ST HELENA UTILITIES REGULATORY AUTHORITY

JULY 2018

REPORT ON THE MAXIMUM CHARGES OR FEES TO BE LEVIED BY CONNECT SAINT HELENA LTD

PART 1 – OVERVIEW

1.1 UTILITY SERVICES ORDINANCE 2013

On 1st April 2013 the Utility Services Ordinance 2013 came into force. This Ordinance established the Utilities Regulatory Authority and created a legal framework to facilitate the private sector provision of licensed public utility services.

These services are —
(a) The generation, distribution and supply of electricity;

(b) The collection, storage, treatment and distribution of water; and

(c) The disposal of waste water.

1.2 UTILITIES REGULATORY AUTHORITY

The members of the Authority are the Chief Magistrate (as Chair), Mr Paul Hickling and Liz March. The Judicial Services Manager is the Secretary to the Authority, to whom any communication should be made*. The Authority, and any person acting under its authority, act entirely independently and are not subject to the direction or control of the Governor, the Executive Council, Legislative Council or any other person or authority.

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1.3 OBJECTIVE OF AUTHORITY

The objective of the Authority is to regulate the development and provision of public utility services in a manner which—

(a) Ensures that users of such services are protected from both unreasonable prices and unreasonably low levels of service;

(b) Ensures (so far as is consistent with paragraphs (d) and (e)) that the prices charged for such services do not create unreasonable hardships for households or unreasonable hindrance to commercial and economic development in St Helena;

(c) Motivates Utilities Providers to improve the quality of the services they provide;

(d) Ensures stability and predictability in the public utilities industry in the medium and long terms;

(e) Supports a progressive reduction in levels of subsidy from public funds; and

(f) has regard to such other regulatory objectives (if any) as may be prescribed.

1.4 DUTIES OF AUTHORITY

It is the duty of the Authority, having regard to its objectives, to carry out its functions and to ensure that Utilities Providers comply with—

(a) Ordinances, regulations and directives issued thereunder, regulating public utility services; and

(b) The conditions of their licence.

1.5 POWERS OF THE AUTHORITY

The Authority may, for the purpose of performing its duties, issue Directives to a Utilities Provider in connection with the provision of any public utility service; and, without prejudice to that generality, such Directives may impose requirements concerning;

(a) The quality or standard of service which the Utilities Provider must deliver to its customers;

(b) Payments of compensation (or abatement of charges) to compensate customers when the service provided does not meet the standards so set;

(c) The maximum charges or fees to be levied by a Utilities Provider for providing the public utility service;

(d) The terms and conditions on which public utility services are to be provided; and

(e) Such other matters (if any) as may be prescribed.

1.6 PENALTIES BY THE AUTHORITY

If the Authority is satisfied that a Utilities Provider has failed to comply with a Directive, or with a condition of its licence, the Authority may order the Utilities Provider to pay a penalty not exceeding the sum of £100,000.

A licence may be revoked by the Governor in Council upon recommendation of the Authority, where the Utilities Provider is in substantial and continuing breach of—

(a) Any of the provisions of the licence;

(b) Any Directives issued by the Authority; or

(c) Any other obligations under the Ordinance.

1.7 UTILITIES PROVIDER- CONNECT SAINT HELENA LTD

With effect from 1st April 2013 Connect Saint Helena Ltd ("Connect") were licenced by the Governor in Council to provide all said public utility services in St Helena. The Authority was instrumental in the drafting of such a licence.

Connect is a private limited company which is wholly owned by the St Helena Government ("SHG"). The Board of Directors consist of a non-executive Chair, two further non-executive directors and two executive directors. The executive directors are the CEO and Operations Director of Connect.

1.8 PURPOSE OF REPORT

The Authority received from Connect a request for permission to adjust the tariffs for water and electricity supplied from July 1st 2018 to 31st March 2019. The detailed proposals are as outlined in the Appendix. In order for such to be permitted, the Authority would require to issue a direction to supersede its Direction for Maximum Electricity and Water Tariffs issued in Gazette Notice No.69 of 1st October 2017.

Why is it proposed that prices increase?

Since divestment Connect have through cost savings reduced the level of subsidy from SHG and have now brought electricity tariff income broadly in line with costs. It is proposed water tariffs are targeted to increase revenue since it would be unfair for electricity consumers to apply a blanket percent increase in tariff charges since this would mean electricity consumers would be subsidizing water consumers. In terms of income the average consumer pays significantly more in electricity consumption charges than for water which means that to generate a reasonable increase in total tariff income the actual percentage increase in water tariff appears disproportionally high. However, when considered as an overall utility bill increase the vast majority of consumers will be subject to a similar increase as they would have done with a lower increase for both electricity and water but with the advantage that charges will be more aligned to costs.

The proposal was not tabled at the beginning of the financial year in order to allow sufficient analysis of data that had not been undertaken at the usual 1st April tariff review time to fully understand the impact on individual consumers, this work was concluded with the analysis showing that the proposal does not disadvantage consumers unduly with the exception of agricultural customers who since they do not consume electricity will see a 20% increase in their bills. Connect understood this reasonably well at the time of discussing the level of their subsidy with SHG and have agreed subsidy as a result. SHG now targets the agricultural proportion of the subsidy directly at that consumer group and has the ability to provide that with conditions which may, for example, require increased levels of water capture from farmers or the more efficient use of the water resource. This is SHG's decision and the principle of reducing the level of untargeted subsidy and targeting it aligns with the undertakings made by SHG in the airport MOU. Connect has therefore already provided mitigation for the consumer group known to be adversely affected by this proposal.

Although the last tariff review was delayed Connect intend restoring the review date to align with the financial year so this year they request implementing new tariffs on 1st July 2018 and then on 1st April 2019.

Since tariff and subsidy go hand in hand to balance the books the proposed tariff was the basis for the subsidy with Elected Members. Initially Connect had proposed a 40% increase in water tariffs since this would have provided inflationary consumer increase and reduced the subsidy from SHG to £595,000 however Elected Members decided a higher level of subsidy to limit the proposed increase to 20%.

The (revised) funding model agreed four years ago continues with a depreciation surplus now budgeted (the original business plan assumed SHG would continue to fund asset replacement) this has placed the business on a more viable footing and ultimately will improve the level of service reliability & predictability. SHG will continue to fund infrastructure development. Further investment in capital assets will also bring cost pressures in the form of maintenance and provision for replacement.

Connect state they recognise the financial constraints SHG are contending with, the proposal includes Connect making a £154k call on its reserves.

<u>The proposal sets the subsidy to £703,000, a reduction of £406,514 since divestment.</u>

1.9 Asset Management / Replacement

Currently most of the water infrastructure except the water treatment plants is worn out with disproportionate levels of break down repair resulting in unnecessary water being lost through bursts and leaks. Based on economic lives and depreciation the table below summarises the amounts that may be required to replace fully depreciated assets over the next five years. It should be noted that £4.9 Million of assets that Connect do not plan to replace have already been removed from the figures.

YEAR	TOTAL ESTIMATED CURRENT COST	DEPRECIATION FUND (Net movement)	SPEND TO DATE	Adjustment for Losses & Amortised Grants	ANNUAL SHORTFALL	RUNNING TOTAL
	£	£			£	
2015	9,967,123	1,437,588	175,875		(8,705,410)	(8,705,410)
2016	970,916	885,681	316,317		(401,552)	(9,106,962)
2017	-	978,633	703,669	(463,611)	(188,647)	(9,295,609)
2018	410,755	1,114,325	532,707	(443,744)	(272,880)	(9,568,489)
2019	33,815	1,114,325		(151,000)	929,510	(8,638,979)
2020	108,049	1,110,003			1,001,954	**(7,637,025)**
Total	**11,490,657**	**6,640,555**	**1,728,568**	**(1,058,355)**	**(7,637,025)**	

In line with the funding strategy agreed by ExCo, capital asset replacement is funded via the revenue account by ring-fencing the annual depreciation charges into a cumulative fund, infrastructural developmental investment will only be affordable with external or DfID funding. If all fully depreciated assets were to be replaced like for like by 2020 without upgrades an estimated £7.6 million would be required from external sources such as SHG. This will be in addition to the money that the company has to generate through annual depreciation charges funded through tariffs with the spend to date being 1.7 million.

For the utilities infrastructure to remain effective now and in the future, replacement of worn out parts of the networks need to be guaranteed and that is only possible when the company's operating budget is balanced out to at least break even each year, this year Connect are budgeting to call upon their own reserves to share burden of the increase of costs.

1.10 Infrastructure Development

Electricity, sewage and water infrastructure projects currently planned to be funded through the SHG capital program will still require those funds. There should be no further requirement for funding from the SHG Capital Program for the purpose of asset replacement once the individual assets are life expired since they will be replaced by the depreciation fund previously described.

1.11 Investment in Renewable Energy

With the factors mentioned above bearing pressure upon the finances of Connect the only way significant cost reduction can be realised is through continual investment in renewable energy. The wind turbines and solar farm together contribute a budgeted 26% of the total power generated. Dependency on generation of electricity through diesel and the consequent variability of international oil prices continue to weigh heavily on the cost and, therefore, the predictability of the cost of electricity production. To realise a tangible cost reduction further investment in renewable energy and power storage assets continue to be needed. At the present time the tender process for the procurement of renewable energy through a power purchase agreement has identified a preferred bidder and contractual negotiations are underway. Once a Power Purchase Agreement has been signed St Helena will see the expansion of wind and solar farms funded by a third party with Connect making monthly payments upon the receipt of electricity generated. The price of this electricity purchased is below the cost of the diesel fuel that would be required to generate the electricity and so Connect expect to see cost savings. These savings will be budgeted in the next financial year once there is a contractual programme agreed.

1.12 Active Sewage Treatment

Connect report that work has commenced in improving the sewerage networks in Jamestown, Half Tree Hollow and Rupert's Valley. Full development permission has been obtained for the Rupert's sewage treatment plant but, at the moment, no funding is available to purchase and install it. Outline development permission was granted for a combined Jamestown and Half Tree Hollow system but, again, there is no funding available through the capital programme to progress the outline permission to a more detailed scheme required to apply for full development permission. While the cost of planned sewage treatment plants will be funded by SHG's developmental capital funding programme, the costs of its running and maintenance will be borne by the business and Connect are aware that this will result in cost pressures. Connect state that this has to be provided for by being gradually built into the tariffs. The outline development permission application detailed three scenarios with budget tariff costs ranging from £34 per quarter to £100 per quarter with Connect Proposing the lowest tariff cost as their preferred option. Currently domestic customers pay £15.00 per quarter and Connect strongly assert that the lowest operating cost option that satisfies the environmental standards is the right solution for the island since the other options will be unaffordable. The full effects of the new environmental legislation have still to be assessed as there is clearly the potential for further costs should further higher discharge standards or planning be required. Whichever option is chosen there will be cost increases and, currently, sewage runs at a deficit.

1.13 Recurrent Expenditure Budget 2108-2019

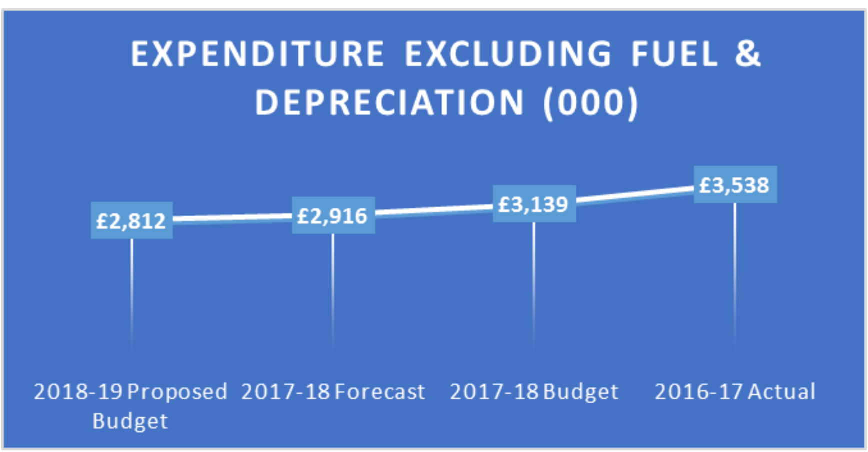
As Connect is required to deliver a balanced budget, Connect state that an elaborate exercise was undertaken to evaluate in detail the budgetary requirements of each cost centre to come up with the draft 2018/2019 budget prepared with the following assumptions:-

8% growth in electricity consumption
10% growth in water consumption
4% general inflation
8.3% fuel inflation
Replacement of capital assets funded from the revenue account through depreciation charges

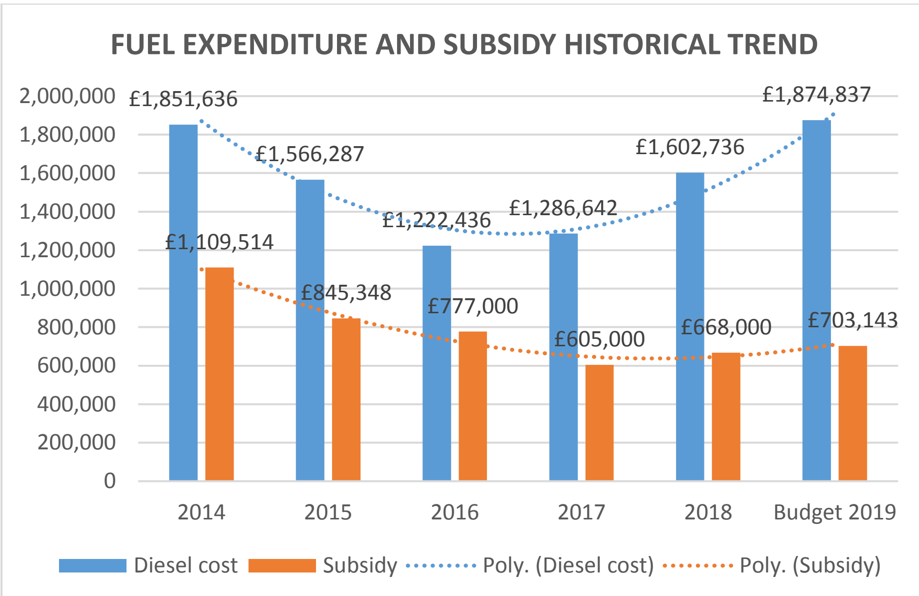
1.14 Operating Expenditure Budget 2018/19

	Proposed Budget	FY 2018 Budget	FY 2018 Actual
Administrative costs	412,797	317,321	384,617
Employee costs	1,210,688	1,451,744	1,307,549
Premises costs	233,332	290,774	224,694
Fuel	1,874,837	1,382,343	1,609,264
Maintenance/Running Costs	824,471	948,452	866,163
Depreciation	1,149,636	952,283	1,114,325
Contracts	130,560	130,796	124,637
Expenditure	**5,836,321**	**5,473,713**	**5,631,249**

The draft budget has a reduction in controllable expenditure which is offset by inflation, increased fuel costs and increased depreciation charges due to the extensive capital that is being invested in the business. Administrative costs increase due to £30K being budgeted for consultancy and a doubtful debt provision of £70k. Budgeted expenditure represents a 3.2% increase on last year's actual. Excluding fuel and depreciation the downward trend on costs continues as shown in the graph below.



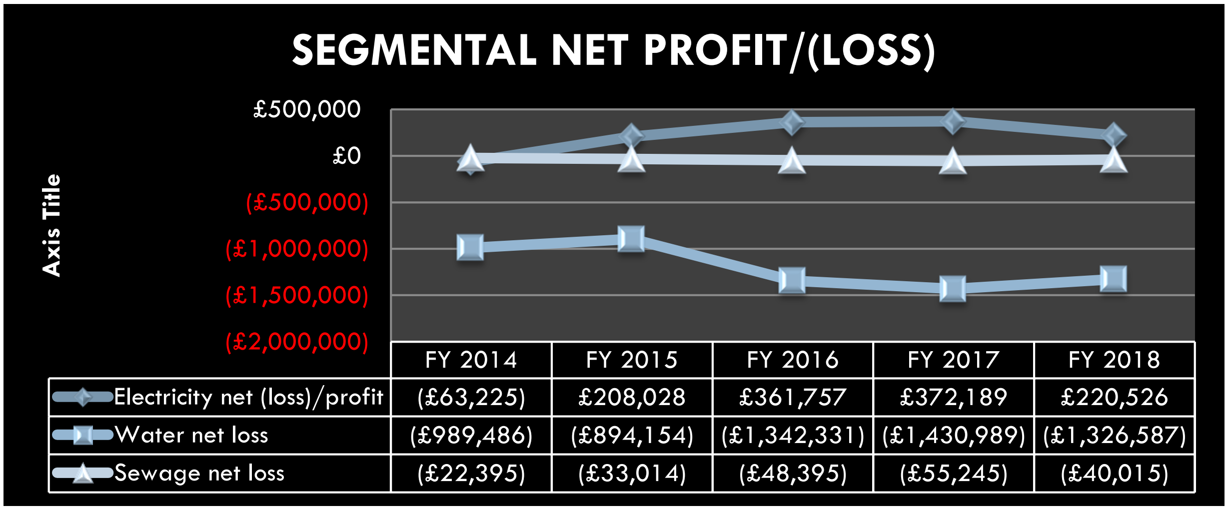
Diesel is a major cost to the business and a significant driver towards renewable energy. The following graph shows how the progress Connect have made in keeping subsidy down despite the significant increase in fuel costs.



To break even the company needs income equal to the £5,836,321 expenditure budget summarised in the above table. At current tariff the company's tariff and service income for the year 2018-2019 is estimated at £4,982,153 resulting in a shortfall or deficit of £828,167 that will have to be partly funded by tariff increase, subsidy and a call on Connect's reserves.

1.15 Segmental cost recovery

While Connect have managed to recover total costs in electricity by having the higher end users effectively subsidising lower end users so that total costs are recovered plus a small margin, Connect state that they are very far away from achieving such results with water. The following graph shows the net profit or loss trend for water, sewage and electricity since the company started operating. The graph demonstrates that electricity profitability peaked during the financial years 2016 and 2017 during which international oil prices and, therefore, diesel were at their lowest and that profitability slows down in 2018 as fuel prices have increased.



	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Electricity net (loss)/profit	(£63,225)	£208,028	£361,757	£372,189	£220,526
Water net loss	(£989,486)	(£894,154)	(£1,342,331)	(£1,430,989)	(£1,326,587)
Sewage net loss	(£22,395)	(£33,014)	(£48,395)	(£55,245)	(£40,015)

Water is still a long way from full cost recovery and Connect state that it calls for bold decisions on tariff review. With a cubic metre of water costing around £7.20 the £1.89 average tariff per cubic metre is only recovering 29% of the cost.

Sewage service is also not yet fully recovering costs. This is a situation that will be more pronounced when the planned sewage facilities are constructed and their depreciation and maintenance charges add on to the cost base.

The above recurrent budget and the deficit together with the aforesaid factors are the compelling forces considered by Connect in developing proposals for the next tariff review. While the draft budget for the next financial year has been compiled with what Connect describe as, 'guarded austerity to ensure cost effective service delivery', Connect state that they cannot escape from turning to tariff review as a failure to increase the tariffs will have a devastating impact on the community on service delivery and threaten the efficiency gains attained since divestment by the government.

PART 2 – MAXIMUM CHARGES AND FEES

2.1 INCREASES

The majority of tariff income comes from electricity, electricity tariffs now align to costs and for that reason no electricity tariff increase is being proposed. Sewage revenue accounts for 1.5% of tariff income and water 10.5%. While their respective costs account for 2.2% in relation to sewage and 31.1% in relation to water. The intention of Connect is to create an average overall 2% increase on the consumer's overall utility bill with the increase being on water and sewage.

2.2 Sewage

The proposal is to increase charges by 20%. For domestic consumers this equates to an average increase of 23p per week.

2.3 Water

The proposal is to increase charges by 20%. This will bring the water cost to tariff ratio to 32% up from the current 29%. For the vast majority of consumers the effect will be an overall 2% increase on their normal bills.
15 cubic metres per quarter is recognised as the quantity of water required for basic needs for an average household. At this rate of consumption the weekly increase will be 27p for usage and 13p for the standing charge.

The principle behind the rise steep rise in water costs are that it is unfair for electricity consumers to be penalised with increase in tariff charges when the cost of providing electricity does not justify such a change. This would mean electricity consumers would be subsidising water consumers. In terms of income the average consumer pays significantly more in electricity

2.4 Electricity

The proposal is to maintain the current tariffs as they are now fully covering the costs. Future annual reviews will be subject to costs variability and with further investment in renewable energy future tariff reductions might be possible. In the situation where the cost of diesel increases and electricity moves back into loss making Connect will apply to the URA for tariff adjustment to prevent the loss.

2.5 Other Services

It is proposed that all the other optional services like connections and septic tank emptying be increased by 4%

This proposal is budgeted to raise an additional £82K in tariff revenue.

SHG still provide a substantial subsidy to Connect to mitigate against the need for increased tariffs to meet recurring and development costs. The Authority is advised that such are generally content with the proposed tariffs and the subsidy that SHG will as a consequence require to provide.

The present funding model provides for depreciation, as opposed to the original Connect Business Plan which proceeded on the assumption that SHG would continue to fund asset replacement. SHG will however continue to fund infrastructure development.

2.6 SHG SUBSIDY

The key justification for tariff increases is the fact that currently the tariffs are lower than the full costs of providing utility services resulting in a deficit that is partly funded by SHG in the form of subsidy.

The SHG budgeted subsidy will be increased by around £35,000 from £668,000 to £703,000. This continuing subsidy allows the proposed tariffs to remain considerably lower than would be required to meet the actual costs of producing both electricity and water services. Were Connect to operate without any subsidy it would require a 21% increase on all products (water, electricity etc.)

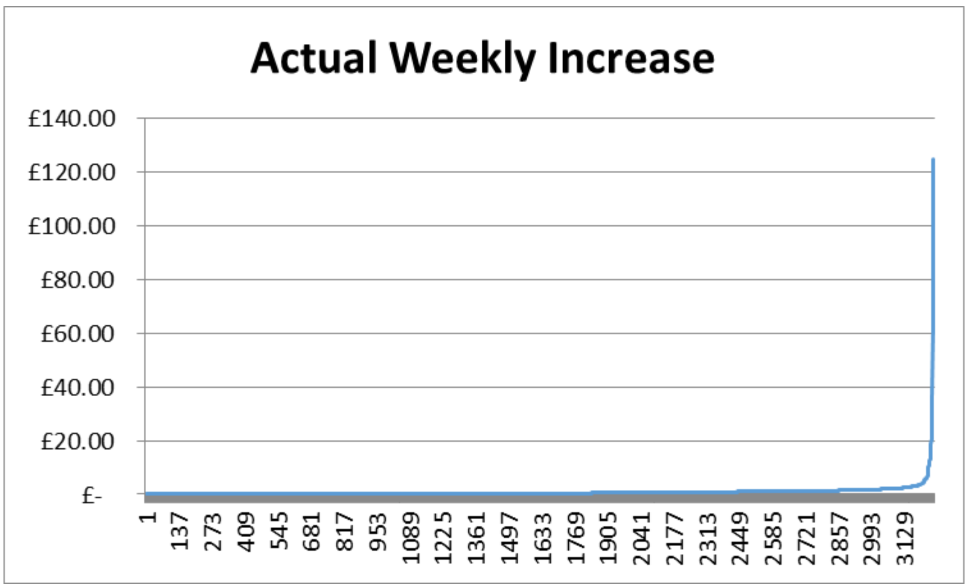
Financial Year	Total Subsidies
2013/14	£1,109,514
2014/15	£ 845,348
2015/16	£ 777,000
2016/17	£605,000
2017/18	£668,000
2018/19 Proposed	£703,000

As provided for in said Utilities Services Ordinance, Connect's Business Plan and the Airport MOU, the SHG subsidy is required to reduce annually. The necessary costs of improvements and maintenance of systems and the need to reduce subsidy will, inevitably, exert pressure on tariffs for the foreseeable future.

2.7 SOCIO-ECONOMIC IMPACT

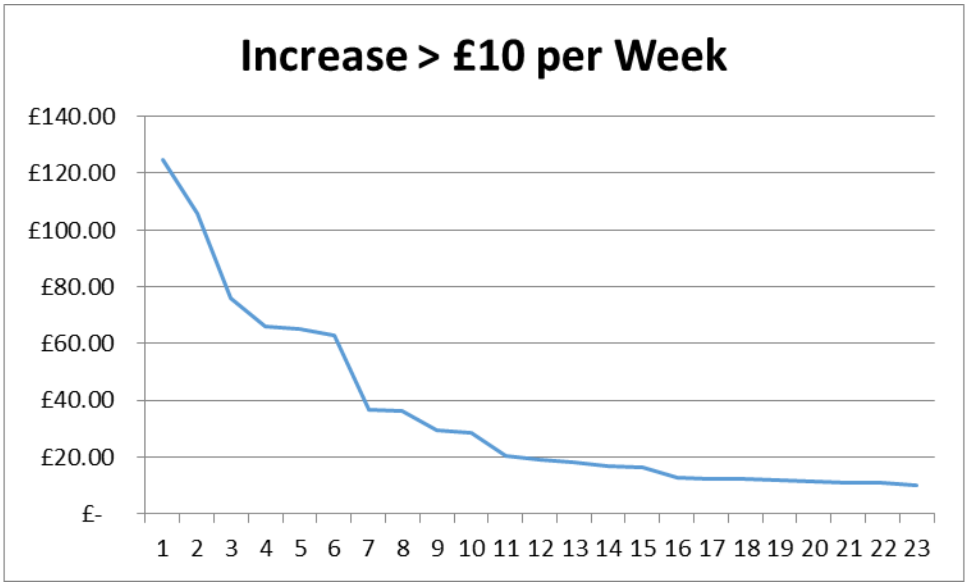
An inflationary increase is quite simple to assess changes to individual customer's bills. Since this proposed rise targets the water tariffs Connect considered it important to model the effects on individual consumers, Connect state that collation of consumption data last year proved very time consuming and since there has been no material change the same consumption data was used for this analysis. The model demonstrates that there are winners and losers, winners being high electricity consumers and losers being agricultural customers. For the vast majority of consumers the increase is 50% inflationary. Standing charge increase amounts to 13p per week for domestic and agricultural consumers and 40p for commercial customers.

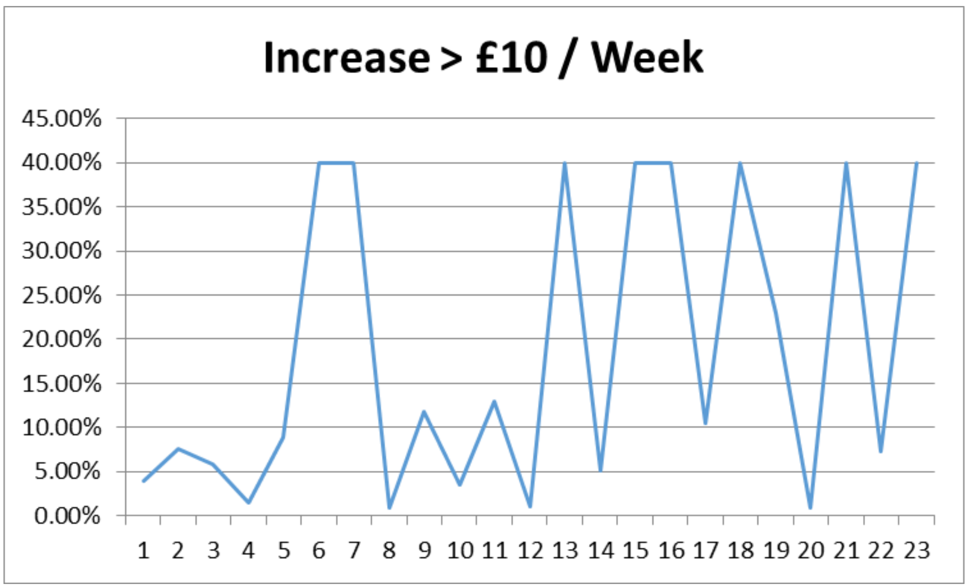
The graph below shows that 3,250 customers sorted in the size of their price increase, to the left of the graph these consumers receive the lowest increases and to the right the greatest increases.



The graph shows that the larger consumption increases are concentrated on a few consumers with the majority of consumers not adversely affected by the restructured tariff.

There are 23 consumers who will see an increase of greater than £10.00 per week. The graph shows the weekly increase and also the percentage increase for the same customers.

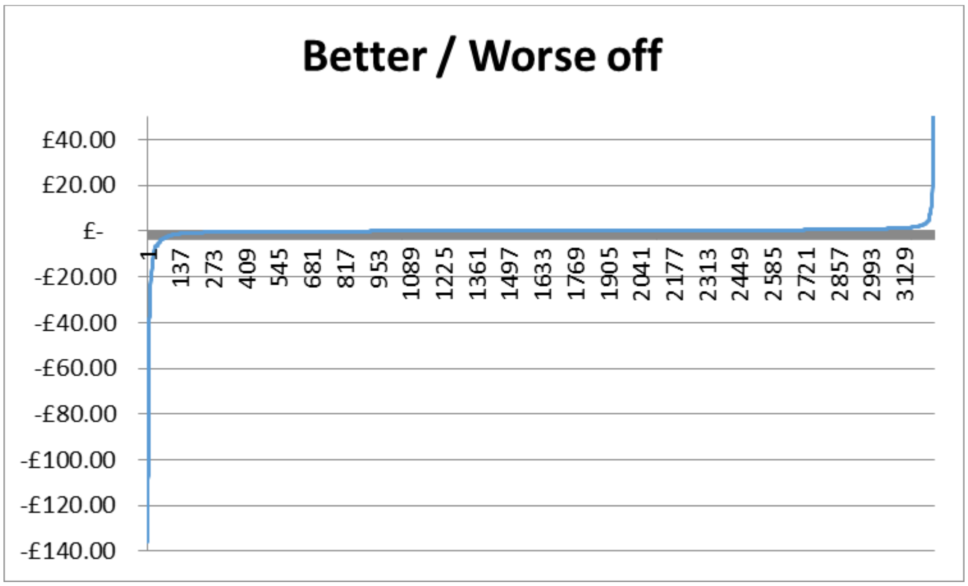




20% increases are for agricultural consumers where Connect has left subsidy with SHG to pay directly to this consumer group. The remainder of these customers whilst having large bills are not seeing excessive percentage increases in their bills. Connect considers that they have fully mitigated any hardship created by taking a reduced subsidy to allow the agricultural customers to be compensated directly.

Turning to agricultural customers the top 6 consumers will theoretically see an increase of between £33.17 and £7.98 per week. These are the larger scale agricultural consumers with the weekly increases for the remainder of agricultural customers being much less. Assuming usage patterns remain the combined total annual increase for these consumers will be £4,547, when Connect negotiated their operating subsidy with SHG they previously identified a total impact on agriculture totaling £7,551 which leaves SHG with £3,000 to direct to the other agricultural customers. Last financial year Connects agricultural tariff income declined from £22,996 to £21,035 despite the 20% increase in tariff suggesting that the increased tariffs encouraged more careful use of water with the farmers being better off since they received this new subsidy directly from SHG despite no increased costs.

Whilst the analysis so far has looked at the absolute effect on consumers it has not considered who benefits from the revised tariff structure and who are made worse off compared to a 2% across the board increase. The graph below shows that for the vast majority of customers there is no significant effect either positive or negative when comparing the proposed new tariff compared to what they would have paid if a straight 2% increase had been applied.



Concentrating on the customers who will be disadvantaged by more than £10 per week there are 3 industrial customers and 5 government customers. The remainder is the agricultural customer group of which it is already established will receive additional subsidy directly from SHG.

The customers who benefit are those who consume larger than average quantities of electricity or less than average quantities of water. Concentrating on customers who will benefit by more than £10 per week we have 12 industrial customers, 9 shops and 4 government customers. The government losses and gains cancel each other out so SHG will not benefit or be worse off by this proposal although budgets may need to be adjusted across directorates. It is good news for industry which includes fishing, baking, communications and butchery since the utility cost of their products will increase at below inflationary rates. There are 9 shops which will also see stabilisation of their utility bills so combined with lower cost of some locally sourced products there is the potential for shoppers to benefit if retailers decide to pass on the savings.

Those receiving income related benefits have protection through the Minimum Income Standard that is adjusted to take into account increases in utility bills.

Connect are content that they have undertaken sufficient analysis of the impacts at an individual consumer level and that suitable mitigation measures are in place to deal with the most vulnerable in society and agricultural customers who would have been disproportionately affected by the proposed tariff increase.

2.8 Benchmarking

The Authority was provided with an independently commissioned 'Socio-Economic Impact of Connect Tariff Charges 2018' which has been considered by the Authority.

It is worth looking at other islands to establish how Saint Helena compares in terms of cost. Electricity prices in Saint Helena are often said to be very high but in reality they are favorable compared to other islands which share similar constraints. Clearly island costs will exceed places where fossil fuel generation efficiency is better but of course nuclear or combined cycle gas turbines are not viable for remote locations. Water is also favorably priced. Aruba benefits from high levels of renewable energy. Ascension Island water is desalinated and demonstrates why the technology is inappropriate for St Helena due to the excessive costs.

Electricity

	Population	Unit	Standing	500kWh Bill	Comparison to St Helena	
St Helena	4,000	£0.30	£0.00	£150.00		
Montserrat	5,000	£0.32	£0.00	£160.00	£10.00	More
Ascension Island	900	£0.47	£0.00	£236.05	£86.05	More
Alderney Island	1,903	£0.38	£9.45	£198.60	£48.60	More
Sark Island	500	£0.66	£0.00	£330.00	£180.00	More
Aruba	105,000	£0.14	£4.94	£74.94	-£75.06	Less

Water

In terms of water supply costs per cubic meter the following charges apply for a domestic consumer using 22 cubic meters per quarter: -

	Population	Unit	Standing	22 Cubic Meter Bill	Comparison to St Helena	
St Helena	4,000	£1.39	£10.33	£40.91		
Montserrat	5,000	£5.69	£0.00	£125.18	£77.49	More

Ascension Island	900	£23.50	£0.00	£517.00	£469.31	More
Alderney Island	1,903	£0.43	£0.00	£67.00	£19.31	More
Sark Island	500	N/A	N/A	N/A	N/A	N/A
Aruba	105,000	£3.13	£0.00	£68.86	£21.17	More

Alderney has the minimum charge of £67 applied

2.9 Business Performance

The Authority note the statement made by Connect in relation to their business performance:-

The Connect Board of Directors is content with the company's overall performance to date. The majority of the Public Utilities Development Plan targets were met at the time of the last review and year to date we are performing well against tighter targets.

The original Business Plan approved by ExCo was on the basis of considerably greater levels of tariff increase than those implemented last year and currently being proposed. Against this backdrop Connect is honouring their commitment to reduce the subsidy whilst improving service standards. Had additional liability in regard to the replacement of depreciated assets not been transferred then Connect would be operating without subsidy well in advance of the agreed timeframe.

A back to back audit of the first two financial years was completed with a single qualification relating to the value of assets transferred from SHG at the time of divestment. On subsequent audits this qualification has been removed with our auditor's content with the presentation of our Financial Statements. Connect appointed an internal auditor who is working to provide assurance to the Board in a number of priority areas with two audits now complete without any significant issues being identified.

The original business plan had a high reliance on SHG to fund asset replacement which is contrary to the requirements of a viable business. In December 2014 Connect presented a tariff / subsidy proposal to Executive Council which enables reserves to be built to fund asset replacement. This revised strategy progressively moves Connect away from the annual capital prioritisation process where there is no guarantee of securing funds. The budgeted depreciation roughly equates to the subsidy so had the asset replacement strategy not been altered Connect would be operating without subsidy. This funding arrangement has continued and is reflected in Connects 2020 Business Plan.

Connect is now in a far better position to provide predictability and reliability in service provision than what was originally envisaged in the initial business plan.

2.10 PUBLIC OBJECTIONS TO TARIFF INCREASE

The Authority has received direct complaints from the public by way of response to consultation in relation to the current proposed tariff changes.

Concern was raised by a business in the accommodation trade that a 20% rise in water rates would have the effect of forcing a rise in price of rooms that could be let. The Authority raised this concern with Connect that it has been envisaged that such a rise would have a negative effect on business and force price rises.

Connect responded by stating that the fear of significant bill increases based on the complaint was that the rise for this business based on their current consumption would equate to £52.88 per annum. Which, when broken down further, is £1.02 a week or 14.5pence per day.

The Authority was extremely grateful for the petition that was raised both on St Helena and overseas. The petition raised a number of questions as follows:-

1. **A motion requesting an assessment of Connect St Helena's operations was unanimously accepted by Legislative Council in March this year, but to date there has been no substantial action taken as far as the public is aware.**

   The Authority has raised this question with both Connect and SHG. The Authority can confirm that there is to be a full independent review conducted of Connect which will include consideration of the business model as a whole. The terms of reference for this review are currently being drafted and it is anticipated that a report will be completed during this financial year.
2. **These proposed increases create a holistic issue. We are in effect, affecting every individual, household and business, as these increased tariffs will filter. Firstly to the consumer by way of the standing charge, then by the number of units of water used within the household for basic needs, and finally, by the increased costs passed on by businesses to ensure that their operations remain cost effective.**

   The Authority raised this issue with Connect who responded as follows:-

   The proposed tariff will increase the total utility bill of an average (20m3 per quarter consumer) by 51p per week. A consumer of 15m3 which is generally accepted as the minimum usage based on WHO(World Health Organization) guidelines will pay an additional 40p.

   There will be increased charges to businesses which will ultimately be passed on to the consumer but for the majority of businesses their consumption is predominantly electricity so when compared to an inflationary increase across the board the increase to shops etc. will be more favorable with the proposed increase. We are not permitted to publish individual consumer data but the Longwood Supermarket has kindly permitted us to use them as an example. Based on the previous year's consumption Longwood Supermarket will have a weekly increase of £1.47 which we consider will have minimal impact when spread across their customer base.

To quantify the effect on construction we have with the permission of a developer who manufactures blocks on site monitored the water consumption to the site. The development is representative of a normal family home with construction currently up to the eaves. This construction site has consumed £10 of water so the proposed increase will add £2 to that cost. Once the house is complete we will have accurate data on exactly how much water goes into the construction of the complete project but with the slab and walls complete we estimate that there will be little additional water required to complete the project.

Farmers should see no additional overall increase since targeted subsidy paid directly from SHG should counter any water cost increases. Likewise the Minimum Income Standard will be increased to counter utility increases.

Sewage customers will pay an additional 23p per week if the proposed charges are approved.

3. **The time for the so called consultation period is inadequate; (a) closure of submissions concerning the review was to end on noon 28th June 2018, which is two and a half days before the advertised implementation date, (b) with the Chair of the Regulatory Authority off-island, how was it possible for the submissions to be reviewed before the 1st July 2018?**

The Authority raised this issue with Connect who responded as follows:-

The original subsidy submission was made to SHG on 3rd April which needed approval prior to advertising the proposed rates. It took some time before the level of subsidy was agreed in principle and the two week notice period of the proposed tariffs was given. Ideally the advertising should have been a week or so earlier and it was unfortunate that the URA Chair returned from overseas leave on the 30th June. However we believe that two weeks consultation is ample time for consumers to consider the impacts of the proposed charges and make representation to the URA if they chose to do so.

The Authority are of the view that it would have been preferable for Connect to have given more notice of the proposed changes. However, Connect have complied with their obligations as defined within their licence to provide at least 14 days' notice of any intention to introduce new prices. In any event, these proposed price increases remain subject to the scrutiny of the Authority, full consideration of submissions has taken place.

4. **Why is *it* necessary to outsource contracts such as meter reading and call outs for a company with a management/technical structure the size of Connect St Helena ltd? A call down service from part time/casual employment surely would be cheaper?**

The Authority raised this question with Connect who responded as follows:-

The way forward with the reading of electricity meters is through a system of smart metering which we are currently investigating. Other contracts as they become up for renewal are compared to the cost to provide the service in-house. We have created a projects construction team who have been busy replacing water mains in HTH in preference to contracting out, justified on cost and likewise we now have a dedicated tree clearance team that prepares areas for the lines teams as well as keeping branches clear of electricity lines again justified on cost savings. The tree clearance team has made significant progress making a positive contribution to the favorable electricity outage KPI.

5. **A previous report from the Authority highlighted that staff costs amounted to £1,261,520 for the year. If we have understood the media correctly the staff costs of £1,261,520 divided by 70 staff gives an average income of £17,000+ per annum per staff member. This is potentially double that of the average wage of half of the island's workforce who receives an average of £8,230 per annum. Connect St Helena ltd is a local company that provides local services and whilst we would all like to reward staff for their work efforts, it is not unreasonable to expect staff costs to be comparative to local conditions, which at this time is bleak.**

The Authority raised this question with Connect who responded as follows:-

The Statistics Office published the average income for 2016/17 as £8,230. In comparison Connect's average was £9,062 but this included exceptional overtime worked during the severe water shortage. Excluding overtime the figure is slightly below the Island's average at £7,574. The figure includes all employees including former TC officers who transferred to local Connect contracts as well as a Chartered Accountant and Chartered Civil Engineer recruited from overseas since we were unsuccessful in recruiting locally. The quoted figures are Median and the bulletin explains that "….the Median is a common measure when estimating average incomes, since the usual alternative – the Mean- is too sensitive to small numbers of large incomes"…. The comparison being drawn is Connect's Mean to the Island's Median (excluding the highest earners) which is not a meaningful comparison.

6. **There is a disproportionate number of executive directors on the Board**

The Authority raised this question with Connect who responded as follows:-

Our Articles of Incorporation state: "At any one time, the company shall have not less than 4 and not more than 7 directors of which at least 2 shall be executive directors and the remainder may be non-executive directors." We have operated with the minimum number of Executive Directors since the company was formed.

7. **We understand that some performance based incentives have been paid. Performance related incentives are usually related to profits. We do not see the justification for payment of performance bonuses if Connect St Helena is receiving Government subsidy (which is essentially public funds) and cannot be confused with profit.**

   The Authority raised this question with Connect who responded as follows:-

   Connect operates a performance based remuneration scheme. These schemes are not generally used in the Public Sector but are used more frequently in the Private Sector to give staff more incentive to work harder. Under a performance related pay scheme employees are set targets against which they are assessed. The base pay award is benchmarked against what we can establish the local market are offering with high performers receiving awards above the base and lower performing staff receiving awards of below the base.

8. **It has been emphasized via the recent press conference that the proposed increases are negligible, but these figure are based on basic amounts which are not comparable with realist standards. The low consumption allowance is a double-edged sword, because low water usage will yield lower revenue receipts and with the extortionate overheads will demand further tariff increases.**

   The Authority raised this question with Connect who responded as follows:-

Below is an extract from the social assessment conducted which concludes that the standards are in fact realistic:

"To assess the banding, this report assumes the average household is 2.5 people (from the 2016 census). It also makes an assumption on what level of water usage is required and this is based on internationally accepted work. The table below outlines the World Health Organisation usage chart for water (per person per day).

Hierarchy of water requirements (inspired by Abraham Maslow's (1908-1970) hierarchy of needs) – Accepted by the UN and World Health Organisation

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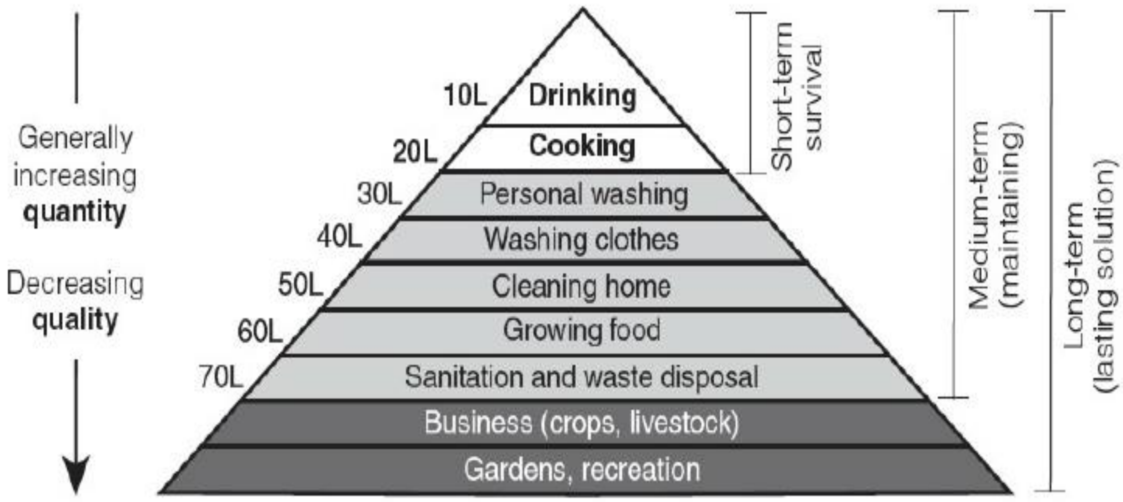

Therefore, if taking a need of 70litres per person, per day, the average household would consume 15.75 cubic meters per quarter. This would suggest that the band level is currently correct (or quite close) and that households that are using more than the current 15 cubic meters per quarter would generally be using more than normal household needs and as such it is justifiable that they can be asked to pay a higher amount over and above through a higher tariff level."

9. **Where does the quoted loss of £5.31 occur? Across the entire system, collection, treatment or distribution phases?**

   The Authority raised this question with Connect who responded as follows:-

   Water expense is grossly below income with losses being across the entire system.

10. **It is understood that Connect St Helena ltd put in a bid for funding to replace their ageing vehicle fleet because of the high maintenance cost attached to their old fleet. However, from observation most of the old vehicles are still in use, thus increasing fleet numbers and expenses. Why is this allowed?**

The Authority raised this question with Connect who responded as follows:-

There was no bid for funding, vehicles have been purchased from internally generated revenues. The fleet inherited from SHG was largely depreciated with some vehicles nearing 30 years old. Some replaced vehicles have been sold, others retained. The increased size of vehicle feet supports greater efficiency with a larger number of smaller work teams. New vehicles are fully equipped work stations containing tools and materials which has significantly improved the operational effectiveness of the operations teams.

The Authority noted a similar question was raised concerning the fleet of vehicles during consideration of the last tariff increase. For the purposes of clarity the authority repeat the response of Connect in response in September 2017.

'Connects assets are distributed across the whole island and having reliable vehicles to transport staff to maintain these assets is essential. When Connect was divested from Government the vehicle fleet was old and unreliable with some vehicles almost 30 years old with almost all fully depreciated which in simple terms means that they have exceeded their expected useful life.

It is therefore not surprising that vehicles regularly failed which created operational and customer service issues. Connect has a depreciation fund where funds are put aside to replace fully depreciated assets and the decision was taken by the Connect Board early on to deal with the aging fleet which would then improve the efficiency of operations both in terms of reducing the failure rate of vehicles but also by providing purpose built vehicles.

Our old vehicles were standard land rovers with racks to carry ladders but with no further adaptions which made carrying of fittings, pipes, cable etc. difficult and as a result there was serious inefficiency because teams showed up unprepared to network failures and then needed tools or parts to be delivered to them or for the team to return to base to collect the parts they needed. The new vehicles have been purpose designed with integral racks so that tools and materials can be carried so that for many of the breakdowns there is everything required to deal with the issue there and then. The new land rovers have made a massive difference to the work rate and we now have teams of two in dedicated vehicles compared to the pre-divestment situation where we had fewer but larger work teams which were far less efficient.

Not all of the vehicles we purchase are new. Land rovers are the real workhorses which are expected to deal with rough terrain but for our surveyors and project managers we took the decision to import quality second hand vehicles from Japan. The purchase cost for vehicles imported from Japan is very cheap and we therefore pay far less duty. Today we could sell these vehicles for what we paid for them and they have performed exactly as expected. The quality of these vehicles is so good that to the public they appear new but are actually not.

We consider a reliable vehicle fleet is not extravagant but is an essential requirement for our business and in our fleet upgrade have maximised the efficiency of manpower. Arguably having a rolling program of replacement would be more normal but when we divested the fleet was so old and decrepit that had we not dealt with in the way we did then we would still be facing the unreliability and inefficiencies.'

The concluding paragraph of the petition to the authority stated as follows:-

We appeal to the authority to carefully consider Connect St Helena's proposal in alignment with the submissions you have now received and that you may discharge your responsibility in accordance with Section 4 of the Utilities Service Ordinance. "It is a duty of the Authority to ensure that the 'prices charged' does not cause hardship"

The Authority has turned to the financial statistics that reflect the cost of living in St Helena. The Authority has used the most recent figures available and had double checked them with the government's statistics office to test their voracity.

The proposed tariff increase will cause hardship?

<u>The proposed increase to overall tariff represents a rise of 2% on the average consumer's utility bill.</u>

The inflation rate (Retail Price Index) for St Helena from the first quarter of 2017 to the first quarter of 2018 was 2.8%.

The average wage has risen from £7,640 in 2015/16 to £8,230 in 2016/17. This represents an increase of 7.7% which reduces, after price rises, to a real increase of 3.4%.

The minimum wage for an adult has risen from £2.95 to £3.05. This represents an increase of 3.4%.

	Bottom 20%	Q2	Q3	Q4	Top 20%	All households
Average weekly expenditure £	101.97	182.75	229.08	230.73	536.97	254.21
Expenditure on water and sewerage £	2.66	2.58	3.75	2.35	3.48	2.96
Water/sewerage expense as % total	2.6%	1.4%	1.6%	1.0%	0.6%	1.2%
Cost of 20% increase on water/sewerage £	0.53	0.52	0.75	0.47	0.7	0.59
Adding 74p per household across quintiles	0.73%	0.40%	0.32%	0.32%	0.14%	0.29%
Increase in water/sewerage as % of total	0.52%	0.28%	0.33%	0.20%	0.13%	0.23%

The increase to the average household weekly utility bill including electricity caused by the rise in tariff will amount to 74 pence.

The average household using 20 cubic metres of water and sewage currently pays £2.96 weekly which is 1.2% of average household total expenditure. The increase in average household expenditure caused by the tariff rise will amount to 0.29%.

The Minimum Income Standard is recommended to rise on 1st August 2018 to account for the tariff increase by 80 pence. This is subject to SCDC and EXCO approval.

High end consumers which are presented by the farming community will continue to receive targeted subsidy through SHG to account for their rise in costs.

The Authority have further considered the perceived risk that has been raised both by petition and also on behalf of business owners that the tariff rises would lead to serious negative impacts. There is concern that an increase in prices will inevitably cascade onto the consumer when businesses adjust their costs accordingly.

The Authority notes the likely increase of the utility bill for the Rose & Crown Supermarket in Longwood will be £1.47 per week.

The Authority have communicated with Solomon & Company (St Helena) Plc. Solomon's have confirmed that St Helena is currently in a challenging economic environment and that increased tariff charges will have to be passed onto their customers. Solomon's represent significant business interests on St Helena. They have a Mercantile operation, a Production division and numerous other services.

However, their own estimated increase in costs, as a result of the tariff increase, over their whole operation amounts to around £2,257.00 for the year. This figure breaks down to an increase of £188.08 per month or £43.40 per week or £6.18 per day (however it should be noted that Solomon's also utilise untreated water resources for their piggery operation which consumes considerable quantities of water and this consumption is not included in the above costs).

With these figures, the Authority cannot conclude that the tariff increase is likely to cause hardship by an increase in costs to the consumer.

2.7 CONCLUSION

Utility tariff increases are naturally unpopular, the Authority is fully aware of the concern that has been raised in relation to the proposed tariff increases. The Authority is very grateful to all those who have chosen to make contact and those that have voiced their concerns through the petition and demonstration on 30th June 2018. Historically tariffs were unaltered for many years which have created an additional burden in filling the gap created between the costs of providing utilities services, including upgrading and maintaining infrastructure, and the tariff charges collected to meet such costs. The tariffs remain subsidised by a substantial SHG subsidy. The Authority note a tariff increase was recently introduced in October 2017, however, there had been no previous increase since March 2016, that increase represented an overall rise of 2% of Tariff revenue. The Authority concludes that this increase in tariff is necessary. The Authority cannot expect Connect to trade as a business insolvently. It is imperative that the services provided by Connect continue to improve. The Authority is satisfied from the information received and upon consideration of the submissions and responses that their proposed budget is realistic. The Authority consider that the overall level of increase in a quarterly bill to the average consumer is low. The Authority considers that the increases, with the protections in place for vulnerable members of society and targeted subsidy for agricultural users, are reasonable, do not create unreasonable hardships for households or unreasonable hindrance to commercial and economic development and serve to ensure stability and predictability in the public utilities industry in the medium and long terms.

The Authority, turns to objective (e). The concern of the Authority is that a principle of the divestment project was to enable Connect to become an enterprise that could 'stand-alone' in its fiscal management. Not to be reliant on general subsidy to operate and to ensure its stability and predictability whilst maintaining its levels of service. The Authority accepts the principle that, ultimately, the true costs of water must be targeted without recourse to being 'propped-up' by income from electricity and general subsidies. The Authority accept the principle that, eventually, costs charged for services must reflect the costs incurred to the provider and that general subsidy must be reduced whilst making considered use of targeted subsidies for sections of the population who are most effected.

The Authority repeat their expectation that Connect will continue to reflect upon its own operations and the increases in costs. The Authority poses the question to Connect as to whether it can more closely scrutinise the costs of the delivery of a quality service to the consumers of St Helena. Can costs be reduced in any way? Can efficiency be improved? The Authority is satisfied to accept the proposed tariff changes. However, the Authority will expect vigilance to be demonstrated by Connect to justify increases in their own running costs.

The Authority further welcomes the Independent Review that it to be conducted within the current financial year. The Authority has great interest to consider the report and will take careful note of its contents. Should the report raise concern regarding the efficiencies, fiscal management or any other area of its operations the Authority will require Connect to provide full explanation.

2.8 DIRECTIVE

It is therefore directed that in terms of Section 5(1)(c) of the Utilities Services Ordinance 2013, the utility charges to be made by Connect St Helena Ltd shall not exceed the maximums specified in the following Schedule.

9th July 2018

Nicholas Aldridge

Chair, Utilities Regulatory Authority

The Castle,

Jamestown

Appendix 1 – New Tariff Proposal

	CURRENT TARIFF	PROPOSED TARIFF	Increase
ELECTRICITY TARIFF CHARGES			
Usage Charges			
Domestic Band 1 (first 1,000units)	£0.30	£0.30	Nil
Domestic Band 2 (units over 1,000)	£0.46	£0.46	Nil
Commercial and 3 Phase	£0.46	£0.46	Nil
WATER TARIFF CHARGES			
Quarterly Standing Charges			
Domestic	£8.61	£10.33	£1.72
Commercial	£25.83	£31.00	£5.17
Agricultural	£8.61	£10.33	£1.72
Domestic Use			
Treated Water first 15 cubic metres	£1.16	£1.39	£0.23
Treated Water over 15 cubic metres	£1.53	£1.84	£0.31
Untreated	£0.77	£0.92	£0.15
Other Use			
Commercial	£3.01	£3.61	£0.60
Agricultural treated	£1.53	£1.84	£0.31
Agricultural untreated	£0.77	£0.92	£0.15
DRAINAGE TARIFF CHARGES			
Domestic Standing	£15.00	£18.00	£3.00
Commercial Standing	£23.68	£28.42	£4.74

	CURRENT TARIFF	PROPOSED TARIFF	Increase
ELECTRICITY OTHER CHARGES			
Disconnection	£39.00	£40.56	£1.56
Reconnection	£39.00	£40.56	£1.56
WATER OTHER CHARGES			
Connection	£33.80	£35.15	£1.35
Disconnection	£33.80	£35.15	£1.35
Reconnection	£33.80	£35.15	£1.35
DRAINAGE OTHER CHARGES			
Empty private septic tank (domestic)	£68.64	£71.38	£2.74
Empty private septic tank (commercial)	£110.24	£114.65	£4.41
Unblock private sewer line (domestic)	£68.64	£71.38	£2.74
Unblock private sewer line (commercial)	£110.24	£114.65	£4.41
Connection	£33.80	£35.15	£1.35
Disconnection	£33.80	£35.15	£1.35

Anyone wanting to understand more how the tariff changes will affect them are welcome to call Connect on 22255 or email enquiries@connect.co.sh

Appendix 2 – Income Statement

	FY 2019 Budget	FY 2018 Actual	FY 2017 Actual	FY 2016 Actual
Subsidy	703,000	668,000	605,000	777,000
Drought grant			232,776	
Tariff income	4,827,714	4,476,203	4,364,640	4,135,709
General income	24,981	40,214	33,581	9,919
Service income	129,549	6,790	199,024	182,667
Total Income	**5,685,244**	**5,191,207**	**5,435,021**	**5,105,295**
Administrative costs	412,797	384,617	466,792	308,265
Employee costs	1,210,688	1,307,549	1,261,528	1,121,922
Premises costs	233,332	224,694	261,533	260,582
Fuel	1,874,837	1,609,264	1,286,642	1,222,436
Maintenance/Running Costs	824,471	866,163	1,294,419	1,233,344
Depreciation	1,149,636	1,114,325	978,633	885,681
Contracts	130,560	124,637	116,309	104,829
Revaluation loss		89,942		
Drought mitigation costs			232,776	
Total Expenditure	**5,836,321**	**5,721,191**	**5,898,632**	**5,137,059**
Profit/(loss) before amortizations	**-151,077**	**-529,984**	**-463,611**	**-31,764**
Amortization of capital grants	395,386	347,149	286,504	379,659
Net Profit/(loss) before tax	**244,309**	**-182,835**	**-177,107**	**347,895**