States' Trading Supervisory Board

GUERNSEY ELECTRICITY

APPLICATION TO INCREASE TARIFFS

DECISION NOTICE

23 May 2023

States Trading Supervisory Board
Brickfield House
St Andrew
Guernsey
GY6 8TY

Tel: +44(0) 1481 222044
Email: tradinggroup@gov.gg

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1 Executive Summary

1.1 Guernsey Electricity Ltd ("**GEL**") has applied to the States' Trading Supervisory Board ("**the Board**") to make changes to its tariffs with effect from 1st July, 2023. Under a "revenue cap" approach, GEL proposed that individual elements of its tariffs should increase or decrease by varying amounts, such that its total revenues would be permitted to increase by 14.25%. Its proposals were the subject of a public consultation process in Q1 of 2023. The Board has rejected that proposed cap, but having completed its own independent assurance process, has agreed that a revenue cap of 13% is permissible.

1.2 GEL's proposals were made for the following principal reasons: to meet the additional costs of importing and generating electricity being incurred as a result of the Ukraine war; to enable it to continue with its "base-case" capital investment programme of £10.7m per annum to maintain the Island's core electricity infrastructure; to continue with a process of rebalancing its fixed and variable tariffs to better reflect the fixed and variable costs of the company; and, to meet other increases in its operating expenditure and a one-off essential repair to its C-Station exhaust stack.

1.3 In considering the proposals, the Board has taken into account, inter alia, the following: its statutory obligations under the Electricity Law, 2001; the policy guidance available to it under the States of Guernsey's agreed Energy Policy; an independent assurance review of GEL's infrastructure investment programme; an independent assurance review of the financial models and assumptions underpinning the proposals; the results of the aforementioned public consultation; and, the results of an independent cost efficiency and tariff benchmarking review of GEL.

1.4 In considering the proposals, the Board has been especially conscious of:

- The pressing need to continue correcting historic levels of under-investment in the electricity network to support the Island's social and economic infrastructure and provide a foundation for growth in electricity demand as part of the energy transition;

- The additional costs of importing and generating electricity, which GEL estimates to be £3.3m in the current financial year, as a result of the market volatility arising from the Ukraine war. This trend is likely to continue as GEL's forward hedging programme progressively unwinds;

- The impact of the proposed increases on consumers, particularly during the current economic climate;

- The need to ensure that GEL remains focused on continuing to improve its productivity. Whilst the benchmarking review found that GEL was efficient in comparison to its peers and did not identify any historic efficiency gaps that needed to be addressed, it did suggest that consideration should be given to applying a forward-looking efficiency target;

- The risk that, if steps are not taken to correct the imbalance in GEL's tariffs, then as more consumers adopt localised or behind-the-meter sources of electricity, GEL's revenues from its variable charges will reduce disproportionately and it will be unable to afford the fixed costs of maintaining and upgrading the Island's electricity network without introducing disproportionate increases in its variable charges. That would most adversely affect customers who cannot afford to adopt micro-renewable technologies or who are unable to do so. That risk has to be balanced against the negative impacts that increases in standing charges can have both on low volume electricity consumers and on the payback period for consumers considering investing in micro-renewable technologies.

1.5 A full assessment of the factors considered by the Board are set out in section 5 of this Notice. Having done so, the Board has decided to reduce the revenue cap originally proposed by GEL for its tariffs from 14.25% to 13% in order to reduce the impact on consumers. The Board believes that, provided GEL continues to focus on its efficiency, a cap of 13% will be sufficient for it to deliver its "base-case" capital investment programme of £10.7m per annum whilst continuing on a trajectory to a point whereby it no longer has to take on additional debt to fund that programme, albeit at a slower pace than the company had initially proposed.

1.6 The Board has been mindful that any rebalancing of GEL's tariffs needs to be phased over time, but that such rebalancing is consistent with the direction established in the Energy Policy. It is conscious that the longer the process is delayed, the greater the risk there is to GEL's ability to generate sufficient revenues to make the necessary investment in the maintenance and upgrading of a reliable electricity network. The Board believes this should be the primary consideration when considering the question of rebalancing. The proposals within the application mark a relatively modest continuation of a process that started in 2022 and the Board has agreed this should continue. Accordingly, it has agreed that GEL should be allowed to increase the proportion of its total permitted revenues that is generated from its standing charges from 7% to 10%.

1.7 In accordance with the above, the tariffs which have now been approved by the Board at its meeting on 23rd May, 2023, for introduction with effect from 1st July, 2023, are attached as Appendix 3 to this Notice.

2. Introduction

2.1 The States' Trading Supervisory Board ("**the Board**") has received an application from Guernsey Electricity Ltd ("**GEL**") to increase its tariffs for the supply of electricity with effect from 1st July, 2023. The purpose of this Notice it to set out the Board's decision in respect of GEL's application.

2.2 Under the provisions of The Electricity (Guernsey) Law, 2001[1] ("**the Electricity Law**"), the prices to be charged by GEL for the supply of electricity shall be in accordance with such tariffs as the Company may fix from time to time, which must be approved by the Board before they are levied. When determining the tariffs levied by GEL, the Electricity Law requires that the Board must have regard to the objectives set out in section 2[2] of The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 ("**the Regulation Law**").

2.3 GEL has applied to the Board to change individual elements of its existing tariffs for the supply of electricity by varying amounts in order to generate a specified amount of additional revenue under a "revenue cap" approach during the year commencing 1st July, 2023.

3. Summary and Purpose of Tariff Application

3.1 GEL's tariffs were last increased on 1st July, 2022, based on a revenue cap of 9% approved by the Board at that time. Those tariff changes were made for the following purposes:

- To generate revenues sufficient to support a short-term (3 year) minimum "base-case" capital investment requirement of £10.7m per annum in order to properly maintain the Island's existing electricity infrastructure and to allow for a small amount of the anticipated growth in electricity demand associated with the energy transition; and,

- To start a process of rebalancing the proportion of its sales revenues recovered from its variable and fixed charges. The proposals were designed to increase the proportion of revenues generated from fixed charges from circa 4% to circa 7%, acknowledging that the fixed costs of GEL's business equated to circa 50% of its total costs.

Whilst the tariffs themselves did not increase until 1st July, 2022, the modelling and data that underpinned the application made by GEL preceded the Russian invasion of Ukraine and the consequential impact that this has had on both wholesale energy prices and general inflation.

3.2 GEL has again proposed to the Board that it should be permitted to increase its revenues by a capped amount. Under its proposed revenue cap, individual elements of its tariffs would increase or decrease by varying amounts, such that total revenues would increase by 14.25%. GEL has noted the ability to adjust individual elements of its tariffs by different amounts provides it with an opportunity to incentivise changes in customer behaviour to discourage electricity consumption at peak periods, thereby "flattening" the demand curve and enabling it to defer

[1] Section 12(1A) – Power to recover charges
[2] Section 2 – General Duties

capital investment that would otherwise be required earlier in its planning cycle to meet peak demands.

3.3 GEL has proposed the changes to tariffs for the following principal reasons:

Wholesale Energy Markets and Inflation

3.3.1 As a result of the Russian invasion of Ukraine and the consequential impact on wholesale energy markets, GEL has reported that the costs of importing electricity from Europe and generating electricity on-island are budgeted to increase by 10% during the current financial year (ending 30th September, 2023). More generally, the rate of inflation (RPIX) in Guernsey has increased to 8%[3] since 31st March, 2022.

3.3.2 GEL's application notes that, whilst price fixing arrangements under the current electricity import contract have sheltered Guernsey from the significant increases in electricity prices experienced in the UK and other jurisdictions, a proportion of its electricity import and generation costs remain linked to movements in the wholesale markets. As a result, these costs are budgeted to be £3.3m higher than originally forecast (as part of last year's tariff application) for the current financial year.

Infrastructure Investment

3.3.3 GEL's application is intended to enable the continuation of its short-term minimum "base-case" capital investment programme of £10.7m per annum in order to properly maintain the Island's existing electricity infrastructure and to allow for a small amount of the anticipated growth in electricity demand associated with the energy transition.

3.3.4 During the current financial year (ending 30th September, 2023), the application anticipates that programme will be funded by a combination of additional revenues of £3.96m and additional debt of £6.74m. During the next financial year (commencing on 1st October, 2023), GEL's application anticipates that the programme will be funded entirely from revenues and that, subject to further increases in its tariffs in future years, profits will be available to enable it to start reducing its existing levels of debt.

3.3.5 The Committee *for the* Environment & Infrastructure ("**CftE&I**") is expected to present a draft Electricity Strategy to the States of Guernsey for their consideration during the course of 2023. It is anticipated that this will require an update of GEL's long-term capital investment plans. Any consequential funding requirements for material investment in generation or interconnector assets, as well as major network upgrades to enable the transition to net-zero emissions by 2050, are not included in the current tariff application.

Tariff Rebalancing

3.3.6 GEL's application proposes that the process that began in 2022 to rebalance the proportion of its sales revenues recovered from its variable and fixed charges should continue. The latter

[3] Guernsey Quarterly Inflation Bulletin - March 2023

currently generate circa 7% of its revenues, whereas its fixed costs equate to circa 50% of its total costs. The fixed costs of the centralised electricity infrastructure GEL provides for the Island will continue to rise as peak demand for electric heating and transport grows. However, if revenues remain disproportionately reliant on the volumes of electricity sold, the application notes the risk that GEL will generate insufficient revenues to cover the fixed costs of maintaining and upgrading the infrastructure as the number of customers self-generating continues to grow.

3.3.7 GEL's application notes that, without rebalancing the tariffs to address the above risk, disproportionate increases in variable charges would be required to generate sufficient revenues to cover the fixed costs of its business. It argues that this would most adversely affect low-income and vulnerable customers who either cannot afford to install renewable generation systems or who are unable to do so because they live in rented accommodation. Accordingly, the application includes provision for a further gradual rebalancing of its tariffs, such that the proportion of revenues generated from its fixed charges would increase from circa 7% to circa 10%.

Other Drivers

3.3.8 GEL's application has also identified an increase in operating expenditure, principally staffing related, to support the delivery of its capital investment programme and investment in its Enterprise Resource Planning system (corporate IT system to support business activities), together with one-off essential repairs to its C-Station exhaust stack.

4. Tariff Application – Approach of the States' Trading Supervisory Board

4.1 In considering the application from GEL, the Board has taken into account, inter alia:

(a) Its obligations under the provisions of the Electricity Law;

(b) The Energy Policy[4] adopted by the States of Deliberation and the policy framework established therein for the effective management of Guernsey's energy needs over the period 2020-2050;

(c) The policy letter[5] and propositions considered and agreed by the States of Deliberation in 2021 on the interim arrangements for the regulation of GEL's tariffs ("**the Tariff Regulation policy letter**"); and,

(d) The States of Guernsey Government Work Plan[6], which includes a prioritised commitment to develop an updated Electricity Strategy. The Plan notes that this Strategy will, inter alia, aim to create an environment which helps the energy market transition to decarbonisation without risking security of supply for Islanders.

[4] Article 8 of Billet d'Etat XI of 2020: States of Guernsey Energy Policy 2020-2050
[5] Article 5 of Billet d'Etat XVII of 2021: Interim Arrangements for Tariff Regulation
[6] Article 1 of Billet d'Etat XV of 2021: Government Work Plan

4.2 In determining the application from GEL, the Board has considered reports on the following:

(a) An independent assurance review of GEL's proposed revenue cap, tariff proposals and financial models undertaken on the Board's behalf by Mr D Hipple;

(b) An independent assurance review of GEL's £10.7m infrastructure investment programme, previously undertaken on behalf of the Board in 2022 by WSP Global Inc ("**WSP**");

(c) A report from GEL setting out the results of the public consultation exercise on its proposed revenue cap and tariff proposals ("**the Public Consultation Report**") undertaken by the company in Q1 of 2023 (a summary of that report is attached as Appendix 1 to this Notice); and,

(d) The results of both an independent cost efficiency benchmarking and tariff benchmarking review ("**the Benchmarking Report**") of GEL undertaken on the Board's behalf by Frontier Economics (a report of these reviews is attached as Appendix 2 to this Notice).

Having considered the above, the Board has proceeded to determine its position on the application.

5. Regulation Law - Objectives

5.1 In determining the application, the Board has had regard to the aforementioned objectives (see section 2 above) set out in the Regulation Law. These are discussed below.

5.2 **Objective 1**: 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.

Key factors identified by the Board in considering this objective included the following:

(a) The Benchmarking Report has concluded that GEL is relatively efficient across all cost categories (net operating expenditure; operating expenditure; and, total expenditure) in comparison to Jersey Electricity and Manx Utilities, these being vertically integrated utility companies that are similar in size and scope to GEL. In the case of net operating expenditure, GEL was identified as being the most efficient. Net operating expenses exclude the costs to GEL of the electricity it imports and of the oil imported for on-island generation, acknowledging that these costs are exogenously determined.

(b) The Benchmarking Report did not identify any historic efficiency "gaps" that needed to be recovered. However, it did suggest that consideration should be given to applying a forward-looking efficiency target to ensure that GEL remains focused on productivity improvements.

(c) The Benchmarking Report compared GEL's typical customer bills to Jersey Electricity, Manx Utilities, electricity suppliers in Northern Ireland and Great Britain. It identified that GEL's 2022 domestic bill was higher than Jersey Electricity, but lower than Manx Utilities and most other suppliers, noting that GEL's domestic tariffs had a relatively high fixed component and a low variable one. Taking into account known tariff changes in other jurisdictions at the time, it noted that, if approved, GEL's proposed 2023 domestic tariffs would place its typical customer bill in the middle of the benchmark table, still higher than Jersey Electricity but also remaining lower than Manx Utilities.

(d) The Benchmarking Report identified that GEL's 2022 customer bill under its industrial tariffs, whether these be for low or high voltage customers, were higher than those in Jersey and lower than the Isle of Man. That position would remain the same under GEL's proposed 2023 industrial tariffs.

(e) The Energy Policy notes that the Island's reliance on the electricity network will increase, given the ongoing and accelerating transition to electricity usage. A principal objective of the tariff proposals is to enable GEL to generate sufficient revenues so that it can maintain its "base-case" capital investment programme of £10.7m per annum during the current and next financial year[7] (acknowledging that this is being eroded in the short-term by high levels of inflation). GEL is continuing to partially fund this programme in the short-term with additional debt financing. This reduces the level of tariff increases that would otherwise be necessary, reducing the impact on customers by spreading a proportion of the investment required over a longer period through a manageable level of additional debt.

(f) The 2022 WSP report previously reviewed GEL's capital expenditure plans and included the following conclusions: firstly, given the anticipated evolution of electricity demand, it is likely that the capacity of the Island's electricity network will need to be expanded rather than simply maintained and sustained; secondly, the risk under GEL's current investment plans of it over-investing in the network is significantly less than the risk of under-investment; and, thirdly, expenditure of £10.7m per annum over the next three years is necessary to properly sustain the network in its current form.

(g) Whilst additional higher levels of investment in the Island's electricity infrastructure will be required to fully meet the needs of the energy transition, the Board's view is that those plans should only be developed and determined once the States has considered the Electricity Strategy being brought forward by the CftE&I in 2023. It is anticipated that this will identify the preferred supply options or "pathway" for meeting Guernsey's predicted electricity demand up to 2050, including the type and scale of technologies to be deployed and the role that GEL will play within the marketplace in delivering those.

(h) A key pillar of the Energy Policy is to facilitate a competitive energy supply market using shared critical infrastructure, as appropriate. The Board acknowledges that investment to maintain and then increase the reliability and capacity of the Island's electricity network is essential to support the transition and to enable the growth and development of distributed electricity generation, including from a wider range of alternative and renewables sources/generators of electricity.

[7] The "base-case" capital investment programme anticipates that this expenditure will increase to £12.2m during the financial years commencing 1st October 2024 and 2025.

(i) Over the last ten years, GEL's tariffs have not kept up with inflation. Since 1st January, 2013, GEL's tariffs have increased cumulatively by 22%. Over the same period, the rate of inflation (RPIX) in Guernsey has increased by 33.5%[8].

(j) The Public Consultation Report noted that, whilst the majority of the 278 respondents understood the need for GEL to increase its tariffs due to rising electricity and importation costs and in order to continue investment in the electricity infrastructure, only a minority supported the need to do so.

5.3 **Objective 2**: to secure, so far as practicable, the provision of utility services that satisfy all reasonable demands for such services within the Bailiwick, whether those services are supplied from, within or to the Bailiwick.

Key factors identified by the Board in considering this objective include the following:

(a) Prior to the increase agreed by the Board in 2022, GEL had been able to apply two increases to its tariffs in the previous ten years, but only to recover uncontrollable costs relating to movements in foreign exchange rates and commodity prices between 2017 and 2020. It had been unable to recover either increases in the underlying costs of the business or the costs of its investment in key infrastructure, including: its investments in the N1, N3 and GJ1 sub-sea interconnectors; and, the installation of the 2D and 3D generators at the power station. These investments were only able to be undertaken with additional debt financing. GEL currently has debt of circa £40m, with servicing costs of circa £2.6m per annum.

(b) GEL's submission is that expenditure of £10.7m per annum is required in the short-term to fund the "base-case" maintenance of the Island's existing electricity infrastructure on which consumers rely and to allow for a small amount of growth in electricity demand associated with the energy transition. The aforementioned WSP report has concluded that expenditure of this level is required to sustain the network in its current form and that the greater risk is of under-investment. In support of its application, GEL has submitted to the Board an updated detailed schedule of its capital expenditure programme over the three-year period commencing 1st October, 2021, which includes details of its investment in its network and generation assets, and totals £32.1m over that period.

(c) As noted earlier, a principal objective of the tariff proposals is to enable GEL to generate sufficient revenues so that it can maintain its "base-case" capital investment programme. Nevertheless, during the current financial year (ending 30th September, 2023), it will only be possible to deliver that programme with additional debt funding of £6.74m. GEL's debt levels have to be carefully managed within the terms of the financial covenants it has agreed with its lenders.

(d) The modelling provided by GEL in support of its application is that, during the next financial year (commencing 1st October, 2024) and subject to further increases in its tariffs in future years, it will be able to fund the "base-case" capital investment programme without the

[8] Guernsey Quarterly Inflation Calculator: 31st December 2012 – 31st March 2023

need for additional debt on an ongoing basis. In addition, it will start generating profits that enable it to start reducing its debt.

(e) The Board's view is that the trajectory should be one whereby GEL is moving to a position of self-financing its base-case capital investment programme and to having the ability to reduce its debt and/or strengthen its balance sheet to shield customers from the impact of future major asset failures or sustained increases in commodity prices. The Board does not believe that it is commercially sustainable for GEL to continue borrowing to maintain its existing infrastructure. Its view is that, in future, GEL should be moving to a position where further borrowing should only be contemplated for capital investment required to support the growth of the business in accordance with the aforementioned new Electricity Strategy being presented to the States by the CftE&I in 2023. Those capital investment plans will be updated following the States' consideration of that Strategy, which it is anticipated will establish the future role that GEL will play in serving the generation, supply and conveyance markets and the further investment required to enable the energy transition.

5.4 **Objective 3**: 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.

Key factors identified by the Board in considering this objective include the following:

(a) As noted in the commentary on objectives 1 and 2 above, one of the main purposes of the tariff application is to enable GEL to continue meeting its "base-case" capital investment plans to maintain the current electricity infrastructure on which the Island depends. The intention of the application is that GEL should be able to start generating sufficient profits in the short term to enable the company to either: reduce its debt levels; improve its resilience in the event of the failure of a major asset; and/or build a buffer with which to shield customers against future commodity price increases. The STSB adopts a "not-for-dividend" policy in respect of GEL, meaning that all profits are retained by the company and reinvested in the business in the best long-term interests of Islanders.

(b) The second objective of the application is to continue a process that commenced in 2022 to rebalance GEL's tariffs so that its variable and fixed charges for the supply of electricity better reflect the variable and fixed costs of the business. This is consistent with the Energy Policy, which stresses the importance of ensuring that cost-reflective tariff systems are put in place across all forms of energy supplies. The Policy's stated outcome is that costs must be properly reflected in tariffs and must be recoverable by energy providers.

(c) The Board acknowledges that, if steps are not taken to correct the imbalance in its charges, the risk is that, as more consumers adopt localised or behind-the-meter sources of electricity, GEL's revenues from its variable charges will reduce disproportionately and it will be unable to afford the fixed costs of maintaining/upgrading the electricity network without introducing disproportionate increases in its variable charges. Those most adversely affected would be the remaining customers who cannot afford to adopt micro-renewable technologies, such as solar PV, or who are unable to do so, including those in rented accommodation or apartments who can also be restricted from such investments.

These challenges are not unique to Guernsey. GEL has previously provided evidence to the Board of multiple European jurisdictions where fixed charges have evolved to represent between 30% and 80% of revenues being generated. This is also reflected in the Benchmarking Report, which includes case studies of different European jurisdictions that demonstrate a trend towards fixed charges representing a greater proportion of overall tariffs in order to support the energy transition and ensure the recovery of fixed network costs. However, the report also notes that this needs to be balanced against possible customer impacts, particularly in the case of low usage and fuel poor customers.

(d) The Tariff Regulation policy letter (see section 4 above) considered by the States in 2021 clearly identified a need to rebalance GEL's tariffs for the reason set out above. It also noted that there was a pressing need to start that process, given that the current tariffs are already sending misleading signals to the wider electricity marketplace by overstating the actual unit costs of electricity that GEL is providing and understating the fixed costs of providing and maintaining the electricity infrastructure.

(e) The Board is also conscious that the arguments in support of rebalancing GEL's tariffs have to be balanced with the following considerations, some of which were highlighted by the Public Consultation Report: firstly, increasing the proportion of revenues recovered by GEL from its standing charges and reducing the proportion from variable charges will increase the payback period for consumers considering investing in micro-renewable technologies and may act as a disincentive to doing so; secondly, increases in standing charges will have a disproportionate impact on those consumers of low volumes of electricity and vulnerable customers; and, thirdly, the proposals pre-empt further work that the States of Deliberation have directed (following their consideration of the Energy Policy) to review structures for cost reflective tariffs and to report back with proposals.

5.5 **Objective 4**: to introduce, maintain and promote effective and sustainable competition in the provision of utility services in the Bailiwick, subject to any special or exclusive rights awarded to a licensee by [the GCRA] pursuant to States' Directions.

Key factors identified by the Board in considering this objective include the following:

(a) GEL is not proposing any increases in its standby charge, which is applicable to larger commercial customers with their own installed generation capacity above a threshold of 25kW, but who also remain connected to the GEL network. The maximum standby charge was reduced to its current level of £3.07 per kW in 2019 by the Guernsey Competition and Regulatory Authority following a review of the competitive impact it was having on the electricity market (a charge of £6.8594 per kW remains for legacy systems where the owner has not requested a change to the reduced rate). In real terms, the cost of the standby charge has fallen since then and, with the charge remaining frozen, that process will continue under GEL's proposals.

(b) GEL is not proposing any increase in the buy-back tariff, this being the rate at which it purchases surplus energy from customers with their own renewable generation. The rate (currently 9.90 pence per unit (ppu)) has remained unchanged since 2012 and, as such, has and continues to fall in real terms. However, the rate exceeds the combined marginal cost GEL incurs when importing/generating its own electricity, which is budgeted at 7.20ppu during the current financial year. It also exceeds the buy-back rate in Jersey (7.76ppu), the Isle of Man (8.20ppu) and many of the rates available within the UK.

(c) The Board acknowledges that the buy-back tariff is an important factor for customers considering the installation of their own micro-renewable facilities and, therefore, that it plays a role in the development of competition from renewable sources. With this in mind, the Board is conscious of the following factors. Firstly, a focus[9] of the forthcoming Electricity Strategy will be on what arrangements can be put in place to facilitate more adoption of local renewable energy at both a micro and macro level and it will examine if/how electricity tariffs might be adapted to incentivise the development and adoption of local renewable energy. Secondly, GEL is subject to a "merit order" which requires it to rank the electricity sources available to it for dispatch into the network based solely on their ascending order of price (such that the cheapest must always be dispatched first). The States has committed[10] to undertaking a review of the merit order, noting that potential changes could include requiring GEL to give a greater priority to the dispatch of locally generated renewable electricity and enabling it to stimulate this part of the market. The Board believes it would be inappropriate to pre-empt the outcomes of the above policy workstreams by making changes to the buy-back tariff in the interim, but will keep the matter under review.

(d) As noted in the commentary on objective 3 above, increasing the proportion of revenues recovered by GEL from its standing charges and reducing the proportion from variable charges will increase the payback period for consumers considering investing in micro-renewable technologies and may act as a disincentive to doing so. Conversely, the increases in the variable charges that GEL is proposing will increase the marginal pricing difference between those renewables and the electricity supplied by GEL, which should have the opposite effect.

5.6 **Objective 5**: to improve the quality and coverage of utility services and to facilitate the availability of new utility services within the Bailiwick.

Key factors identified by the Board in considering this objective include the following:

(a) As set out in the commentary on the previous objectives, one of the main purposes of the tariff proposals is to continue correcting historic levels of underinvestment in the Island's electricity infrastructure to enable GEL to meet its "base-case" capital investment plans to maintain the existing electricity infrastructure on which the Island depends. The WSP report has confirmed that level of investment as being necessary.

[9] Article 5 of Billet d'Etat XVII of 2021: Interim Arrangements for Tariff Regulation – Explanatory Note to Amendment 2 laid by the President and Vice-President, CftE&I.
[10] Resolution 2(c) of Article 5 of Billet d'Etat XVII of 2021

(b) As set out in the commentary on the previous objectives, the ongoing rebalancing of tariffs set out in GEL's application is intended to ensure that GEL can continue to generate revenues to invest in the maintenance and upgrading of a reliable electricity network without having to introduce disproportionate increases in its variable charges.

(c) As set out in the commentary on the previous objectives, investment in the network is required to enable the growth of distributed electricity generation and supply, including a wider range of alternative/renewable sources of electricity.

5.7 <u>**Objective 6**: to lessen, where practicable, any adverse impact of utility activities on the environment.</u>

Key factors identified by the Board in considering this objective include the following:

(a) GEL's proposals underpin its short to medium-term "base-case" capital expenditure plans, which are intended to correct historic levels of under-investment. The intention is to stabilise the electricity network and to start preparing it for the growth in demand for electricity that is anticipated by the Island's Energy Policy. Short and long-term investment in the Island's electricity infrastructure are key enablers in meeting the Energy Policy's decarbonisation objectives and the target for net-zero emissions by 2050.

(b) GEL's proposals include the alignment of its Heat Pump tariff, which is currently more expensive than its Superheat tariff (the latter being designed for domestic customers using electrically heated "wet" central heating and hot water systems). In doing so, it is also proposing to introduce a fixed secondary meter charge for Heat Pumps, fully aligning it with other domestic tariffs. GEL's submission notes that the average domestic Heat Pump customer[11] would save £177 per annum. GEL's hope is that this will stimulate the use of Heat Pumps, which provide an energy efficient heating solution and generate no harmful emissions from a property. This would be particularly helpful in capacity constrained areas of the current electricity network and could enable a reduction or deferral in required network investment.

6. Tariff Application – Decision of the States' Trading Supervisory Board

<u>Revenue Cap</u>

6.1 Notwithstanding the tariff increases introduced in 2022, GEL's tariffs have not kept up with corresponding increases in the rate of inflation over the last ten years. That is a consequence of the historic regulatory impasse, the reasons for which are set out in the Tariff Regulation policy letter. As a result, levels of investment in the Island's electricity infrastructure had fallen well below the level needed to maintain the existing asset base and are significantly below the level required to deliver the energy transition. In determining its position on the proposed revenue cap of 14.25%, the Board's primary consideration has been the pressing need to continue correcting historic levels of under-investment in the electricity network. Such investment is

[11] Source: GEL - Based on aa annual consumption of 6,800 units.

needed to maintain and upgrade the network as an essential part of the Island's social and economic infrastructure and is required to provide a foundation for the anticipated growth in electricity demand as part of the energy transition anticipated by the Energy Policy.

6.2 The Board is also conscious that, whilst the hedging arrangements put in place by GEL have largely shielded both the company and its customers from the volatility in the energy markets and the substantial increases in tariffs witnessed in other jurisdictions, the Island is not immune to these impacts. GEL has already budgeted for increases of £3.3m for the current financial year in the costs of electricity importation and generation and, as the existing hedges continue unwinding, that trend is likely to continue, albeit acknowledging the difficulty in accurately forecasting future market conditions.

6.3 The Board has considered carefully the case made by GEL that increases in tariffs are necessary to enable it to start reducing its existing levels of debt and to move quickly to a position whereby it can at least fund its existing "base-case" capital investment programme (ie maintenance of the existing electricity network) without having to continue taking on additional debt. Whilst it agrees with this in principle, this needs to be balanced with the following considerations:

- The impact of the proposed increases on consumers at any time, but in particular during the current economic climate; and,

- The need to ensure that GEL remains focused on continuing to improve its productivity. The Benchmarking Report confirmed that GEL is relatively efficient across all cost categories in relation to Jersey Electricity and Manx Utilities and, in the case of net operating expenditure, GEL is the most efficient. It did not identify any historic efficiency "gaps" that needed to be recovered, but did suggest that consideration should be given to applying a forward-looking efficiency target to ensure that GEL remains focused on productivity improvements.

6.4 Against the above background, the Board has decided that a revenue cap of 13% should form the basis of this year's changes to tariffs, rather than the 14.25% originally proposed by GEL. All other things being equal and provided that GEL continues to focus on its efficiency, the Board believes that this will be sufficient to enable GEL to deliver its "base-case" capital investment programme and continue on a trajectory whereby it no longer has to take on additional debt to fund that programme, albeit at a slower pace than the company had initially proposed.

6.5 Looking ahead and taking into account the recommendations of the Benchmarking Report, the Board is taking this opportunity to flag its intention to introduce an ongoing efficiency target for GEL in future, based on its net operating expenses. However, the development of such a target cannot be considered in isolation and will need to take into account the Electricity Strategy. It is anticipated this will be presented to the States by the CftE&I during the course of 2023 and is likely to have significant implications for both GEL's future capital investment programme and the role it plays within the local electricity market.

Fixed and Variable Tariffs - Rebalancing

6.6 The Board has been mindful that any rebalancing of GEL's tariffs needs to be phased over time. The proposals within the application mark a relatively modest continuation of the process that started in 2022 that will increase the proportion of total revenues that GEL generates from its standing charge from 7% to 10% and will continue to correct the misleading signals that the historical tariffs have been sending to the marketplace.

6.7 The Board does not believe that the relatively modest change envisaged at this time is sufficient to prejudice the aforementioned future work that the States of Deliberation have previously directed should be undertaken by the Committee *for* Economic Development on a review of cost reflective tariffs. The proposals are consistent with the direction established in the Energy Policy in 2020 and the intent that was clearly flagged in the Tariff Regulation policy letter in 2021.

6.8 The Board believes the greater risk arises from not continuing to take action to rebalance GEL's tariffs. It is conscious that the longer a rebalancing process is delayed, the greater the risk there would be to GEL's ability to generate sufficient revenues to invest in the electricity network. It has concluded that the need to ensure GEL can continue to invest in the maintenance and upgrading of a reliable electricity network as an essential part of the Island's social and economic infrastructure should be the primary consideration. Therefore, the Board has concluded that it supports the proposed rebalancing set out in GEL's application and has agreed that the tariffs should be structured in such a way to enable GEL to increase the proportion of its total revenues that it recovers from its standing charges to 10%.

6.9 Looking ahead, the Board is taking this opportunity to flag its intention to temporarily pause any further rebalancing of GEL's tariffs beyond the 10% mark. The Board accepts that rebalancing is necessary for the reasons set out earlier in this Decision Notice. However, it remains conscious that the States have previously directed that further work should be undertaken on cost reflective tariffs. It anticipates that an update on this subject will feature in the forthcoming Electricity Strategy. Pending completion of that work, the Board does not currently anticipate that it would agree to any further rebalancing of GEL's tariffs beyond that which it has determined in this application.

Approved Tariffs

6.10 In accordance with the Board's decision to apply a reduced revenue cap of 13%, GEL has submitted revised tariffs, which were approved by the Board at its meeting on 23rd May, 2023, for introduction with effect from 1st July, 2023. These are attached as Appendix 3.

23rd May 2023