P.2021/65

THE STATES OF DELIBERATION
of the
ISLAND OF GUERNSEY

POLICY & RESOURCES COMMITTEE, COMMITTEE *FOR* ECONOMIC DEVELOPMENT AND STATES' TRADING SUPERVISORY BOARD

GUERNSEY ELECTRICITY – INTERIM ARRANGEMENTS FOR TARIFF REGULATION

The States are asked to decide:-

Whether, after consideration of the policy letter 'Guernsey Electricity - Regulation' dated 18th May, 2021, they are of the opinion:-

1. To agree that the Guernsey Competition & Regulatory Authority's current responsibilities for determining the tariffs and prices charged by Guernsey Electricity Ltd for the supply of electricity should be transferred to the States' of Guernsey, acting by and through the States' Trading Supervisory Board;

2. To issue a States Direction to the Guernsey Competition & Regulatory Authority that, in undertaking its responsibilities under the Electricity Law, 2001, it should ensure its actions and decisions are consistent with and support the implementation of the States' extant Energy Policy and Electricity Strategy and, in particular, reflect the Energy Policy's focus on: establishing targeted competition to support establishing on-island (including off-shore) renewable energy; and, facilitating a competitive energy supply market using shared critical infrastructure;

3. To direct the preparation of such legislation as may be necessary to give effect to the above decisions.

The above Propositions have been submitted to Her Majesty's Procureur for advice on any legal or constitutional implications in accordance with Rule 4(1) of the Rules of Procedure of the States of Deliberation and their Committees.

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POLICY & RESOURCES COMMITTEE, COMMITTEE *FOR* ECONOMIC DEVELOPMENT AND STATES' TRADING SUPERVISORY BOARD

GUERNSEY ELECTRICITY – INTERIM ARRANGEMENTS FOR TARIFF REGULATION

The Presiding Officer
States of Guernsey
Royal Court House
St Peter Port

18th May, 2021

Dear Sir

1 Executive Summary

1.1 The Energy Policy[1] adopted by the States in 2020 established a policy framework for the effective management of Guernsey's energy needs over the period 2020-2050. It set out high-level policy direction to enable the States to manage the global transition to decarbonisation in the energy market at a local level. This policy letter proposes some interim arrangements in relation to both Guernsey Electricity's (GEL) tariffs and the licencing of the Island's electricity sector to enable that transition whilst the States develops and puts in place some of the detailed strategies and policies that are required to support the delivery of its Energy Policy.

1.2 The Energy Policy established emissions reduction targets for Guernsey which it anticipated would be achieved partially by facilitating targeted competition within the electricity market to potentially enable additional and local renewable or low carbon energy operators to serve the market. Two of the key work streams identified as being necessary to support that were as follows: firstly, the introduction of a licensing framework to support establishing on-island renewable energy generation; and, secondly, ensuring that cost-reflective tariff systems are put in place across all forms of energy supplies in order to provide greater clarity for investment by energy suppliers and greater transparency for consumers when choosing what to buy.

[1] Article 8 of Billet d'Etat XI of 2020: States of Guernsey Energy Policy 2020-2050

1.3 The Energy Policy envisages that Guernsey Electricity (GEL) will play a fundamental role in supporting the energy market transition, in particular by: continuing to invest in a conveyance and supply network that can sustain the forecast increase in electricity consumption; and, the development of a second subsea cable direct from Guernsey to France which has been agreed in principle by the States[2]. However, decisions on such investments need to be underpinned by clarity in the future regulatory environment under which GEL will operate.

1.4 Historically, GEL has been subject to sector specific economic regulation by the Guernsey Competition and Regulatory Authority (GCRA). This policy letter sets out the regulatory vacuum that has existed in the electricity market following a review of that historic regulation which began in 2012. As a result, there has been no comprehensive review of GEL's tariffs since that time, even though it has invested over £115m in Guernsey's electricity infrastructure over that period. The regulatory uncertainty is likely to continue until the States puts in place the aforementioned new system of licensing for the electricity market. It is not expected that work on that system (and any new legislation that may be required) will be completed until at least 2023. However, GEL now needs to start generating additional revenues to enable it to continue investing in the electricity infrastructure at the level required to support the energy transition and the Island's new Energy Policy.

1.5 This policy letter also sets out a case for both a restructuring and rebalancing of GEL's current tariffs as a high priority to support the objectives of the Energy Policy. These exercises will be undertaken on a revenue neutral basis for GEL.

1.6 A restructuring process will ensure its tariffs properly reflect the fixed and variable costs incurred by the Company in accordance with the Energy Policy. Its current tariffs are distorting and misleading the market place by overstating the unit costs of the electricity it supplies and understating the fixed costs. This must be addressed before the electricity generation market is opened up to more competition.

1.7 A rebalancing exercise will enable GEL to offer a range of "innovative" and more flexible tariffs that take advantage of the times when cheaper imported renewable electricity is available. Not only should this drive behavioural change amongst consumers in support of the Energy Policy, but it will also benefit the community by reducing the average unit cost of electricity consumed.

[2] Article 8 of Billet d'Etat XI of 2020 - States of Guernsey Energy Policy 2020-2050: Resolution 8: To approve the cable strategy set out in 8.17 and agree in principle the need for a second interconnector, subject to the consideration of a full business case; and to direct the States Trading Supervisory Board via Guernsey Electricity Limited to revert to the States of Deliberation with the full business case.

1.8 The Policy and Resources Committee (P&RC), the Committee *for* Economic Development and the States' Trading Supervisory Board (STSB) (hereinafter referred to as the joint Committees) believe that a pragmatic and proportionate solution is required on an interim basis until the new licensing framework is in place. This must enable a comprehensive review of GEL's tariffs to be undertaken in support of the Energy Policy whilst allowing time for policy proposals and legislation to be brought forward to establish a new licensing framework for electricity market. The joint Committees do not believe that reverting to the historic system of regulation should be an interim option, as this would necessarily involve spending time addressing the concerns that were previously identified by the aforementioned review with that system, when the focus should be on looking forward to the development of the new licensing system.

1.9 Accordingly, this policy letter includes proposals for the approval of GEL's tariffs by the States, acting by and through the STSB, on an interim basis and pending the subsequent development and agreement by the States of a new licensing framework for the electricity market. It also includes proposals for States Directions to be issued to the GCRA to ensure that the current regulation of the electricity market is consistent with the Energy Policy following the end of GEL's licence exclusivity in the supply and conveyance markets on 31st January, 2022.

2 Background

2.1 <u>Legal and Regulatory Framework</u>

2.1.1 GEL is a commercialised utility established as a States Trading Company under the provisions of the States Trading Companies Law, 2001. The States' Trading Supervisory Board ("STSB") acts as shareholder in the Company on behalf of the States of Deliberation.

2.1.2 Under the provisions of both the Regulation of Utilities Law, 2001, and the Electricity Law, 2001, GEL has been subject to economic regulation by the GCRA. The GCRA exercises its duties in respect of GEL with reference to: firstly, the same General Duties[3] that are set out for both the Authority itself and the States in the Regulation of Utilities Law, 2001; and, secondly, in accordance with any Directions that the States may give to the Authority, the provision and scope for which are set out under that Law[4].

2.1.3 The electricity market in Guernsey is regulated by the GCRA in three distinct areas: generation; conveyance; and, supply. A licence is required in each area unless the scope of the activity concerned falls within the terms of a licence

[3] Section 2 – General Duties - The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001;
[4] Section 3 – States Directions - The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001.

exemption established by the GCRA. GEL is licensed in each area and, in the case of the supply and conveyance markets, has protected licence exclusivity under Direction from the States[5] at least until 31st January 2022 (albeit that exemptions from the requirement to hold a supply licence are available to other operators). GEL does not have licence exclusivity in the generation markets.

2.1.4 The legal and regulatory framework set out above includes the following provisions in respect of pricing and tariffs:

- Under section 2 of the Regulation of Utilities Law, 2001, **both** the States and the GCRA have a duty to promote and balance objectives that include: firstly, protecting the interests of consumers and other users in the Bailiwick in respect of prices charged for utility services; and, secondly, securing, so far as practicable, the provision of utility services that satisfy all reasonable demands for such services within the Bailiwick;

- Under section 12 of the Electricity Law, 2001 (and subject to some provisos set out within that Law) the prices charged for electricity by the holder of an electricity supply licence have to be in accordance with tariffs approved beforehand by the GCRA; and,

- The licence issued to GEL by the GCRA includes provision for the Authority to determine the maximum level of charges that GEL may apply and, in certain circumstances, provides for the Authority to require GEL to change the charges that it is levying. Section 5 of the Electricity Law, 2001, enables the GCRA to include such conditions in the licences that it issues where the licensee has a dominant position in the market concerned.

GEL is currently the only energy supplier in Guernsey's gas, oil or electricity market whose tariffs are subject to the specific prior approval of the GCRA. Whilst a licence to generate electricity has previously been granted to the International Energy Group[6] (IEG), it is not required to hold an electricity supply licence as a result of the aforementioned licensing exemptions established by the GCRA and, as such, its tariffs do not have to be approved by the Authority.

2.1.5 It should be noted that the summary set out above only includes legislation and provisions that are specific to the electricity sector. In addition, and like its competitors, GEL must also comply with the "general" competition legislation[7] that was separately introduced by the States several years after the electricity sector laws. The competition legislation includes the prohibition of practices that

[5] Resolution 11 of Article XIV of Billet d'Etat XV of 2011 – Review of Utility Regulation
[6] Now the Islands Energy Group
[7] The Competition (Guernsey) Ordinance 2012

are either an abuse of a dominant market position and/or are anti-competitive, including those involving the imposing or fixing of prices.

2.2 Review of Regulation

2.2.1 In 2015, the States considered a policy letter[8] jointly submitted by the former Treasury & Resources (T&R) and Commerce & Employment (C&E) Departments (the Departments) that included proposals to exempt both GEL and Guernsey Post (GPL) from the requirement to be licensed by the GCRA. This followed a review process initiated by both Departments in 2012. One of the principal reasons for that review was to ensure that the oversight arrangements represented value for public money. The review sought to consider the overall impact, cost, effectiveness and added value derived from the current system and whether a model of 'lighter touch' regulation was possible, taking into account that both companies were owned by the States of Guernsey.

2.2.2 Having considered the matter, the States did resolve to exempt both GEL and GPL from the requirement to be licensed by the GCRA. In tandem with that decision, it was agreed that the former T&R should expand and strengthen its role and capability as sole shareholder in both companies. It would take a more proactive role in exercising its responsibilities than had previously been the case through, for example, the establishment of clear shareholder objectives for the companies and the monitoring of performance against industry benchmarks and quality standards. Importantly, it was also intended that T&R would be responsible for the approval of tariffs in future, rather than the GCRA. Those decisions were reflected in the subsequent decision of the States to establish the STSB as a new Committee of the States in 2016, which included within its mandate responsibility for acting as shareholder in GEL and GPL.

2.2.3 In 2016, the States also approved follow-up proposals[9] from the former C&E setting out the detailed legislative amendments and consequential matters that would be necessary to implement these changes in the regulatory arrangements for GEL and GPL. Whilst work on the drafting of that legislation had reached an advanced stage by mid-2017, a number of factors meant that it was not finalised. These included:

- A decision by the GCRA in 2017 to approve an application from IEG for an electricity generation licence. The proposals approved by the States in 2015 and 2016 had not anticipated the existence of a second licensee in the electricity generation sector, meaning that additional drafting instructions would be required from the States before the legislation could be finalised;

[8] Article 3 of Billet d'Etat VI of 2015: Alternative Framework for the Oversight of GEL and GPL
[9] Article 17 of Billet d'Etat III of 2016: Legislative Changes Relating to the Future Oversight of GEL & GPL

- A need to review the market and regulatory structures within the electricity sector as plans evolved in 2018 for the extension of the UK's membership of the World Trade Organisation (WTO) to the Bailiwick. There was a risk that exempting GEL from the requirement to be licensed, whilst leaving a licensing regime in place for the rest of the market, would not be compliant with the obligations that WTO membership would bring; and,

- The work that was then being initiated by the Committee *for the* Environment & Infrastructure (CfE&I) for a new Energy Policy. At an early stage in that process, it was evident that the emerging policy might need some form of alternative licensing within the local energy market to support the delivery of the new policy's objectives.

2.2.4 As a result of the above, the resolutions agreed by the States in 2015/16 were never implemented. However, the resolutions were not rescinded until June, 2020, when the States agreed a new Energy Policy. That policy sets out a pathway to agreeing a new licensing framework for the electricity and wider energy sectors, albeit the details remain to be determined (see section 2.3 below).

2.2.5 The unfortunate consequence of all the above is that there has been a regulatory vacuum since 2012 for all key stakeholders, most especially GEL and the GCRA. This has inhibited and/or delayed a number of key operational and strategic decisions that need to be made by GEL, most notably in reviewing its tariff structures. There is a pressing need to ensure its tariffs are aligned with both the States' new Energy Policy and the energy market transition that is central to it so that the Island is well placed to decarbonise by taking full advantage of technological advances, particularly in renewable generation, electric vehicles and energy storage.

2.3 Energy Policy

2.3.1 In 2020, the States considered a policy letter from the CfE&I on a new Energy Policy. One of this policy letter's main conclusions was that a licensing framework in the energy sector would be required to support the development of on-island (including offshore) renewables. The policy letter did not specify either what that licensing framework or who the regulator should be, albeit it did stress that the licensing framework should be appropriate, proportionate and cost-effective.

2.3.2 Having considered the policy letter, the States resolved[10], inter alia, to direct the Committee *for* Economic Development (CfED) to undertake a technical consultation on a licensing framework for targeted competition to support

[10] Resolution 6 of Article 8 of Billet d'Etat XI of 2020

establishing on-island renewable energy and to report back to the States by the end of 2021. It was acknowledged that this work would supersede the States' previous resolutions in 2015 and 2016 in respect of the future regulation of GEL. Accordingly, the States also resolved[11] to rescind those previous resolutions insofar only as they related to GEL (noting that the resolutions in respect of GPL remain in place), thereby enabling the CfED to carry out work on a new licensing framework afresh and without the outcome being partially pre-determined.

2.3.3 The policy letter acknowledged that provision would need to be made to ensure that GEL could continue to maintain electricity supplies whilst awaiting a new licensing framework and recognised that the CfED might need to bring proposals to the States to enable this to happen if it was not possible to issue licences under the new licensing framework in sufficient time. It also acknowledged that any new market structures would need to be compliant with the Bailiwick's future trading relationships (such as the WTO).

2.3.4 The timelines envisaged in the Energy Policy were established prior to the onset of the COVID-19 pandemic and, whilst it had originally anticipated that the CfED would be in a position to report back to the States with its proposals for a new licensing framework by the end of 2021, this is no longer realistic. The Policy also anticipated that the new framework would require the introduction of new or amended legislation and, whilst it is an identified priority of the new Government Work Programme, it is unlikely to be complete before the end of 2023.

2.3.5 This work stream provides an important opportunity to examine whether the legislation for the electricity market can be rationalised, bearing in mind there are now three different regulation regimes that are potentially in scope, as follows:

- Firstly, the current sector specific regulation of GEL (and the wider market) by the GCRA under the aforementioned 2001 Electricity Law;
- Secondly, the Competition Ordinance introduced by the States in 2012, which now precludes pricing practices deemed to be anti-competitive or an abuse of a dominant position; and,
- Thirdly, the new licensing framework for the electricity market envisaged under the Energy Policy.

For example, given the stated focus in the Energy Policy on ensuring that regulation of the market is appropriate, proportionate and cost-effective, work on the development of a new licensing framework could include evaluating how the newer competition legislation might be used or modified to support the delivery of the Policy's objectives and whether that could also provide an alternative (partial or otherwise) to the current and older model of regulation

[11] Resolutions 17 & 18 of Article 8 of Billet d'Etat XI of 2020

under the Electricity Law.

2.3.6 This policy letter is concerned with the regulation of GEL's tariffs and, as such, it should be noted that the Energy Policy recognised some issues of fundamental importance in this area. The Policy stressed the importance of ensuring that a cost reflective tariff system must be put in place across all forms of energy supplies. Tariffs would need to be consistent and transparent in areas including: the costs of energy commodities themselves; the costs of the arrangements put in place for maintaining adequate security of energy supplies for the Island; and, customer and other services. The Policy's stated outcome was that costs must be properly reflected in tariffs and must be recoverable by energy providers. This would ensure greater clarity for investment by both existing suppliers and new market entrants, whilst providing customers with transparency in respect of what they choose to pay for.

2.3.7 In GEL's case, the issue of cost reflectivity in its tariffs will become of even greater importance as the electricity market is developed to encourage additional competition in local renewable generation in accordance with the Energy Policy. GEL's cost base is split almost 50:50 between fixed and variable costs, but this is not reflected in its tariff structures, where approximately 10% of its revenues are generated through fixed charges and 90% through its variable charges. This means that the unit costs of electricity supplied by GEL compare poorly with the unit costs of alternative suppliers of renewable generation that might be available now or in the future, as fixed costs are being recovered through the variable charges. Reform of its tariff structures is therefore essential to ensure that the Company can compete on a level playing field in the future and must be a pre-requisite to the introduction of additional competition in the market.

2.3.8 Therefore, in agreeing the Energy Policy, the States also resolved[12] to direct the CfED to undertake a review of structures for cost reflective tariffs (including fixed and variable costs) and to bring proposals to the States of Deliberation by the end of 2020 (noting again that this timeline was established prior to the full onset of the COVID-19 pandemic). The Policy's intended outcome of this work is that there should be an open and level playing field for competition in the electricity generation and wider energy markets and that prospective investors in renewable generation should be able to fully understand all the associated connection and power purchase arrangements.

3 Guernsey Electricity – Tariffs

3.1 GEL supports the commitment within the Energy Policy to establish a new licensing arrangement that will enable the development of a market structure that is fully aligned to the Policy's objectives. In conjunction with that work, it

[12] Resolution 12 of Article 8 of Billet d'Etat XI of 2020

also believes it remains critical to establish how costs should be recovered through tariffs that are transparent and properly reflective of those costs.

3.2 From GEL's perspective, the need for certainty about its future regulatory environment is of critical importance. Without that, it cannot plan effectively the long-term investment programme in the Island's electricity infrastructure that is necessary to support the energy market transition and to fulfil the role that the Energy Policy envisages for the Company in supporting and delivering its objectives.

3.3 The immediate importance of these work streams to the Company is best illustrated by the very difficult challenges GEL is facing today as a result of the regulatory vacuum that has existed since the aforementioned review of regulation that started in 2012 (see section 2.2 above) and which will continue until new licensing arrangements are agreed by the States. These challenges are discussed in more detail in sections 3.4 and 3.5 below.

3.4 Financial Performance and Investment Planning

3.4.1 The regulatory vacuum has meant that, since 2012, GEL has operated in an environment where it has had no long-term mechanisms in place that allow it to control and plan its future revenues and, as a result, the business has been unable to build up financial reserves in a consistent manner to support its investment planning.

3.4.2 The last full regulatory review of GEL's prices was undertaken by the GCRA in 2011. Since then, there has been no full and fundamental review of the Company's tariffs, with the exception of:

- A tariff increase in 2012 to address only the increased costs being incurred by GEL in on-island generation arising from the failure of the sub-sea cable between Guernsey and Jersey (GJ1) that year;

- Two separate and temporary "cost pass throughs" (CPTs) enabling GEL to recover uncontrollable costs relating to movements in foreign exchange rates and commodity prices between 2017 and 2020. The first of these was for 6.8% with effect from 1st July 2019 and the second was for 4.8% with effect from 1st September 2020. These apply to tariffs across the board, but are time limited and will expire in each case after three years.

Beyond the above, GEL has been unable to effectively adjust its tariffs and revenues to take account of any other changes in the underlying costs of the business, inflation or other. Since 2011, this has included a capital investment programme of over £115m, including: the replacement of the GJ1 cable; investments in additional importation capacity to the Channel Islands through the Channel Islands Electricity Grid's N1 and N3 cable projects; and, the investment in two new medium speed diesel generators, enabling it to continue meeting peak demand requirements and its obligations under the N-2[13] security of supply policies previously agreed by the States.

3.4.3 GEL currently has borrowings of £44m. This is made up of £33m in commercial borrowings and an £11m loan from the States of Guernsey bond (primarily used for the replacement of the GJ1 cable). The annualised cost of servicing this debt is circa £2.6m and this has the effect of reducing funds that would otherwise be available for reinvesting in the business by 25%. Without changes to its tariffs, the Company does not believe any further increase in borrowing is sustainable. Had GEL been able to adjust its tariffs in order to recover the agreed level of return on its regulated asset base previously determined by the GCRA, its cash position would currently be £30m better than it is today.

3.4.4 Despite a range of cost-cutting and efficiency measures introduced by the Company, GEL's financial performance is below the level required to continue funding the necessary investment in the Island's electricity infrastructure to support the energy market transition. The position has been exacerbated by the need to bring forward the replacement of the GJ1 cable by approximately 10 years following its failure in 2018. The Company's long term investment programme anticipates expenditure of £12½m per annum, but in the last financial year, it was only able to reinvest £4.6m[14]. The agreement and implementation of a forward-looking tariff model is now more pressing than ever to support a capital programme that can be properly funded.

3.5 <u>Tariff Structures and Cost Reflectivity</u>

3.5.1 Of equal importance for the Island's new Energy Policy is to ensure that GEL's current tariffs are both "rebalanced" and "restructured".

3.5.2 Guernsey Electricity's tariff structure has not significantly changed since 1993, when the Island was entirely dependent on local oil-fired generation at the power station and when hourly generation costs were relatively static. Since then, the Island has moved to a reliance on renewable electricity imported from the European grid, which now satisfies more than 90% of annual demand. Under the Power Purchase Agreements that are now in place for those imports, GEL has access to renewable electricity from Europe at costs that can vary depending on the time of day, the day of the week and the time of the year.

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[13] The N-2 criterion requires GEL to ensure that it has sufficient generating plant to meet maximum demand ("N") with its two largest sources of supply (excluding the subsea cable) simultaneously unavailable

[14] Figure of £4.6m is derived on a pro-rata basis from expenditure of £7m for the 18 month period ending 30th September, 2020.

3.5.3 There is a substantial opportunity to "rebalance" the company's tariffs so that they are aligned with the variable costs of imported renewable electricity. This would enable GEL to offer a range of "innovative" and more flexible tariffs that take advantage of the times when cheaper imported renewable electricity is available in order to drive behavioural change amongst consumers in support of the Energy Policy and to drive forward the energy market transition in Guernsey. For example, tariffs could be offered to encourage the use of electric vehicles or to switch to renewable or lower carbon sources of energy, particularly in the decarbonisation of heating. Additionally, lower weekend tariffs might be offered to encourage customers to switch activities that they might previously have carried out on weekdays after work (typically a peak period) to weekends. The alignment of tariffs with the costs of imported electricity will also enable GEL to encourage usage at times when there is a greater level of spare capacity on the subsea cable, thereby reducing the need to run the on-island power station.

3.5.4 There is also a pressing requirement to undertake a "restructuring" of GEL's current tariffs to ensure that they properly reflect the Company's underlying cost base. The Energy Policy sets out the importance of ensuring tariffs across the energy market are properly reflective of costs (see section 2.3 above) and, as a result, directed the CfED to report back to the States with proposals to address this matter across the energy market. However, in GEL's case, there is an immediate need to address this matter, as its current tariff structures are distorting and misleading the market place.

3.5.5 GEL's tariffs do not currently reflect the fixed and variable cost structures of generating, supplying and conveying electricity. As set out earlier in this policy letter, its cost base is split approximately 50:50 between fixed and variable costs. However, only circa 10% of its revenues are generated through fixed charges and 90% through its variable charges. Within the context of the new Energy Policy, this has two important consequences.

3.5.6 Firstly, GEL's fixed cost base is primarily determined by the infrastructure it needs to have in place to satisfy the Island's peak maximum demand (typically early on a cold winter's evening). With the energy transition, that peak demand will increase as more customers switch to electric heating, electric vehicles and so forth. As a consequence, the capacity of the network will have to be increased in order to meet that maximum demand, even if that capacity is not being used all of the time. The energy transition will see the continuing emergence of new technologies, such as solar PV, wind and battery storage, which offer consumers the opportunity to self-generate and store energy for their own use. However, whilst this will lead to a reduction in the consumption of electricity sourced from the grid (ie GEL), it will not result in a corresponding sized decrease in maximum demand. As 90% of GEL's revenues are generated through its variable charges, the fall in consumption will leave GEL with insufficient income to maintain the secure and resilient network on which the Island will be increasingly dependent and which is required to meet maximum demand.

3.5.7 The second consequence of the current tariff structures is that the variable charge does not properly reflect the cost of each unit of electricity being consumed and, indeed, substantially overstates that cost. By way of illustration, the standard domestic tariff unit charge of electricity[15] levied by GEL is 19.78 pence per kilowatt hour (kWh). This compares to an average cost of generation of c7 pence per kWh. If one takes into account GEL's two part tariffs, which have a higher daytime normal rate, then the differential is even higher. It is essential that this imbalance is corrected at as early an opportunity as possible. The current tariffs are sending misleading signals to the market place and, specifically, to customers thinking about investing in renewable and storage technologies, by overstating the actual unit costs of electricity that GEL is providing. For example, a customer thinking about investing in solar panels today might base that decision on payback calculations based on offsetting tariffs that are currently overstating the real unit costs of electricity that GEL can provide and without fully understanding the fixed costs of providing and maintaining the electricity infrastructure on which they will continue to rely when their own renewable electricity supplies are either unavailable or insufficient for their needs.

3.5.8 These are real issues that are already affecting Guernsey's electricity market today. They underline the importance of providing complete transparency to all electricity customers of both the fixed costs of providing reliable and secure electricity for the Island and the true variable costs of generating that electricity from the different available resources. GEL does have the ability under the aforementioned Electricity Law to enter into "bespoke" commercial agreements with customers that sit outside of its published and regulated tariffs. It has started introducing such arrangements with its largest commercial customers to start mitigating the risks that the current tariff structures are creating. These agreements represent a positive step towards a fairer pricing system because it means that those larger customers are making an appropriate contribution to the fixed costs of the infrastructure they require and that the remaining smaller domestic customer base are not unfairly subsidising them. However, the situation can only be properly resolved with a full restructuring of GEL's current tariffs.

4 Regulation of Tariffs – Interim Proposals

4.1 The regulatory vacuum and uncertainty that has existed since 2012 and which will continue until the States adopts new proposals for the licensing of the electricity and wider energy markets is not only prejudicing GEL's ability to invest in the infrastructure required to support the Island's transition, but it is also

[15] The equivalent of the standard variable charge

sending misleading signals to the market place. Without a restructuring of GEL's tariffs, the consumers of today and tomorrow will: firstly, continue picking up the unrecovered fixed costs of the infrastructure enjoyed by yesterday's customers; and, secondly, will effectively be subsidising the fixed costs of remaining connected to the grid for those customers who have invested in, for example, solar renewables. These latter customers would have made those investment decisions based on tariffs that do not properly reflect the fixed and variable costs of the electricity they consume today.

4.2 The work being undertaken by the CfED on both a new licensing system and cost-reflective tariffs in the wider energy market should address these issues for the longer-term in due course. However, there is today an immediate need to address GEL's tariffs to ensure that: firstly, the Company's tariffs are structured in such a way to support the energy transition that has already started; and, secondly, it can fulfil the role that the Energy Policy envisages the company will provide in future by investing in and providing the secure and resilient electricity infrastructure that the Island needs. For example, this includes: an on-island conveyance network that can sustain the forecast increase in electricity consumption; and, the development of a second subsea cable direct from Guernsey to France which has been agreed[16] in principle by the States as part of the cable strategy included within the Energy Policy.

4.3 The current regulatory system for the electricity market has been largely dormant since 2012. Whilst that system could now be used to address the issues relating to GEL's tariffs, the joint Committees do not believe this is the best approach for several reasons:

- Firstly, reactivating that regulatory system in full would require the investment of resources by both the GCRA and GEL at a time when the focus should be on supporting the CfED on the development of a new licensing framework as a matter of high priority;

- Secondly, whilst the resolutions agreed by the States in 2015/16 relating to the previous review of regulation have been rescinded to enable the CfED to progress with the development of a new licensing framework, it does not follow that the issues and concerns about that older regulatory system that were identified at the time have been resolved, particularly in relation to its cost and proportionality. The joint Committees believe those issues and, in particular, the previous price control mechanism for tariff setting, would need to be addressed if the system was to be fully reactivated. Resolving this

[16] Resolution 8 of Article 8 of Billet d'Etat XI of 2020: To approve the cable strategy set out in 8.17 and agree in principle the need for a second interconnector, subject to the consideration of a full business case; and to direct the States Trading Supervisory Board via Guernsey Electricity Limited to revert to the States of Deliberation with the full business case.

single issue could take some significant time as no price control has been carried out since 2011. However, rather than investing resources in looking backwards, they believe that the focus should be on the development of the new modern licensing framework envisaged by the Energy Policy, acknowledging the commitments given therein that this should be proportionate and cost-effective; and,

- Thirdly, many of the issues that will need to be taken into consideration in reviewing GEL's tariffs involve factors that go beyond the principles of economic regulation that are typically involved in the current regulatory system. For example, shaping tariffs to ensure they support the Island's environmental objectives and encourage change in consumer behaviour would be one such factor. There will also be issues of social equity to take into consideration by, for example, considering how all customers can benefit from renewables, rather than just those who can afford the upfront capital investment that can often be required. In addition, the restructuring of GEL's tariffs to ensure that its standing charges properly reflect its fixed costs will have to address the impact on customers who only consume low levels of electricity and will not see corresponding savings in their variable charges that fully offset the increase in their standing charge. This may require consideration of social policy interventions.

4.4 Therefore, the joint Committees believe that there is a requirement to put in place an alternative interim arrangement that enables the issues around GEL's tariffs to be addressed whilst providing the CfED with the time to develop and bring forward policy proposals and, then, legislation for a new licensing framework. It is therefore proposed that responsibility for determining GEL' electricity prices and tariffs should be transferred from the GCRA to the States, acting by and through the STSB, on an interim basis and pending the agreement of a new licensing framework for the electricity sector, which may or may not include alternative provision for the future regulation of prices and tariffs.

4.5 The following factors have been taken into consideration in proposing this approach:

- It would mirror the arrangements that are in place for a number of the States' other trading businesses, where fees and charges are determined by the STSB. These include the Ports, Guernsey Waste, Guernsey Water and Guernsey Dairy;

- The States would, through the STSB, retain control of GEL's prices and tariffs, enabling them to ensure that they were aligned with its environmental and other policy objectives;

- To the extent that it should be necessary until a new licensing framework is determined, the GCRA could continue to exercise the other regulatory responsibilities for which it is currently responsible under the Electricity Law, 2001, such as service standards, and charge GEL such licence fees as may be necessary to fund the cost of that residual work. Such an arrangement is not uncommon; indeed, whilst the STSB is responsible for determining the tariffs charged by the Ports, Guernsey Waste, Guernsey Water and Guernsey Dairy, each of those businesses is also subject to some form of external independent qualitative regulation (for example, by the Civil Aviation Authority or the Office of Environmental Health & Pollution Regulation);

- These arrangements can be implemented without compromising the Bailiwick's WTO obligations, which are principally concerned with issues of market access, not the mechanisms for the approval of electricity tariffs and prices.

Whilst some legislation will be required to give effect to the above proposals, it is anticipated that this will be relatively minor in nature and should involve only amendments to the Laws set out in section 2.1 above. Amendments to those Laws can be made by Ordinance and do not require an Order in Council. In the event that those Laws are amended, then the GCRA would have to make some consequential amendments to the licences it has issued to GEL.

4.6 In the event that the States approves these proposals, then it would be the STSB's intention to adopt a phased approach to working with GEL to review its tariffs and prices.

4.7 The first priority would be to undertake the restructuring and rebalancing of GEL's tariffs. Restructuring the tariffs at an early opportunity is essential, given the misleading and distorting effect that the current tariffs are having on the market place and the energy transition. The second priority would be to rebalance the tariffs, given the opportunities this presents to align them with the variable cost of electricity that is available through its Power Purchase Agreements and to offer more innovative tariffs as a result. These initiatives should be revenue neutral for GEL, but do offer the opportunity to reduce the average unit cost of electricity consumed in the Island by encouraging use of imported electricity at times when it is cheaper.

4.8 The third priority will be to review the tariffs so that GEL can start generating additional revenues to enable it to continue investing in the electricity infrastructure at the level required to support the energy transition and the Island's new Energy Policy. The intention would be to ensure that any increases in tariffs are presented as part of a smooth tariff evolution strategy over a transitional period, thereby avoiding any price shocks for the market, particularly as the Island's economy recovers from the COVID-19 pandemic.

4.9 It is important to note that key safeguards will remain in place under the proposed arrangements, as follows:

- Under the provisions of the Regulation of Utilities Law, 2001, the States are already and will remain under the same statutory obligation as the GCRA to promote (and balance) objectives which include: firstly, protecting the interests of consumers in respect of prices; secondly, securing the provision of utility services that satisfy all reasonable demands within the Island; and, thirdly, ensuring that utility activities are carried out in such a way to best serve the economic and social development and wellbeing of the Island; and,

- In developing its tariff proposals for consideration by the STSB, GEL would still have to comply with the requirements of the Competition (Guernsey) Ordinance, 2012 (and associated legislation), including its provisions on the prohibition of practices that are either an abuse of a dominant market position and/or are anti-competitive. This legislation was not in existence when the Electricity Law and current system of regulation was originally introduced.

The STSB's policy is that GEL should be operated on a "not for dividend" basis and that any profits earned by the Company should be either re-invested in the business for the benefits of customers and the Island's environment or "returned" to customers by freezing (or even reducing) tariffs.

4.10 In exercising its proposed responsibilities in respect of GEL's tariffs, the STSB anticipates that it will need to commission external assurance to assist it in determining the Company's future tariffs. The cost of any such assurance would, quite properly, be met by the Company. However, the STSB anticipates that this would be offset by a reduction in the licence fees that GEL pays to the GCRA, which have been set by the Authority at £180,000 in 2021 (£120,000 in 2020).

5 Supply & Conveyance Licences

5.1 Under the provisions of the Regulation of Utilities Law, 2011, the States has the authority to give Directions to the GCRA. Section 2.1 above notes that, in the case of the supply and conveyance markets, GEL has protected licence exclusivity under Direction from the States to the GCRA at least until 31st January 2022 (albeit that exemptions from the requirement to hold a supply licence are available to other operators). GEL does not have licence exclusivity in the generation markets.

5.2 Under the terms of the legislation, the term "conveyance" covers the transportation of electricity from the generating station to the final substation. This is closely aligned to GEL's high voltage (HV) network. The term "supply" encompasses Guernsey Electricity's low voltage (LV) cabling that is provided between the final substation and the property receiving the electricity. In a small number of cases, supply activities can also encompass elements of the HV network, as some customers are supplied with HV directly. The breakdown of GEL's current network is approximately one third HV and two thirds LV. Therefore, GEL's licensed "supply" activities extend beyond simply the retail arrangements it has in place for the sale of electricity to its customers, but also involves the provision and maintenance of the substantial proportion of the Island's electricity network.

5.3 In accordance with the Energy Policy, the CfE&I will be bringing forward proposals in due course for an update to the Island's Electricity Strategy. It is anticipated that this Strategy will include recommendations on the establishment of a target for the generation of on-island renewable energy. In doing so, it could identify what additional detailed policies the States could put in place to facilitate more adoption of local renewable electricity. These might include: changes to the electricity market structures; adapting tariffs to incentivise the development and adoption of local renewable energy; and/or, changes to the "merit order" under which GEL is currently required to operate[17].

5.4 In considering the future market structures, the updated Electricity Strategy will provide an opportunity for the States to consider how the development of local renewable electricity relates to the States' current N-2 security of supply requirements under which GEL is currently required to operate, noting that a key pillar of the Energy Policy is that all suppliers should in future share responsibility for security within a more open energy market.

5.5 It is anticipated that the updated Electricity Strategy will be submitted to the States for consideration by the CfE&I by or during the third quarter of 2022. However, with GEL's exclusivity in the supply and conveyance markets ending before then on 31st January, 2022, the States need to consider what guidance should be issued to the GCRA in respect of its licensing responsibilities from that point and until any new licensing framework is adopted by the States.

5.6 It is therefore recommended that a States' Direction should be issued to the GCRA that, in undertaking its responsibilities under the Electricity Law, 2001, it should ensure its actions and decisions are consistent with and support the implementation of the States' extant Energy Policy and Electricity Strategy and, in particular, reflect the Energy Policy's focus on: establishing targeted

[17] The merit order ranks the electricity sources available to GEL for dispatch into the network and is based solely on their ascending order of price (such that the cheapest must always be dispatched first). Changes to the merit order could require a greater weighting or priority to be given to the dispatch of locally generated renewable electricity and would enable GEL to stimulate the market by entering into committed power purchase agreements with suppliers of such electricity.

competition to support establishing on-island (including off-shore) renewable energy; and, facilitating a competitive energy supply market using shared critical infrastructure.

6 Consultation

6.1 In May, 2021, the joint Committees undertook a targeted closed consultation of the GCRA and the members of the Energy Forum in respect of the potential for extending GEL's exclusivity in the case of the supply and conveyance markets. The GCRA confirmed that an extension of the arrangement would be a reasonable approach in the current context, but it was clear from the responses that there were differing views, and that overall an alternative approach was needed that would balance removing barriers for on-island businesses and market entrants in respect of renewables while preserving the approach of sharing the base network.

6.2 The joint Committees have also consulted with the GCRA in respect of the recommendations regarding tariff regulation. The GCRA's overall view is that maintaining the current regulatory regime "will support the expediency needed and provide the most appropriate safeguards to address the real issues identified". However, the joint Committees have set out above the reasons why the change of approach in the interim is recommended. Notwithstanding, the helpful observations made by the GCRA will be useful in ensuring an effective approach in the interim should the States support the propositions.

7. Compliance with Rule 4

7.1 Rule 4 of the Rules of Procedure of the States of Deliberation and their Committees sets out the information which must be included in, or appended to, motions laid before the States.

7.2 In accordance with Rule 4(1), the Propositions have been submitted to Her Majesty's Procureur for advice on any legal or constitutional implications.

7.3 In accordance with Rule 4(4) of the Rules of Procedure of the States of Deliberation and their Committees, it is confirmed that the propositions above have the unanimous support of the Policy & Resources Committee and the States' Trading Supervisory Board. The propositions have the majority support of the Committee *for* Economic Development, with Deputy Vermeulen not supporting the propositions.

7.4 In accordance with Rule 4(5), the Propositions relate to the duties of the: Policy & Resources Committee to promote and facilitate cross-committee policy development; the Committee *for* Economic Development to advise the States on regulation in the economy; and, the States' Trading Supervisory Board to carry out the States' role as shareholder in Guernsey Electricity.

7.5 In accordance with Rule 4(5), the joint Committees consulted with the Committee *for the* Environment & Infrastructure, the Guernsey Competition & Regulatory Authority and the members of the Energy Forum. A letter of comment from the Committee *for the* Environment & Infrastructure is appended.

Yours faithfully

Policy & Resources Committee:	**Committee *for* Economic Development:**	**States' Trading Supervisory Board:**
P T R Ferbrache President	N R Inder President	P J Roffey President
H J Soulsby Vice-President	S J Falla Vice-President	C N K Parkinson Vice-President
M A J Helyar J P Le Tocq D J Mahoney	A Kazantseva-Miller N G Moakes S P J Vermeulen	N G Moakes S J Falla MBE J C Hollis

APPENDIX 1

Committee *for the* Environment & Infrastructure

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Deputy P Ferbrache
President
Policy & Resources Committee

Via e-mail

27 May 2021

Dear Deputy Ferbrache

LETTER OF COMMENT ON THE INTERM TARIFF REGULATION POLICY LETTER

The Energy Policy submitted to the States Assembly by the predecessor Committee *for the* Environment & Infrastructure, and adopted by the States in 2020, established a policy framework for the effective management of Guernsey's energy needs over the period 2020-2050. It sets out high-level policy direction to enable the States to manage the global transition to decarbonisation in the energy market at a local level.

The Committee's view is that the policy letter from the joint Committees marks a significant first step in reaching the aims and objectives of the Energy Policy.

The Committee concurs that there is a strong case for restructuring and rebalancing GEL's current tariffs as a high priority to support the objectives of the Energy Policy. The Committee supports the rationale for the interim approach that is being proposed in respect of tariff regulation. This balances the need for certainty for the market, including Guernsey Electricity Limited (GEL), the need for the States to move quickly in that respect, and the need to find a pragmatic and effective approach given the significant demands on government resources in a challenging local and global environment post-Covid and post-Brexit.

The 2020 policy letter does specifically acknowledge the importance of taking steps in the interim to ensure that GEL could continue to maintain electricity supply whilst awaiting a new licensing framework, and recognised that the States might need to enable this to happen if it was not possible to issue licences under the new licensing framework in sufficient time. This approach is consistent with that.

This approach will be further supported by the Electricity Strategy currently being developed by the Committee, for which the aim is to present it to the States Assembly in mid-2022 following consultation and engagement with energy users and the industry. This will set out work *inter alia* on source and security of supplies and merit order despatch. That policy letter will set out how the Electricity Strategy can support the on-island generation and trading of renewable energy, both to support the Energy Policy and the development of an economic sector for renewables in the Bailiwick.

The Committee also notes that GEL's licence exclusivity in the electricity supply and conveyance markets will expire on 31 January 2022. The Committee is aware that the joint Committees considered, consulted on but ultimately decided against including recommendations on any extension of the exclusivity in the policy letter and, as such, GEL's exclusivity will currently expire as scheduled early next year.

As a result of the above, the policy letter acknowledges that the States need to consider what guidance should be issued to the GCRA in respect of its licensing responsibilities from that point and until any new licensing framework is adopted by the States. Whilst supporting the overall approach, the Committee notes that its success will depend significantly on how the GCRA interprets the States' Energy Policy. This will need to be carefully monitored and, if necessary, consideration given to putting in place additional States' Directions to the GCRA. The Committee will seek to actively work with the Committee for Economic Development on such a Direction, and ensure it is reaffirmed on the Electricity Strategy that is being developed.

Yours sincerely

HdeSausmarez

Deputy L De Sausmarez
President
Committee *for the* Environment & Infrastructure

Cc Deputy Peter Roffey, President, States' Trading Supervisory Board
Deputy Neil Inder, President, Committee *for* Economic Development