



E1453G

Cost Pass-through for Guernsey Electricity Limited 2019
(Guernsey)

Draft Decision

Document No: CICRA 19 / 10

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CONTENTS

1. Executive Summary	3
2. Structure of this Document	4
3. Legislative Background	5
4. Cost pass-through amount	7
5. Draft Decision	8
6. Next Steps.....	9

1. EXECUTIVE SUMMARY

Having engaged in a Call for Information process with Guernsey Electricity Limited (**GEL**) as a result of a request by GEL, the Guernsey Competition and Regulatory Authority (**GCRA**) is issuing this Draft Decision regarding a proposed unit tariff increase of 6.8%, to be in place for 3 years from 1 July 2019. This is with a view to allowing GEL to recover historic uncontrollable costs of £9.8m related to importation and generation of electricity, these being primarily related to the price of oil and exchange rate movements. The period to which the costs to be recovered relate is April 2017 to March 2019.

This Draft Decision paper sets out the reasons for the proposed allowance of a 6.8% rise and the basis upon which the allowed amount has been calculated.

2. STRUCTURE OF THIS DOCUMENT

This document constitutes a Draft Decision. The document sets out the conclusions which the GCRA has reached, having taken full account of information gathered in the Call for Information process with GEL. The document contains a statement of what the GCRA is minded to allow GEL with respect to recovery of uncontrollable costs and the consequent unit tariff increase.

The document is structured as follows:

Section 3	Outlines the legal framework
Section 4	Sets out the elements considered in reaching a preliminary view of the appropriate cost pass-through amount
Section 5	Contains the Draft Decision
Section 6	Sets out the regulatory process

Respondents are requested to comment on the Draft Decision. All comments should be submitted before 5.00pm on 26 March 2019 to:

Guernsey Competition and Regulatory Authority
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La Plaiderie
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All comments should be clearly marked 'Comments on E1392G Draft Decision – Cost Pass-through for Uncontrollable Costs of Guernsey Electricity Limited 2019'.

In line with CICRA's consultation policy, CICRA intends to make responses to the Draft Decision available on the CICRA website, the combined website of the GCRA and JCRA. Any material that is confidential should be put in a separate annex and clearly marked as such so that it may be kept confidential. CICRA regrets that it is not in a position to respond individually to the responses to this consultation.

3. LEGISLATIVE BACKGROUND

Current Licensing Regime

The States of Guernsey has issued a number of States Directions in relation to the licensing of electricity activities in Guernsey. In accordance with those Directions, the GCRA (formerly the Director General) issued the first licences for electricity generation, conveyance and supply to the incumbent electricity company – GEL - on 1st February 2002.

Legal Background

Under the Regulation of Utilities (Bailiwick of Guernsey) Law 2001 (the **Utilities Law**), the objectives that the GCRA has a duty to promote (and, where they conflict, to balance) must be achieved in a way that gives equal regard to the interests of the residents of all islands of the Bailiwick. They include protecting the interests of consumers and other users in Guernsey in respect of the prices charged for, and the quality, service levels, permanence and variety of, utility services. In order to ensure the permanence of electricity supplies, the GCRA must have regard to allowing GEL to raise revenues to cover the efficient cost for generation, conveyance and supply of electricity.

Detailed provision for the regulation of electricity in Guernsey is contained in The Electricity (Guernsey) Law 2001 (the **Electricity Law**). Section 5 provides that the Authority may include in licences such conditions as appear to the Authority to be appropriate having regard to the nature of the application for the licence, the objectives set out in the Utilities Law, and the enforcement of the Utilities Law and the Electricity Law.

The Electricity Law specifically provides that such conditions can include (but are not limited to):

- Conditions regulating the prices, premiums and discounts that may be charged or (as the case may be) allowed by a licensee which has a dominant position in a relevant market.

These provisions allow the Authority to regulate unit tariffs.

Regulatory Framework

In a previous GCRA document (OUR03/07), proposed findings of market dominance in Guernsey were set out following a review of the market. The GCRA considered that GEL was dominant in generation, conveyance and supply of electricity.

The licence of GEC includes conditions in respect of Price Regulated Services (licence condition 20). Condition 20.2 of the Licence provides that:

“The Director General [now the GCRA] may determine the maximum level of charges the Licensee may apply within a relevant market in which the Licensee has been found to be dominant. A determination may:

(a) provide for the overall limit to apply to such charges;

(b) restrict increases in any such charges or to require reductions in them whether by reference to any formula or otherwise; or

(c) provide for different limits to apply in relation to different periods of time falling within the periods to which any determination applies.”

This condition allows the Authority to regulate the prices that GEL charges for electricity it supplies in a way and for a time that it deems appropriate, provided GEL has a dominant position in the relevant market.

As set out in OUR03/07, Guernsey’s retail electricity market possesses a monopolist/dominant operator that also has a dominant position through the electricity supply chain. This position of economic strength is unlikely to change in the near to medium future.

4. COST PASS-THROUGH AMOUNT

Foreign exchange movements and commodity cost changes uncontrollably increased the cost of electricity generation for GEL during 2017/18 and 2018/19. It now also has reduced control over decision making regarding the choice of local generation or importation as a result of the failure of their GJ1 cable, which is used for the transmission of electricity from France via Jersey. The combination of this reduced control and increased foreign exchange and fuel oil and other commodity costs is putting significant financial pressure on GEL.

GEL has therefore submitted a request for an increase in unit tariffs to allow it to recover uncontrollable costs related to the importation and local generation of electricity. These primarily relate to exchange rate movements and the price of fuel oil.

The last full review of GEL's tariffs was undertaken by the GCRA's predecessor body, the Office of Utility Regulation (**OUR**), its decision being issued in March 2011. Given that what would normally be the basis for the review of uncontrollable costs is not appropriate given its age, a baseline of two recent representative years (2015/16 and 2016/17) when GEL did not suffer significant constraints on its determination of the mix of importation and generation of electricity was suggested by GEL. The GCRA proposes to accept this baseline.

In addition to the appropriateness of the baseline, the GCRA has considered the appropriateness of the costs included, and the overall amounts of the claim by GEL.

As a result, the GCRA is inclined to allow GEL a cost pass-through amount of £9.8m for uncontrollable fuel, lubricant, exchange rate and other marginal costs related to generation of electricity and for exchange rate costs related to the importation of electricity for the years 2017/18 and 2018/19.

The GCRA notes that in any future full review of tariffs it will require evidence of improving efficiencies in the operations of GEL and that should any such review show that this pass-through amount was materially excessive it could be recovered in the course of future price controls.

In order to allow GEL to recover the amount of £9.8m over a three year period, the GCRA is therefore minded to allow GEL to increase its unit tariffs by 6.8%, such increase to be in place for 3 years from 1 July 2019.

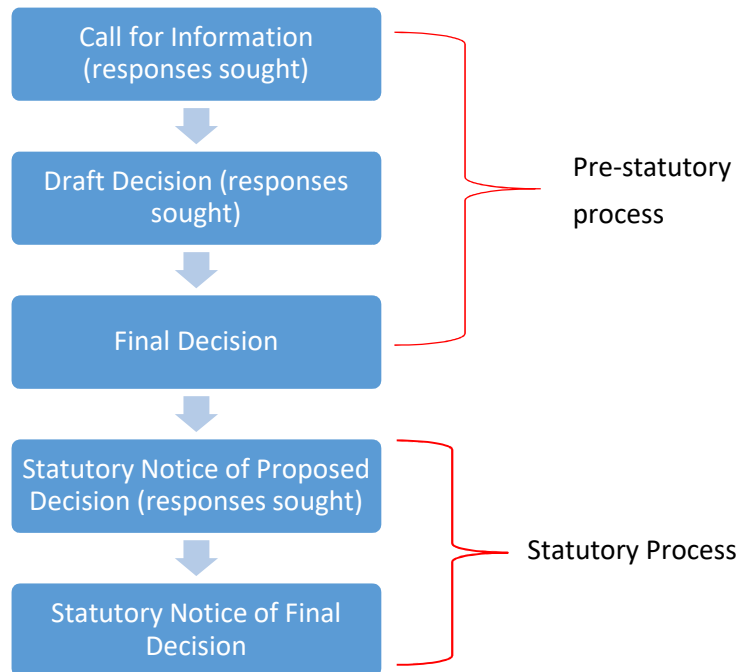
The GCRA now invites comments on its proposed decision.

5. DRAFT DECISION

The GCRA is inclined to find that the maximum unit tariffs charged by GEL should be increased by 6.8%, the increase to remain in effect for 3 years from 1 July 2019. This is in order to allow GEL to recover uncontrollable cost increases of £9.8m related to electricity generation and importation during its financial years 2017/18 and 2018/19.

6. NEXT STEPS

CICRA has recently introduced a revised process for consultations. The Information Notice, CICRA 18/29 “Regulatory Consultation Process” published in July 2018 outlines the new process to be undertaken before carrying out certain regulatory functions in accordance with the relevant statutory process. This process is set out below in diagrammatical form:



Under the new process there is a pre-statutory process. The pre-statutory process consists of a Call for Information, a Draft Decision and a Final Decision. In the context of a cost pass-through, the Call for Information stage consists of information gathering from the licensee because of the confidential nature of the information required. The Draft Decision stage then provides the opportunity for public responses, following which a Final Decision is issued. This paper is thus the second actual stage, and first public stage, of the pre-statutory process.

In order to change the maximum unit tariffs which GEL may charge, the appropriate pre-statutory process is followed,¹ and subsequently a decision determining the maximum level of standby charges requires the statutory process to be followed.²

Accordingly, the GCRA is issuing its Draft Decision before proceeding to a Final Decision and then to the statutory process. While the GCRA considers any Decision made as part of the pre-statutory process to be the starting point for later parts in the process and as a statement of its current expectations, this Decision is not binding until such time as it has been included in the Statutory Notice of a Final Decision.

The GCRA invites responses to this Draft Decision as detailed in Section 2 above.

¹ See Information Notice CICRA 18/29 “Regulatory Consultation Process”, July 2018

² Sections 5(4) and 5(5) of The Electricity (Guernsey) Law 2001