

**Office of Utilities Regulation**

**Jamaica Public Service Company Limited  
Hurricane Dean Compensation Revision**

**Determination Notice**



**OFFICE OF UTILITIES REGULATION**

March 15, 2011

## Abstract

Hurricane Dean, a category 4 tropical cyclone, impacted Jamaica in August 2007 causing damage to the overhead transmission and distribution network of the Jamaica Public Service Company Limited (JPS).

JPS in its Annual Rate Adjustment submission (March 2008) submitted a claim for compensation in relation to the damage suffered and income losses arising from the Hurricane (the Claim). The Claim amounted to J\$1,234 million and included sub-claims for: (i) hurricane restoration costs, (ii) loss of revenue and (iii) the opportunity costs of capital associated with the restoration effort and revenue losses.

The OUR assessed the Claim and determined in October 2009 that the compensation to be awarded to the company was US\$7,147,340 or J\$635.8 million. This decision was set out in the OUR's *Jamaica Public Service Company Limited – Hurricane Dean Compensation Determination Notice Ele 2009/05: Det/04 dated October 8, 2009* (the 2009 Hurricane Dean Determination).

Shortly after the Hurricane Dean Determination (2009) was published JPS requested that the OUR reconsider its decision on the ground that a 0.25% deductible which featured in the compensation calculation was not applicable.

The Office, having reconsidered the Claim and the Hurricane Dean Determination (2009), agrees that the deductible should not have been applied in light of the time that the submission of the Claim was made. The Hurricane Dean Determination (2009) has therefore been revised and this document sets out the Office's determination and provides the rationale for the decisions taken.





## 1.0 Background

Hurricane Dean, a category 4 tropical cyclone, impacted Jamaica in August 2007 damaging the overhead transmission and distribution (T&D) network of the Jamaica Public Service Company Limited (JPS).

On March 31, 2008 JPS submitted a claim against the Z-factor provision of the Performance-based Rate-making Mechanism (PBRM) in the All-Island Electric Licence, 2001 amounting to J\$1,233,997,000 for damage associated with the hurricane. The components of the claim are shown in Table 1.1 below.

**Table 1.1 Summary of JPS' Claim**

Category of Claim	J\$'000	US\$ (Equivalent) <sup>1</sup>
Restoration costs	688,538	9,860,203
Loss of Revenue	410,459	5,877,975
Opportunity cost of Capital	135,000	1,933,267
<b>TOTAL</b>	<b>1,233,997</b>	<b>17,671,445</b>

While the Claim submitted by JPS was for compensation under the Z-factor provision of its licence, the OUR was of the view that it should have correctly been made against the Electricity Disaster Fund (EDF).

The EDF was established in 2004 to provide compensation for damage to the T&D infrastructure caused by natural disasters. The establishment of the fund was in response to the fact that it was no longer possible to get insurance coverage for T&D assets on reasonable terms because the Caribbean and the South Eastern Coast of the USA were designated as high risk zones by insurers, owing to their heightened vulnerability to tropical cyclones.

In order to determine the level of compensation due to JPS from the EDF, the OUR engaged the services of Loss Adjuster, Axis (Jamaica) Limited, to evaluate the claim. The loss adjuster's final report was received on September 9, 2009.

The OUR made a determination on the claim in Determination Notice entitled "*Jamaica Public Service Company Limited Hurricane Dean Compensation*" Document Number: *Ele 2009/05: Det/04* [Hurricane Dean Determination (2009)] which became effective on October 14, 2009.

<sup>1</sup> The conversion rate applied is JPS' August 2007 billing exchange rate of US\$1:J\$69.83

The Hurricane Dean Determination (2009) allowed for a total compensation to JPS of J\$499,099,000 or US\$7,147,340<sup>2</sup>.

JPS, in a letter dated October 14, 2009, requested that the OUR reconsider the determination on its Claim on the ground that the application of a deductible in the amount of 0.25% of the net book value of its T&D assets was invalid. JPS contended that Hurricane Dean occurred, and the associated claim was made, before the date the EDF Rules took effect (i.e. August 1, 2008). Consequently, the application of a deductible introduced by EDF Rules should not have been included as a determinant in the final compensation allowed to JPS.

## 2.0 Deductible

The EDF Rules as set out in the OUR's "*Electricity Disaster Fund Rules of Procedure for Operation and Administration*" Document Number *Ele 2008/09:Rul:01* became effective on August 1, 2008, four years after the establishment of the fund. This was the culmination of a process encompassing research, regulatory design and consultation. The aim was to put together a set of procedures and guidelines that would facilitate the growth and maintenance of a healthy fund capable of addressing the gap created by the absence of traditional insurance for JPS' T&D assets.

Given that deductibles are a normal feature of asset insurance and based on the fact that the EDF was actually a substitute for traditional T&D insurance, it was considered reasonable that this feature should be a component of the rules governing the EDF. Deductibles are the classic way of reducing the risk of moral hazards.

In general, moral hazards arise because the behaviour of the insured is often altered after insurance coverage is obtained. This change in behaviour is often reflected in lower maintenance levels of assets and sometimes outright carelessness on the part of the insured. Invariably, moral hazards unreasonably increase insurance payouts when disaster occurs which may be a threat to the insurers viability. The extent of the changed behaviour varies inversely with the level of responsibility that the insured shares with the insurer in restoring the assets after an event. As such, in line with accepted practice in the insurance industry, it is in the interest of the EDF that a deductible be applied to JPS claims.

Notwithstanding the foregoing, JPS's grounds for reconsideration by the OUR of the Hurricane Dean Determination (2009) is not without merit since:

- a) the EDF Rules were formalized and became effective subsequent to both the Hurricane Dean event and the Claim; and

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<sup>2</sup> Conversion rate derived from Scotiabank Sep 30, 2009 exchange rate of US\$1:J\$88.95



- b) in the other two compensation claims submitted by JPS for hurricane damage prior to the establishment of the EDF Rules, namely the April 2005 Claim in respect of Hurricane Ivan and the April 2006 Claim in relation to damage caused by Hurricanes Dennis, Emily and Wilma, a deductible was not taken into account in the OUR's determination of the compensation payable to JPS.

Although the EDF Rules, including an amendment to the rules which fixed the applicable deductible at 0.25% of the net book value of JPS's T&D assets<sup>3</sup>, became effective prior to the issue of the Hurricane Dean Determination (2009), it is acknowledged that, except where a claim was submitted after the establishment of the EDF Rules, the methodology followed in arriving at the compensation should be consistent with that applied in previous hurricane determinations. As such, the OUR has decided to reverse its application of the 0.25% deductible to JPS's Claim, since the Claim preceded the establishment of the EDF rules which introduced the deductible.

### 3.0 Adjustment to the Compensation Payment

In the Hurricane Dean Determination (2009) the total compensation approved by the OUR was US\$7,147,340 comprising of US\$6,678,508 for restoration cost and US\$468,832 for opportunity cost.

JPS' Audited Financial Statements revealed that the net book value (NBV) of the company's T&D assets at the beginning of 2007 was US\$243,454,000. The Hurricane Dean Determination (2009) assumed a deductible of 0.25% of the NBV of the T&D assets. This resulted in a reduction in the compensation for restoration cost by US\$608,635 or J\$42,500,982 based on JPS' billing exchange rate<sup>4</sup> in August 2007 when the hurricane occurred.

The application of the deductible which lowered the compensation allowed for restoration cost also resulted in a lower compensation payment for opportunity cost. Applying the same interest rate of 11% per annum employed in the original compensation calculation over the 26½ months spanning the last week of August 2007 to the end of October 2009, while making an appropriate adjustment for the cash advance of US\$5,000,000<sup>5</sup>, translates to an opportunity cost of US\$633,565 instead of the US\$468,832 payment allowed in the Hurricane Dean Determination (2009). Consistent with the acknowledgement that the deductible was not applicable to the

<sup>3</sup> In the original EDF Rules (effective August 1, 2008) the deductible was established as 0.5% of the net book value of JPS' T&D assets. The Rules were amended effective February 2, 2009 in the OUR Determination Notice entitled "Amendments to the Electricity Disaster Fund Rules of Procedure for Operation and Administration" Document Number Ele 2009/02:Det/02, lowering the deductible to 0.25%.

<sup>4</sup> The billing exchange rate was US\$1:J\$69.83

<sup>5</sup> JPS received a cash advance of US\$5,000,000 from the EDF early in September 2007. The principal upon which interest was computed was accordingly reduced at that point going forward for 26 months.

Claim the overall compensation payment should have been US\$7,920,709 instead of US\$7,147,340.

#### 4.0 Summary of Compensation

The Office has determined that the grounds upon which JPS requested that the application of the 0.25% deductible to the Hurricane Dean compensation be reconsidered have merit. By dint of fact that the principle of deductible was introduced with the formal establishment of the EDF Rules on August 1, 2008, seven (7) months after the claim was made, the deductible ought not to have been applied to the computation of the compensation.

It is in this context, that the Hurricane Dean Determination (2009)<sup>6</sup>, has been revised to reflect this adjustment. Consequently, the total compensation allowed has been revised upwards from US\$7,147,340 (or J\$635,756,000)<sup>7</sup> to US\$7,920,709 (or J\$704,547,000). The overall compensation based on this revision therefore represents 57%, instead of 52%, of the original claim of J\$1,234 million.

**Table 4.1 JPS Claim and the Revised Compensation**

Category of Claim	Foreign Exch. Rate US\$1:J\$	Original Compensation		Revised Compensation		Difference	
		J\$'000	US\$	J\$'000	US\$	J\$'000	US\$
Restoration costs	69.83	466,360	6,678,508	508,861	7,287,143	42,501	608,635
Loss of Revenue	69.83	-	-	-	-	-	-
Opportunity costs	69.83	32,739	468,832	44,242	633,565	11,503	164,733
<b>Total</b>	<b>69.83</b>	<b>499,099</b>	<b>7,147,340</b>	<b>553,103</b>	<b>7,920,709</b>	<b>54,004</b>	<b>773,368</b>
<b>Total Compensation</b>	<b>88.95</b>	<b>635,756</b>	<b>7,147,340</b>	<b>704,547</b>	<b>7,920,709</b>	<b>68,791</b>	<b>773,368</b>
Advance		(444,750)	(5,000,000)	(444,750)	(5,000,000)	-	-
<b>Net Compensation</b>	<b>88.95</b>	<b>191,006</b>	<b>2,147,340</b>	<b>259,797</b>	<b>2,920,709</b>	<b>68,791</b>	<b>773,368</b>

The increase in the total compensation payment is attributable to an increase of US\$608,635 in the compensation for restoration cost and increase of US\$164,733 in opportunity cost compensation. Table 4.1 above summarizes the JPS Claim and the revision to the approved compensation.

<sup>6</sup> Document No: Ele 2009/5: Det/04

<sup>7</sup> Based on the exchange rate applied at the time of the original Determination -US\$1:J\$88.95



## 5.0 Determinations

With regard to JPS's request for a reconsideration of the treatment of the deductible in the compensation for the Hurricane Dean Claim, the Office has determined that:

1. JPS's Claim was submitted prior to the date at which the requirement for the application of a deductible took effect. Consequently, the decision to apply a deductible to the Claim has been reversed.
2. The compensation payment to JPS is to be increased by US\$608,635 consistent with the removal of the 0.25% deductible applied in the original treatment of the restoration cost.
3. The compensation payment to JPS is to be increased by an additional US\$164,733 to reflect the increase in opportunity cost associated with the incremental restoration compensation denied in the original compensation payment.

The reversal of the deductible has led to a revision of the compensation payment and as such JPS is entitled to an additional US\$773,368 or J\$68,791,000<sup>8</sup>.

In light of this determination, the **OUR HEREBY GRANTS** its approval to the JPS to withdraw the sum of **US\$773,368** from the EDF in respect of its Claim and **FURTHER REQUIRES JPS** to notify the OUR of the withdrawal no later than three (3) days after the date of the execution of the transaction.

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<sup>8</sup> Exchange Rate of US\$1:J\$88.95

