority.

¹⁰The rationale for the submission of the plan was not clear as LEWA does not have the authority of approving the plan.

- e) **Separation of Assets by Financiers:-** The Company will, in the coming financial year, submit the required information so that it can earn a required return on its investment.

7. ANALYSIS

7.1 LEC's Costs and Required Revenues

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

- a) Bulk Supply Purchases;
- b) Operating Expenses;
- c) Labour Costs;
- d) Depreciation; and
- e) Return on Investment.

7.1.1 Bulk Supply Purchases

In 2013/14 financial year, LEC was allowed M285.30 million for bulk supply costs and the company has forecasted to expend M275.30 million as shown in Table 6 below.

Table 6: LEC's Actual and Forecasted Bulk Supply Costs

Intake Point	Forecasted Amount to be Paid in Maloti (M) in 2013/14	Forecasted amount to be Paid in Maloti (M) in 2014/15	Difference in Maloti (M)	Percent age increase	Average Price Increase from 2013/14 to 2014/15
Maseru Bulk Supply	112 340 229.00	181 177 464.67	68 837 235.67	61.0%	35.0%
Butha-Buthe-Clarens	49 703 228.00	60 324 903.11	10 621 675.11	21.0%	21.0%
Qacha's Nek	6 506 990.00	2 903 676.45 ¹¹	-3 603 313.55	-55.0%	-55.0%
'Muela	62 083 642.00	63 371 226.31	1 287 584.31	2.0%	2.0%
EDM	44 620 022.00	13 441 224.71 ¹²	-31 178 797.29	-70.0%	-76.0%
Total	275 254 111.00	321 218 495.25	45 964 384.25	17.0%	11.0%

¹¹LEC admitted that the value is not correct and they have not changed it.

¹² The forecasted price decreases is in contradiction to LEC's Application and presentation that the price from EDM will increase by 12%.

For 2013/14 Financial Year, LEC might over-recover¹³ by M17.50 million instead of M21.00 million projected in order to compensate the company for under-recovery in 2012/13 in bulk purchases. In line with Pass-through Principle and its Implementation Procedure, LEC is entitled to recover the outstanding M4.00 million in its tariffs during the 2014/15 financial year. However, based on the analysis of out-turn sales for 2013/14, LEC's sales are expected to increase by at least M12.00 million due to omitted sales to Lesotho Highlands Development Authority (LHDA). Thus LEC would be able to recover the M21.00 million under-recovered in 2012/13. However, the projected sales will be audited fully when complete data for 2013/14 is available.

The EDM and Qacha's Nek decreases in applicable charges were inexplicable by LEC. As observed from the table above, the average price for EDM decreases by 76.0%, as opposed to the 12.0% increase stated by LEC during the public hearings. For Qacha's Nek, the decrease is 55.0% yet the forecasted energy volumes remain the same. Even though the projected bulk purchase costs appear slightly over-estimated¹⁴ by LEC, the company should be allowed the requested costs for bulk supply purchases and should be monitored in line with the Pass-Through Principles and Implementation Procedure.

7.1.2 Operating Expenses

LEC's allowed operating expenses, excluding depreciation and labour costs, were M67.90 million in 2013/14 but LEC's actual operating expenses were M72.00 million, indicating a 6.0% increase compared to the allowed costs by the Authority. For 2014/15, LEC proposes a budget of M78.20 million for operating expenses which is 15.0% higher compared to the 2013/14 allowed revenue.

The basis on which the Authority assesses the reasonableness of these costs is annual inflation, growth in sales and increase in customer connections. According to the data provided by LEC, connections would increase by 9.0% and sales by 2.0% as

¹³For the past 10 months LEC has paid M223.10 million for bulk purchases. When the average projections are made for 12 months, LEC is likely to pay M267.70 million for bulk purchases.

¹⁴When the projected bulk costs are compared with the projected actual bulk cost for 2013/14, the increase is about 21%.

shown in Table 7 below. Based on the inflation rate of 5%¹⁵, half of the predicted growth in sales and the increased customer connections¹⁶, the operating expenses in LEC's allowed revenues would be M75.00 million, an increase of 10.5% instead of 15.0% proposed by LEC.

Table 7: Energy Sales (kWh), Connections and Revenue per kWh

Item	Actual in 2013-14	Projected in 2014-15	Increase in Percentage
Energy Sales (kWh)	720 142 134.00	738 023 770.53	2.0%
Number of Connections	153 527	167 493	9.0%
Total Revenue in Maloti (M)	584 785 568.10	761 598 090.26	30.0%
Revenue (M) Required per kWh	0.8120	1.0319	27.1%

7.1.3 LEC's Labour Costs

LEC's allowed labour costs for 2013/14 was M117.50 million, almost the same as the actual costs for the company. For the financial year 2014/15, the company proposes M134.10 million for the labour costs indicating 15.0% increase compared to the allowed labour costs in 2013/14 financial year. While the company had provided the Authority with justification for the increased staff costs (mainly due to 36 new employees to be hired), it was not based on efficiently staffed utilities as it compares itself with Botswana Power Company, Swaziland Electricity Company and Nam Power in terms of employee/customer ratios, which are far below the targeted 400¹⁷ customers per employee, as set by the Authority. For 2013/14, LEC's staff/connection was 300 and in 2014/15, it would be 305. This showed a slight improvement and the company needs to be incentivized to achieve the required target of 400 by not being allowed full recovery on the labour costs. The 15.0% increase in labour costs proposed by LEC is attributed to increases in salaries (at and above inflation rate) and staff

¹⁵This is the 2013 annual inflation in the country.

¹⁶Based on international best practices (incentive-based regulation), labour costs are allowed to increase in line with growth in business and in LEC this is shown by increase in connections and MWh sales.

¹⁷This target was approved by the Authority in 2010 after it had conducted the Benchmarking Study in order to set target for LEC regarding efficient staffing level.

numbers which are above the efficient levels recommended by the benchmarking study undertaken by the authority.

In order to maintain an efficient level of staffing at LEC, the Authority has considered increase in staff costs that is in line with inflation and customer numbers. This would mean that labour costs are allowed to increase by half the increase in customer numbers plus the rate of inflation. On this basis, labour costs in LEC's allowed revenue would be M128.20 million instead of M134.10 million proposed by LEC. This would represent an increase of 9.5% compared to the allowed labour costs in 2013/14.

7.1.4 Depreciation Charge

The allowed LEC's depreciation charge for 2013/14 was M69.80 million and this figure appears to be low compared to the actual figure of M78.60 million. For the Financial Year 2014/15, LEC proposes a depreciation charge of M85.60 million, an increase of 23.0% compared to the one allowed in 2013/14. While LEC has not provided all information, as required by Tariff Filing and Review Procedure, supporting the increased depreciation charge, the Authority allows this figure and the same would be reviewed in the next Financial Year. Since this cost is pass-through and should be used for capital maintenance. LEC is required to open a 'Depreciation Account' that should be ring-fenced and reported separately to the Authority.

7.1.5 LEC's Return on Investment

For years now the company has not been able to provide the Authority with proper asset register that clearly identifies all assets by their financiers. This makes it difficult to determine the Regulatory Asset Base (RAB) that does not include assets that are financed through grants and donations and by customers.

While it is important for the company to earn a reasonable return in order to grow its business, submission of accurate data to the Authority remains critical for its determination of a fair return for the company. However, in order to enhance the company's ability to grow its business, LEC should be allowed half of the requested

return on its investment, that is, **M39.88 million**. The allowed return would be reviewed in 2015/16, subject to LEC's compliance with providing the Authority with accurate asset register that clearly identifies the assets by their financiers. For avoidance of doubt, LEWA reserves the right to reduce the company's return on investment if the required information is not provided. This is premised on the fact that there will be no basis for setting an appropriate return if LEC funded investment data is not availed.

7.2 LEC's Adjusted Revenue Requirement

Adjustments made in 7.1 above lead to the revenue requirement shown in Table 8 below.

Table 8: LEC Revenue Requirement in 2014-15 Financial Year

Cost Items	Approved Revenue in 2013/14 (M)	Actual Revenue in 2013/14 (M)	Variance between Approved and actual Revenue in 2013/14 (M)	Projected LEC Costs for 2014/15 (M)	Adjusted Costs for 2014/15 based on the approved costs in 2013/14 (M)	Adjusted LEC Cost minus projected for 2014/15 (M)
Cost of Sales	302 395 949.00	293 662 850.00	8 733 099.00	396 843 695.00	343 743 695.00	- 53 100 000.00
Bulk Purchases	285 261 749.00	275 254 110.00	10 007 639.00	321 218 495.00	321 218 495.00	-
Repairs and maintenance	16 190 200.00	17 032 740.00	-842 540.00	21 253 200.00	21 253 200.00	-
Diesel and oil	944 000.00	1 376 000.00	-432 000.00	1 272 000.00	1 272 000.00	-
System Improvements	-	-	-	53 100 000.00		-53 100 000.00
Operating Expenditures	257 955 360.31	271 264 855.00	- 13 309 494.69	301 594 083.00	292 447 660.99	- 9 146 422.01
Labour	117 066 839.60	117 454 996.00	-388 156.40	134 072 110.00	128 188 189.36	-5 883 920.64
Depreciation	69 767 031.60	78 610 707.00	-8 843 675.40	85 621 213.00	85 621 213.00	-
Other expenses	67 900 081.11	71 977 744.00	-4 077 662.89	78 200 760.00	75 029 589.63	-3 171 170.37
LEA License	3 221 408.00	3 221 408.00	-	3 700 000.00	3 608 669.00	-91 331.00
Sub-total (Cost of sales and operating expenditures)	560 351 309.31	564 927 705.00	-4 576 395.69	698 437 778.00	636 191 355.99	-62 246 422.01
Return on Asset	12 000 000.00	33 702 589.00	-21 702 589.00	79 756 759.00	39 878 379.50	-39 878 379.50
LEC's Total Required Revenue (excl. levies)	572 351 309.31	598 630 294.00	-26 278 984.69	778 194 537.00	676 069 735.49	-102 124 801.51

Based on the figures in the Table 8 above, on average, tariffs would need to increase by 12.8%¹⁸ without levies and 12.6% inclusive of levies.

7.2.1 Tariff increase

In order to achieve the adjusted required revenue indicated in Table 8 above, the increase in tariffs would be 12.4% and the tariffs would be increased as indicated in Tables 9 and 10 below.

Table 9: Approved LEC Energy Charges for 2014/15

Customer Categories	Old Energy Charge (M/kWh)	Approved percentage change	Approved Energy Charges (M/kWh)	Adding Customer Levy @M0.030/kWh	Adding Rural Electrification Levy @M0.02/kWh large customers and @M0.035/kWh for others (M/kWh)	Final Approved Energy Charge (M/kWh)	Old Energy Charges including levies (M/kWh)	Final Tariff Percentage increase
Industrial HV	0.1347	12.4%	0.1514	0.1814	0.2014	0.2014	0.1801	11.8%
Industrial LV	0.1491	12.4%	0.1676	0.1976	0.2176	0.2176	0.1945	11.9%
Commercial HV	0.1347	12.4%	0.1514	0.1814	0.2014	0.2014	0.1801	11.8%
Commercial LV	0.1491	12.4%	0.1676	0.1976	0.2176	0.2176	0.1945	11.9%
General Purpose	1.1011	12.4%	1.2378	1.2678	1.3028	1.3028	1.1615	12.2%
Domestic	0.9741	12.4%	1.0950	1.1250	1.1600	1.1600	1.0345	12.1%
Street Lighting	0.5530	12.4%	0.6216	0.6516	0.6866	0.6866	0.6134	11.9%

Table 10: Approved LEC MD Charges for 2014/15

Customer Categories	Old Maximum Demand Charge (M/kVA)	Approved Percentage Change	Approved Maximum Demand Charges (M/kVA)
Industrial HV	189.7000	12.4%	213.2433
Industrial LV	221.5700	12.4%	249.0686
Commercial HV	189.7000	12.4%	213.2433
Commercial LV	221.5700	12.4%	249.0686

The figures in Tables 9 and 10 above exclude VAT.

The above tariffs would enable the utility to generate M676.10 million from its customers. This is shown in Table 11 below.

¹⁸ Average price increase is equal to expected total revenue divided by expected sales (M/kWh) compared to previous year's average M/kWh.

Table 11: LEC 2014/15 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 (M)
<i>Industrial HV</i>	0.1514	213.2433	204 893 747.74	423 708.79	121 377 522
<i>Industrial LV</i>	0.1676	249.0686	41 359 238.10	171 615.62	49 676 058
<i>Commercial HV</i>	0.1514	213.2433	81 833 842.22	197 335.41	54 471 514
<i>Commercial LV</i>	0.1676	249.0686	56 180 132.48	169 585.79	51 654 540
<i>General Purpose</i>	1.2378		95 026 748.00		117 619 862
<i>Domestic</i>	1.0950		254 425 701.00		278 594 512
<i>Lighting</i>	0.6216		4 304 360.99		2 675 727
Total			738 023 770.53		676 069 735

7.2.2 Other Charges

Despite LEC's contention in its 2013/14 Tariff Application to the Authority that the company was subsidising other charges such as connection fee, wiring testing, wiring re-testing, surveying, re-surveying, licensing for wiring, meter testing and house extension, the company has not requested the Authority to review these charges in this application. The LEC confirmed during the public hearings that an application for review of some of those charges would be submitted in due course during the financial year.

7.2.3 Regulatory Accounts

LEC was yet to submit to the Authority, its Cost Allocation Manual for approval and, on the basis of the approved manual and allowed revenues, prepare regulatory accounts for 2014/15. These accounts would be the basis for 2015/16 preparation and submission of regulatory information to the Authority.

7.2.4 Compliance with Regulatory Decisions and Tariff Filing and Review Procedure

Compliance and provision of accurate and reliable data to the Authority remains a challenge to LEC. Information supporting a tariff application, such as the company's budget was not approved by the Board¹⁹ as per earlier directives by the Authority in its previous Tariff Determination and approved procedures for tariff filing and review. The full regulatory compliance by LEC was critical for ensuring that the quality of service is provided to ESI customers.

7.2.5. LEC'S FINANCIAL PERFORMANCE

In order to assess the financial viability of LEC, the Authority reviewed some of the key financial performance indicators for LEC as stated below:

a. Profitability

According to the Draft Financial Statements for the year ended 31 March, 2013, LEC's gross profit was M257.90 million which represents 49.8% of the sales. This was not sufficient to cover all the operating costs of M280.00 million. This resulted in operating loss amounting to M22.60 million. Contributing factors were mainly increase in staff costs and depreciation by 9.0% and 30.0% respectively. Expenses for 2013/14 included levies which are liabilities not costs to LEC. Management accounts for the period ended 31 October, 2013 show a profit before tax of M49.35 million compared to a budget of M54.20 million for the same period. The gross profit has slightly improved to 52.7% of the sales.

¹⁹ There was no Board in place at the time when the tariff application was lodged.

b. Liquidity

The principle behind these indicators 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. Ratios used were the current and quick ratios which show the company's liquidity.

- **Current ratio (Current Assets/Current Liabilities)**

The current ratio of LEC has declined from 0.82 in 2012 to 0.55 in 2013. The current ratio as at 31 October, 2013 has improved to 0.9. This was below the recommended threshold of one (1).

- **Quick ratio (Current Assets less Inventory/Current Liabilities)**

The quick ratio has also deteriorated from 0.6 in 2012 to 0.4 in 2013 and to 0.7 as at 31 October, 2013. This implies that LEC's ability in settling its short term commitment is worse with the exclusion of the inventory.

Low liquidity ratios suggest that LEC may have a problem in settling short-term obligations.

c. Gearing Ratio

The capital gearing is a measure of the proportion of the company's capital that was debt. The LEC's gearing for 2012/13 has increased by M44.10 million compared to 2011/12. That means long – term debt was 3.5% of Equity in 2013. The management accounts for October 2013 show a gearing of 3.0%. In deciding on the level of borrowing required, one should bear in mind the impact it has on the liquidity of the company and the return on investment. In a healthy financial situation, interest cover (**Profit before interest and tax / interest costs**) is expected to be more than 3 times.

In conclusion, LEC has not performed well because all the key ratios of liquidity and profitability have declined and it therefore needs to improve its financial performance.

8. CONCLUSIONS

From its analysis of LEC's Tariff Application, the written and oral submissions from stakeholders during public consultation process, reasons, facts and evidence provided, and LEC's response to both LEWA and public comments, the Authority has found justification for M778.10 million revenue requirement inadequate. LEWA Board therefore concluded as follows:

- a. The requested 26.8% increase in energy and demand charges, requested by LEC generates M762.60 million. In order to meet its revenue requirement of M778.10 million, energy and maximum demand charges would need to increase by 29.4%;
- b. The LEC revenue requirement includes M53.10 million for system improvement costs as operating expenses to be recovered from the 2014/15 electricity tariffs. Normally these costs should be financed by LEC and then recovered through depreciation;
- c. The LEC revenue requirement, after making the adjustments, is M676.10 million and to achieve this adjusted required revenue, the average increase in tariffs would be 12.8%;
- d. The required data to justify the company's return on assets as requested was not provided. The non-provision of the data may result in a relatively low return and this might inhibit LEC's ability to grow its business;
- e. The company's operating expenses are proposed to increase by 15.0% but this is not related to inflation, increased sales and customer connections. The Authority has approved 10.5% instead of 15.0% proposed by LEC;

- f. LEC's staff costs increase of 15.0% is high and this is not related to inflation and increase in customer connections. LEC's staff/connection is currently 1:300 and this needs to improve to 1:400 as it is the target set by the Authority. The Authority has allowed an increase of 9.5%, compared to the allowed labour costs in 2013/14 and this increase translated to M128.20 million allowed staff costs for the year 2014/15;
- g. LEC's forecasted bulk supply costs of M321.00 million were considered reasonable and therefore allowed as applied for. The allowed revenue to cover the bulk costs would be monitored during the year in line with Pass-Through Procedure and its Implementation;
- h. The depreciation costs of M85.00 million have been allowed as proposed by LEC in order for LEC to be able to replace the aging assets and this should be used for capital maintenance. LEC should open a 'depreciation account' that is ring fenced and the use of the funds must be reported separately to the Authority on a quarterly basis;
- i. LEC needs to improve the quality, credibility and consistency of the data submitted to the Authority both during the year and on submission of tariff reviews applications;
- j. The allowed rate of return on assets is M39.88 million and this must be used for LEC's growth in business. During the year 2014/15, the LEC should provide the Authority with the accurate asset register that clearly identifies the assets by their financiers which would provide the basis for the review of both the 2014/15 allowed return and the future rate of return on assets;
- k. The proposed repairs and maintenance costs were considered reasonable compared to the approved costs for 2013/14 and had been allowed as proposed by the Company; and

- I. The LEC full compliance to tariff filing and review procedure for electricity and water in applying for tariffs review must be adhered to and in all future tariffs' applications. Non compliance shall render the application incomplete.

9. APPROVAL

- A. The Board therefore approved that the LEC tariffs should be increased as shown in Tables 12 and 13 below.

Table 12: Approved LEC Energy Charges for 2014/15

Customer Categories	Old Energy Charge (M/kWh)	Approved percentage change	Approved Energy Charges (M/kWh)	Adding Customer Levy @M0.030/kWh	Adding Rural Electrification Levy @M0.02/kWh large customers and @M0.035/kWh for others (M/kWh)	Final Approved Energy Charge (M/kWh)	Old Energy Charges including levies (M/kWh)	Final Tariff Percentage increase
Industrial HV	0.1347	12.4%	0.1514	0.1814	0.2014	0.2014	0.1801	11.8%
Industrial LV	0.1491	12.4%	0.1676	0.1976	0.2176	0.2176	0.1945	11.9%
Commercial HV	0.1347	12.4%	0.1514	0.1814	0.2014	0.2014	0.1801	11.8%
Commercial LV	0.1491	12.4%	0.1676	0.1976	0.2176	0.2176	0.1945	11.9%
General Purpose	1.1011	12.4%	1.2378	1.2678	1.3028	1.3028	1.1615	12.2%
Domestic	0.9741	12.4%	1.0950	1.1250	1.1600	1.1600	1.0345	12.1%
Street Lighting	0.5530	12.4%	0.6216	0.6516	0.6866	0.6866	0.6134	11.9%

Table 13: Approved LEC MD Charges for 2014/15

Customer Categories	Old Maximum Demand Charge (M/kVA)	Approved Percentage Change	Approved Maximum Demand Charges (M/kVA)
Industrial HV	189.7000	12.4%	213.2433
Industrial LV	221.5700	12.4%	249.0686
Commercial HV	189.7000	12.4%	213.2433
Commercial LV	221.5700	12.4%	249.0686

The figures in Tables 12 and 13 exclude VAT.

- B. The current charges for connection, wiring testing, wiring re-testing, surveying, re-surveying, licensing for wiring, meter testing and house extension remain the same for the financial year 2014/15 until LEC applies for the review of the charges to the Authority for consideration and approval.

10. EFFECTIVE DATE

The effective date for the approved tariff levels shall be 01 May 2014.

11. COMMUNICATION

The decision of the LEWA Board has been communicated to the applicant, LEC, by a letter dated 11 April 2014, and to the general public through press conference, press release and via print and electronic media.



CHAIRPERSON OF THE LEWA BOARD

DATE.....23 May 2014.....