



# Standby Charge for Embedded Electricity Generation (Guernsey)

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## Final Decision

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## 1. Introduction

The Guernsey Competition and Regulatory Authority (**GCRA**) launched its consultation on standby charges for embedded electricity generation applied by Guernsey Electricity Limited (**GEL**) by publishing a Call for Information on 4 July 2018 (CICRA 18/30) (the **Call for Information**). In response to that paper, interested parties were invited to make written submissions. Taking into account those representations, on 20 December 2018 the GCRA issued its Draft Decision to the respondents (CICRA 18/54) (the **Draft Decision**), such decision containing the GCRA's provisional view on standby charges in Guernsey and again inviting interested parties to submit written representations.

This Final Decision considers the responses received to the Draft Decision, these being submitted by GEL and International Energy Group (**IEG**). Taking into account these two responses, the GCRA remains of the view that the standby charge applied by GEL is not justified, is high compared to elsewhere to the extent we can find comparators and should as an interim measure be reduced forthwith until a full review has been undertaken on the appropriate level. This immediate response to the reduction in standby charges is required as a result of the credible risk to competition in the energy market should the current level remain.

Further, the GCRA remains of the opinion that the underlying rationale for such a charge is reasonable and that as a short term measure it is appropriate to adopt the rate as concluded in the review of the Jersey Electricity Company (**JEC**)'s proposed rate in Jersey as conducted by NERA Economic Consulting (the **NERA Report**).

Accordingly, this Final Decision proposes a reduction in the standby charge set by GEL to £3.07/kW/month for the immediate future for parties who would otherwise have to pay the charge, subject to those parties agreeing to reimburse GEL should a subsequent regulatory decision (or a decision of comparable legal standing) set a different rate, and again for GEL to reimburse those parties should the rate be too high. The scope of the standby charge to be limited to the category of users currently subject to the higher charge.

In view of the effect a delay to reducing standby charges would have on competition within the energy market in Guernsey, this rate of £3.07/kW/month will be introduced as an interim measure. Following the issuing of a final decision in the statutory process, a full review of the appropriate options available for addressing the standby charge to be applied by GEL should be undertaken. This assessment will be significantly assisted by States of Guernsey policy, including clarification as to the nature of regulatory oversight going forward.

## 2. Executive Summary

A standby charge is a monthly charge levied by GEL on customers with embedded generation capacity based on their installed capacity.

The issue of the level of standby charges is a matter under review by governments and regulators in many European jurisdictions. By way of illustration, the JEC had voluntarily agreed to defer application of its standby charge pending outcome of a review by Jersey's Environment Department. JEC's rates are currently set at £3.10 per kW excl GST (i.e. £3.25 incl GST) for installations up to 50kW. The charge set by GEL is £6.8594 per kW i.e. more than double.

The current standby charge applied by GEL has not been the subject of any specific review by the GCRA. The last review by the GCRA of GEL's tariffs was in 2012 but that review (and earlier reviews) did not focus on the structure of every tariff as such an approach at the time would have been disproportionate in view of the additional resource requirements that would have had to be placed on both the GCRA and GEL.

Whilst to date no specific review has been undertaken by the GCRA into the standby charges, a complaint has been raised by IEG that the current level of standby charges is a barrier to its ability to provide a service and compete with GEL. In order to fulfil its duties, including particularly with regard to that of introducing, maintaining and promoting effective and sustainable competition in the provision of utility services in the Bailiwick, the GCRA considers it appropriate to act in response to this complaint.

The rate currently applied by GEL is therefore one that has not been set by the GCRA as regulator but has been determined by GEL. In view of the rates applied in other jurisdictions, and the lack of justification for the current level of charge in Guernsey, the GCRA considered the standby charge applied by GEL to be high compared to elsewhere to the extent we can find comparators. An assessment therefore needed to be conducted which looked at whether the standby charge should be reduced and if so to what level and by when.

Accordingly, in July 2018 the GCRA issued a Call for Information to which seven responses were received, and in December 2019 issued a Draft Decision to which two responses were received. This document sets out the responses received to the Draft Decision for future standby charges. Further, it summarises the issues involved, and sets out the directions that the GCRA proposes to issue to GEL under condition 20.2 of the licence issued to GEL. This Decision will then be the subject of further consultation under the statutory consultation process.

### 3. Structure of the document

This document constitutes a Final Decision in the pre-statutory process. The document sets out the conclusions which the GCRA has reached, having taken full account of responses to the Call for Information and Draft Decision, and having carried out further research to ensure it has fully addressed respondents' points. The document contains summaries of particular points raised to illustrate the GCRA's reasoning.

This document broadly follows the structure of the Draft Decision and is structured as follows:

Section 4	Outlines the legal requirements and licensing framework
Section 5	Sets out the basis for reducing Standby Charges
Section 6	Summarises and responds to points made by the respondents to the consultation
Section 7	Contains the Final Decision
Section 8	Next Steps

## 4. Legislative and Licensing 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.

The market for generating electricity is, in principle, open to competition. In terms of conveyance, under the current regime no other operator could lay electricity cables until 2012 and anyone generating electricity must therefore use the existing electricity network of GEL to convey that electricity from their generation plant to customers. Until 2012 only GEL was entitled to sell electricity to end customers.

### 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 charges for utility services.

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 intended to prevent and control anti-competitive behaviour; and
- 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 Standby Charges, should there be a need for regulatory intervention.

### 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) and Fair Competition (licence condition 13).

In respect of Price Regulated Services, Condition 20.2 of the Licence provides that:

*“The Director General 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 the GEC charges for its services in a way and for a time that it deems appropriate, provided GEC 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.

In respect of Fair Competition, Condition 13.1 of the Licence provides that:

*“Subject only to the Licensee’s exclusive rights as described in Parts IV and V of this Licence, the Licensee shall:*

- (a) Not engage in any practice or enter into any arrangement that has the object or the likely effect of preventing, restricting or distorting competition in the Generation Business, Conveyance Business and/or Supply Business; and*
- (b) Comply with any direction issued by the Director General for the purpose of preventing any practice or arrangement that has the object or effect of preventing, restricting or distorting such competition.”*

Condition 13.1 of the Licence thus provides that the GEC must comply with any Direction issued by the GCRA for the purpose of preventing any market abuse.

It follows that, before it can make a decision for the purpose of preventing market abuse under Condition 13.1 of the Licence, the GCRA must have made a determination that GEC holds a position of significant marker power (dominance) in respect of the generation, conveyance and supply of electricity.

## 5. Basis of Reducing Standby Charges

### *Embedded Generation Technology*

IEG has provided evidence that the current level of standby charges is a barrier to its ability to provide a service and compete with GEL. The rationale for this standby charge is that GEL is a provider of last resort when premises that source some or all of their electricity from alternative sources then turn to GEL when those are not available.

The technology IEG will use is successfully established elsewhere (winning auction bids in the UK and Ireland) and among the more competitive technologies in other jurisdictions, while standby charges are rare elsewhere and the GCRA is aware of no standby charges at a similar level to that set by GEL. From the GCRA's historic involvement as the regulator of GEL, no economic regulatory review set this particular charge. The rate of the standby charge is thus established by GEL.

### *Regulation*

While there was a policy proposal from the Commerce and Employment Department in 2015 seeking to exempt GEL from the licensing and regulation provisions within the electricity laws by no later than 1 January 2016, this has not been implemented through legislative changes necessary to give effect to the Department's proposals. Instead, the States of Guernsey are now reviewing their energy policy and the status of its resolution to remove electricity from regulation by the GCRA is currently unclear. Until such time as regulation of the electricity sector has been determined by the States of Guernsey, this places constraints on the regulatory approach to addressing matters such as a comprehensive price control review. Nevertheless, until this matter is brought before the States of Guernsey, the GCRA remains the economic regulator of the electricity sector in Guernsey in law and therefore has a duty to respond to the complaint raised by IEG.

A Call for Information paper was issued on 4 July 2018 to which seven responses were received, these being from two Guernsey departments, a group of private individuals, GEL, IEG and two other private businesses. The Draft Decision was issued to those respondents only on 20 December 2018 on the basis that the NERA Report had at that stage not been made public, and was published on CICRA's website on 15 February 2019 following confirmation that the NERA Report was in the public domain.

In response to the Draft Decision, two written submissions were received, these being from GEL and IEG. Having considered the responses to the Draft Decision and related evidence, the GCRA remains of the view that there is a credible risk that if this issue is not resolved in the short term a potential investor in this sector and competitor to the incumbent (i.e. IEG) will exit the market, with diminished choice and opportunity of lower prices for customers who might otherwise take up such an alternative service. Should this issue not be addressed as a matter of urgency, there is also the risk that GEL will look to take on customers which may have otherwise taken on a contract with IEG.

In normal circumstances an economic regulator would have been in a position to undertake a full review and resolve the dispute by setting a level of charge justified by the evidence it

considered. In the current circumstances the GCRA has encouraged the parties to resolve matters commercially. However, IEG has been a licensee since 30 August 2017 but since that time it has been unable to reach a commercial arrangement with GEL. This is despite evidence submitted by both parties that they have sought to advance commercial discussions.

The Call for Information and Draft Decision indicated the current level of standby charge was high in comparison to elsewhere, was not common in other jurisdictions, and there appeared to be no basis to justify the current level of the charge. The underlying rationale for such a category of charge did however seem to the GCRA to be reasonable, insofar as it provides funding for the provision of infrastructure required to provide a service in case of need. The responses received to the Draft Decision have not altered these views that the current level needs to be reduced. The GCRA also remains of the view that a charge should be applied. In circumstances where the rate needs to be reduced imminently, as a short term measure the GCRA proposes to set GEL's maximum standby charge at the same rate as concluded in the NERA Report.

By way of background, in Jersey the JEC is not subject to economic regulation, although it is subject to the competition laws applying to the economy as a whole in Jersey. Accordingly, there being no explicit regulation of JEC's revenues or charges, the introduction of the reduced standby charge by the JEC is a voluntary arrangement. The JEC proposed a standby charge of £3.10/kW per month (excl GST) (i.e. £3.25 incl GST) to all new commercial customers choosing to install embedded generation of up to 50kW of installed capacity. The States of Jersey Department of Environment commissioned NERA Economic Consulting to assess whether this proposal is "fair and reasonable".

Having reviewed and appraised, *inter alia*, the detailed calculations underpinning the £3.25/kW charge, and assessing whether the structure of this charge is appropriate as a means of reflecting the costs associated with changes in embedded generation in Jersey, NERA Economic Consulting calculated a rate of £3.22/kW/month including GST, and thus £3.07/kW/month excluding GST.

Notwithstanding that the GCRA proposes to charge the same rate as that concluded by NERA Economic Consulting as an interim measure, it is likely that the GCRA as an economic regulator would take into account a wider set of factors than those considered by NERA Economic Consulting when assessing whether a standby charge rate is "fair and reasonable".

### ***GCRA's Duties***

The GCRA has a number of duties set out in Part II of the Utilities Law. These include the obligation to protect the interests of consumers and other users in the Bailiwick in respect of the prices charged for, and the quality, service levels, permanence and variety of, utility services and to ensure that utility activities are carried out in such a way as best to serve and contribute to the economic and social development and well-being of the Bailiwick. It further includes the objective of introducing, maintaining and promoting effective and sustainable competition.

The above concerns with regard to the current standby charge appear to the GCRA as particularly relevant to a number of its duties referred to in Part II of the Utilities Law and are

likely to outweigh any change of income faced by GEC by imposing a reduction in standby charges.

The urgency for the reduction in standby charges is informed not only by the unclear basis for the current rates as applied by GEC, but also the extent of the difference between standby charges in Guernsey and elsewhere, and the wider economic risks to Guernsey should the reduction not be brought into effect. The GCRA is aware of intentions by IEG to leave the Guernsey market should standby charges not be reduced with the result being consumers will suffer from no choice and the lost potential for the efficiencies and lower prices likely to be brought about through competition in the electricity sector. The GCRA is of the view that this is a significant issue with risks to the wider economy of Guernsey that must be taken into consideration in setting the immediate reduction in standby charges. To address concerns that the proposed rate may be too high or too low, the reduced rate should only apply where the customer agrees to reimburse GEL should a subsequent regulatory decision (or of comparable legal standing) set a different rate and GEL to reimburse the customer where the final reviewed rate is lower.

## 6. Consultation Responses

### Introduction

In this section we summarise the written submissions made by GEL and IEG, and the GCRA's response to the same.

### Proposed Standby Charge Rate and Thresholds

IEG remains of the view that the rate should be set at zero until the energy market becomes developed. IEG was not convinced that the NERA Report covered all aspects of the applied charge appropriately, primarily due to the JEC not being a fully regulated utility and therefore being mindful that the costs covered by the JEC may not be transparent and solely applicable for the required levels of security of supply. IEG was also of the opinion that standby charges (if any are decided upon) should only be for embedded generation systems in excess of 25kW installed capacity.

GEL submitted that it has had a standby charge in place for 20 years, it is not a "new" charge and is applied to existing CHP units that operate in the island. GEL further submitted that the standby charge is not rare and can be found in various forms across the sector, particularly where photovoltaic technology (PV) is mature. GEL was of the view that it was fair to assume that GEL should apply the prescribed rate to all generators and not just those more than 25kW (as per current policy), with the assumption being that the application of the charge above 50kW being covered by commercial agreements.

GEL further submitted that the NERA Report applies to PV only and not to combined heat and power installations (CHP), and that there should be a separate rate to reflect the technology used. Noting that the GCRA would consider a wider set of factors than those considered by NERA when assessing whether a standby charge is "fair and reasonable", GEL contended that these wider factors may result in a figure that is likely to be different to the figure noted in the NERA Report and that the level of charge for CHP is still likely to be higher than that charged by GEL today.

### GCRA Analysis

The current level of the charge is £6.8594 per kW of installed generating capacity per month. The Draft Decision indicated this was high in comparison to elsewhere, that standby charges are not common in other jurisdictions, and there appeared to be no basis to justify the current specific level of the charge applied by GEL. Indeed its existence at the same level for 20 years suggests that it is likely no longer to be appropriate given the changes in technology and costs in that time. GEL has provided no justification or evidence in support of the level of charges. The rationale for such a category of charge, namely the provision of the infrastructure required to provide the standby service did however seem reasonable. Responses to the Draft Decision have not altered these views.

Working on the presumption that some charge may be incurred, the GCRA remains of the opinion that it may not be appropriate to set the rate at zero but rather to consider imposing

some level of maximum standby charge. In circumstances where the GCRA considers it needs to act urgently to address the concerns with the current rate, and in any event prior to the completion of a full review which is anticipated to take a number of months, the alternative approach to set a benchmarked figure on an interim measure is a reasonable one.

To minimise any risks the proposed approach may cause, the parties would be required to provide a tightly worded commitment to make good any shortfall suffered by GEL or its customers.

It is noted that the current standby charge applied by GEL is for installations exceeding 25kW. It is noted that the NERA Report considered a rate which applied to installations of up to 50kW, with any charges for commercial installations of more than 50kW to be determined on a case-by-case basis.

The GCRA is not in a position to decide on alternative thresholds or scope of users caught by the standby charge through this interim assessment process. In these circumstances, the GCRA's decision therefore only substitutes the current standby charge with the revised level as applied to the same category of use or scope of the existing standby charge. The GCRA has no further information to refine or alter the thresholds that might apply.

The GCRA notes GEL's comments on the differential rates for CHP and PV. Whilst normally a full review would be conducted, this is an unusual position the GCRA finds itself in and in the circumstances the GCRA considers it appropriate to apply the same rate for the two types of installations. As explained in the Draft Decision, the GCRA recognises that there are some anomalies in how the standby charge is currently applied. The question for the GCRA is how, within the constraints imposed on it, does it deal with the matter at hand in a way that avoids or reduces distortions to the market in circumstances where there is reason to believe the practical effect of the GEL standby charge as currently applied is unfair.

As set out in the Draft Decision, the GCRA recognises that self-generation implies a risk of a material reduction in the revenue received by GEL which, all things being equal, reduces the contribution to meeting its 'insurance costs'. There is therefore a presumption that a means of recovering that revenue will be needed. After all, if all premises in Guernsey employed self-generation technologies, if they choose not to be permanently disconnected from the grid, GEL would need to maintain all necessary infrastructure and operating capability to meet demand at all times for all premises in Guernsey whether or not this is called upon.

### **Reviewing Standby Charges as an Interim Remedy and before Overall Review**

GEL contends that a full review should take place once the wider tariff re-balancing results are known which will ensure standby charges can be reviewed in the proper context of over tariff provision and the impact upon competition thereon.

IEG is concerned that any temporary arrangement could easily become permanent. IEG notes that the Draft Decision places no obligation or timeframe on GEL to provide any detailed information to CICRA or the market to justify this charge. IEG requested that, if the rate is set at £3.07 for a specific period, any contracts entered into by IEG with their customers at this value are grandfathered until the final standby charge value is concluded.

### ***GCRA Analysis***

For the reasons identified in this decision, the GCRA is of the view that it needs to act forthwith in setting the standby charge. However, as stated in the Draft Decision following the issuing of a final decision in the statutory process the GCRA considers that a full review should be undertaken of the standby charge to be applied by GEL and a level of charge justified by the evidence should then be set.

On the basis that this is an interim remedy only, the GCRA does not consider it appropriate for grandfathering provisions to apply for long term contracts. This rate change is only intended as a temporary solution to a problem which should be resolved by further work on the appropriate level of the charge through a subsequent regulatory decision (or decision of comparable legal standing) which will be significantly assisted by States of Guernsey policy, including clarification as to the nature of regulatory oversight going forward.

### **Dominance of GEL in the markets concerned**

GEL is the incumbent in the market for conveyance, supply and generation of electricity in the Bailiwick of Guernsey. Two licensees are active in the sector, including GEL, although the other licensee, IEG, does not currently have a substantial share of any of the above categories in the Bailiwick. As such, we consider that GEL continues to be dominant as determined by the OUR in its decision 03/07. The GCRA does not consider a full market review to be required to make such a determination and the Draft Decision was issued on the premise that the existing finding as set out in OUR03/07 was still valid.

### ***GCRA Analysis***

Interested parties were invited to comment on this position. No responses were received to suggest that the existing decision regarding dominance should change. The GCRA considers the existing finding as set out in OUR03/07 remains still valid.

## 7. Final Decision

The Authority has considered in full the responses received to its Draft Decision.

For the reasons set out in this document, the Final Decision of the GCRA is as set out below. This decision is the final stage of the Pre-Statutory process. As explained in Section 8, whilst this decision is the starting point for later parts in the consultation process and as a statement of the GCRA's 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 finds that GEL continues to be dominant in all the activities that constitute the electricity supply chain under the current legislative framework. These are:

- the generation of electricity;
- the conveyance of electricity across the electricity network; and
- the supply of electricity directly to homes and businesses.

These terms are referenced in the Electricity Law and govern the current licensing framework as outlined above.

The GCRA will issue a direction to GEL under Condition 20.2 of GEL's licence as follows:

1. The rate charged by the relevant licensee for standby charges for embedded electricity generation shall be no more than £3.07/kW/month. This only substitutes the current standby charge with the revised level as applied to the same category of use or scope of the existing standby charge;
2. This is a flat rate (i.e. no time of day or weekend distinction);
3. This rate is only applicable where the parties agree to reimburse the other should a subsequent regulatory decision (or of comparable legal standing) set a different rate. The wording for that agreement is as follows:

*"In consideration of [customer's name]'s accepting the rate as set by the Guernsey Competition and Regulatory Authority (the **GCRA**) in Final Decision [Ref], the [customer's name] undertakes to reimburse Guernsey Electricity Limited (**GEL**) to the extent that over the relevant period the GCRA determines that a higher rate for standby charges should have been set following the GCRA's receipt of a full review on the same tariff.*

*GEL further agrees to reimburse the [customer's name] to the extent that over the relevant period the GCRA determines that a lower rate for standby charges should have been set following the GCRA's receipt of a full review on the same tariff.*

*In either case the amount to be reimbursed is the difference in the charges which would have been applied if the finally determined rate had been applied over the relevant period and that which was actually charged in the relevant period in accordance with Final Decision [Ref].*

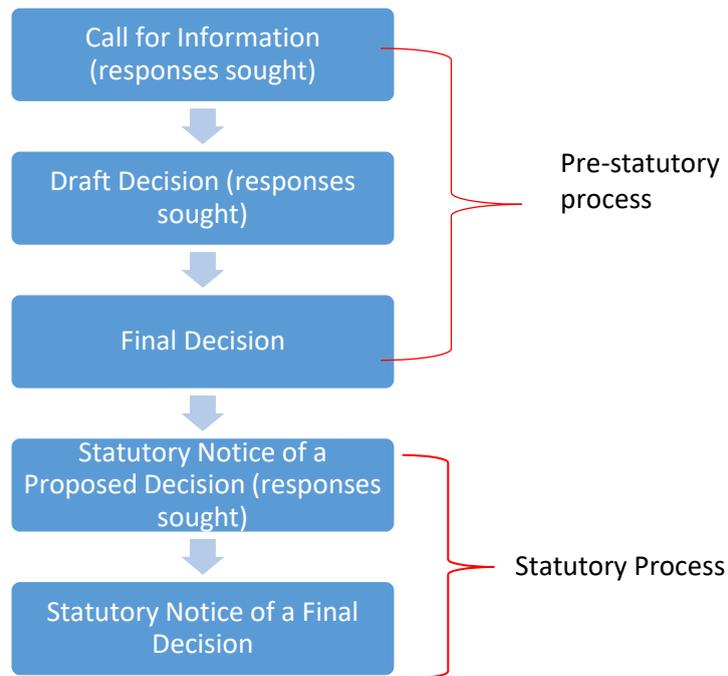
*For the purposes of this agreement, the relevant period shall be defined as the date from which the rate as set in the Final Decision [Ref] is charged to [customer's name] until the new rate as set by the GCRA is charged to [customer's name]."; and*

4. For the avoidance, nothing in this direction is intended to preclude GEL from entering into an arrangement with any customer or other party which sets a charge to cover the provision of a standby service at any lower or higher rate, fixed for any period, if the parties were to agree to such a charge between themselves.

The directions shall be deemed to have come into effect on specified calendar days after the Statutory Notice of a Final Decision is issued, and shall expire following further direction on the rate to be applied.

## 8. 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 to be followed in Guernsey. The pre-statutory process consists of a Call for Information, a Draft Decision and a Final Decision. Responses are sought from stakeholders at the Call for Information and Draft Decision stage, following which a Final Decision is issued. This paper is thus the final stage of the pre-statutory process.

Before carrying out certain regulatory functions, following the pre-statutory process the appropriate Guernsey statutory process is followed.<sup>1</sup> In Guernsey a decision determining the maximum level of standby charges requires the statutory process to be followed.<sup>2</sup>

Accordingly, the GCRA will now proceed 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.

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

<sup>2</sup> Sections 5(4) and 5(5) of The Electricity (Guernsey) Law 2001