



Office of the Sark Electricity Price Control Commissioner

Proposal to make a Variation

November 20th 2020

Summary

1. My Office published a Review of the December 2019 Price Control Order and Proposed Variation on 15th October 2020 (**the Proposed Variation**). I proposed to reset the maximum price Sark Electricity Limited (SEL) may charge for electricity at around 58 p/kWh for 2021. This would have allowed SEL to recover an estimated £65,000 (6p/kWh) from Jan-Sept 2020 to make up for this year's shortfall resulting from the lower electricity consumption and earn an appropriate return on its investment. In its response to this proposal, SEL has proposed a new tariff arrangement, whereby a minimum monthly charge will be levied for each customer.
2. I support this proposal as it ensures that every property contributes a fairer share of the fixed costs of electricity supply. If adopted, I intend to set the maximum unit price for electricity in 2021 to be in the range 48-55.5 p/kWh and the minimum monthly electricity bill in the range of £35-45 for the majority of customers, though there will be a higher monthly charge for customers with historic annual consumption of over 32,000 kWh. As before, there will be an adjustment mechanism to accommodate differences between the actual and forecast values for electricity consumption and diesel fuel prices.
3. As a consequence of this new tariff structure, during 2021, SEL should be able to make up for the "under-recovery" arising from the lower electricity consumption in 2020 (which is likely to amount to around £85,000 by the end of the year) and enjoy a reasonable return on its Regulated Asset Base.
4. I would hope that no full-time resident of any property will suffer an increase in annual electricity costs as a consequence of the introduction of this new tariff arrangement. I have proposed a control structure for SEL's new tariff arrangement on the basis of only limited historical data. I therefore intend to monitor the situation closely.

Background

5. On finding that the 66 p/kWh price of electricity charged by SEL¹ was not fair and reasonable, my Office made a Price Control Order on 20th December 2019 (PCO) under section 15 of The Control of Electricity Prices (Sark) Law, 2016 (The "**2016 Law**"). In accordance with section 15(3)(a) of the 2016 Law, this specified a maximum per unit price of 54 p/kWh at which electricity could be sold in Sark until December 2021.
6. In terms of the Proposed Variation, I proposed that the maximum unit price for electricity in Sark should be reset to 58 p/kWh for 2021 on account of consumption being lower than previously

¹ See Determination 8th November 2019 at www.epc.sark.gg



forecast. Interested parties were invited to respond to the Proposed Variation by 30th October 2020.

7. My Office received 11 responses to the Proposed Variation, and they are available to be viewed on the Commissioner's web-site: www.epc.sark.gg. SEL responded on 9 November so 12 responses were received in total. The Proposed Variation specifically asked for views on the matters listed below and corresponding summaries of responses are as follows:-

- Rate of Return** Seven respondents commented on this issue. Five agreed with the proposed range. One was of the view that 2% should be the maximum rate of return. SEL thought that the original 7.3% pa. in the PCO was too low, but would consider 3.7% pa. for 2020 and 2021.
- Adjustments** Three respondents commented on this issue and all thought that the rate of Return (RoR) should vary with economic conditions.
- 2021 forecast** Three respondents commented on this issue. Two thought 1,140,000 kWh should be used for the forecast. SEL suggested 1,150,000 kWh.
- 2021 unit price** Eight respondents commented on this figure. Five agreed with 58 p/kWh, but one was concerned it might encourage own generation. One suggested a different tariff structure, another that Mr Jackson should take a salary cut and another that Mr Jackson should seek recompense from the previous owners.
- Island-wide** Five responded on this matter. Four agreed with the use of island-wide consumption to set the tariff. One questioned whether own generators would provide the necessary information.
- Adjustments** There were 6 responses on the suggestion of four-monthly tariff adjustments. Four agreed, two suggested six-monthly.
- New Structure** Eight responded on this issue. All agreed with the idea of higher standing charges and lower unit charges. SEL has suggested a minimum monthly charge but retention of the present 54 p/kWh cap.

8. Respondents were also asked if they wished to raise any other matters for consideration. These fell into another 8 categories and are summarised below:

- Own generation** Stocks Hotel confirmed that they would rather remain connected to the Grid and would welcome a sensible buy back arrangement. They would like islanders to have access to their green electricity and describe SEL's Policy 26 as 'ridiculous'. They also confirmed that the price of electricity was such that they would have to close the hotel if they did not install their own generation. One other respondent mentioned that they are contemplating generating their own electricity but would wish to remain connected to the Grid and a further respondent said that they would do the same if they could afford it. Three other respondents mentioned the need for a fairer buy back tariff and one was



concerned about further fragmentation of the system. SEL thought the present buy-back tariff arrangement was appropriate and that a feed-in tariff is not. I disagree with SEL's assessment.

- Trust** Four respondents raised this topic, saying it is a major issue between SEL and its customers.
- Supply Security** Four respondents raised security of supply and all expressed concern.
- Information** Two respondents raised the matter of the provision of information to my Office. Both were concerned by the quality and availability of information from SEL to my Office. SEL acknowledges that its information handling has been poor in the past but is taking steps to improve the quality and accessibility of the information. I can confirm the improvement.
- Wayleaves** Five respondents raised this matter. Two suggested Mr Jackson should have been aware of their absence when he acquired the company. One suggested that most landowners would be happy to grant them to SEL but one thought that many landowners would not agree to 'unlimited' wayleaves and expressed concern at what they considered to be SEL's mishandling of the situation at La Tour. SEL suggested that my Office should have been aware that the lack of wayleaves would cause SEL difficulties when trying to raise finance. I had raised this matter with David Gordon-Brown on many occasions but he was unwilling to attempt to rectify the situation.
- Reverse Flow** One respondent thought that reverse flow might cause heating on one side of the transformers. Some UK transformers are limited to 50% of their capacity in the reverse direction. SEL did not comment on the current ability of its network to absorb additional renewable electricity in its response.
- Investment** Two respondents were concerned by SEL's lack of investment.
- Fit & Proper** Two respondents did not believe Mr Alan Jackson to be a fit and proper person to run SEL. One questioned how SEL could be run from Alderney.

Considerations for the Proposed Variation

9. The Proposed Variation set out the details of my considerations according to section 13(2) of the Control of Electricity Prices (Sark) Law (2016) ("**The 2016 Law**"). I have considered the representations received, as described above, and have come to the following preliminary decisions on the material matters below.

Costs (Section 13(2)(a))

10. The Proposed Variation contained a forecast of SEL's costs in 2021. SEL's own budget for the year anticipates a similar amount for the fixed cash costs but adopted a higher figure for depreciation. In arriving at the estimate of the Regulated Asset Value of SEL's equipment and the associated



depreciation, WSP, the consulting engineers, had not included the cables that were assumed to be installed by customers, rather than SEL. SEL had noted that, in my consultation paper of December 2017, I had assumed that a depreciation allowance should be allowed for such cables because “SEL will have to replace them”. This was an error on my part and was corrected by WSP when they published their study in 2019 (available at www.epc.sark.gg). After all, if the cables are replaced by SEL, an allowance for depreciation and a return on investment would be added to the tariff. It is not reasonable for customers to pay twice.

11. SEL had not updated WSP’s depreciation allowance for inflation and the retirement of equipment, unlike the process used in the Proposed Variation. I therefore intend to use the estimates of fixed cash costs and depreciation in the Proposed Variation to calculate the maximum prices for regulated electricity supplies in Sark.

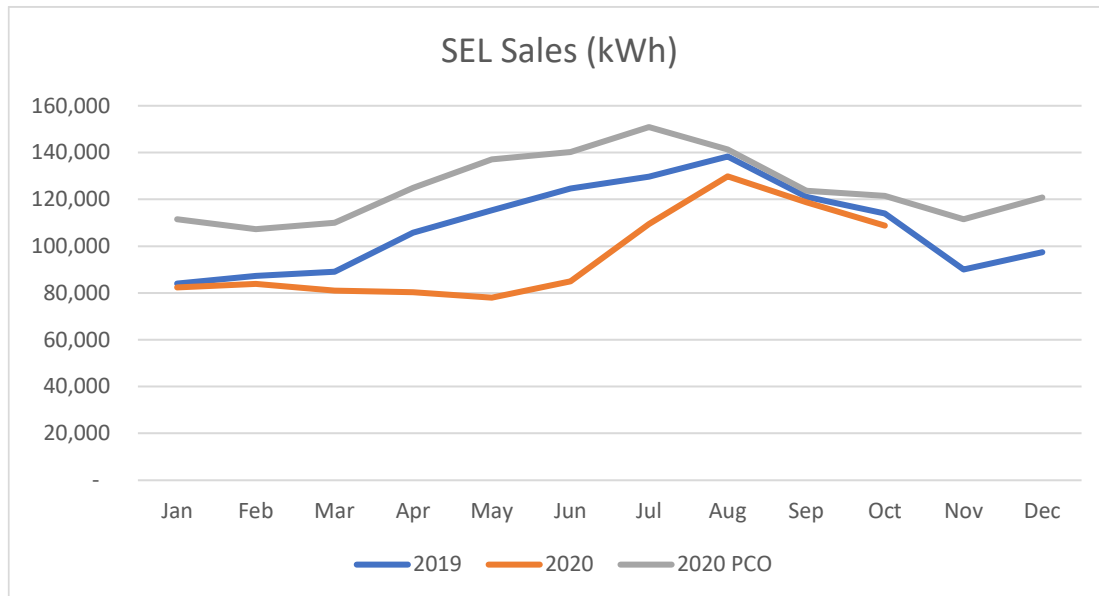
Revenues (affects considerations under Section 13(2)(a))

12. Electricity consumption in Sark has been considerably lower than the PCO’s forecast, as described in the Proposed Variation. Figure 1 below compares the island-wide consumption in 2020² and in 2019 and the PCO’s forecast for 2020 of 1,500,000 kWh for the whole year but adjusted to a monthly basis. It seems to me that the electricity consumption suffered a downturn caused by the impact of the Coronavirus on Sark’s economy. Consumption now appears to have recovered and has returned to the levels of 2019. The electricity consumption during March to August was around 140,000 kWh lower than in 2019 and I assume that consumption in 2021 will be similar to that in 2019, i.e. around 1,300,000 kWh, rather than the 1,140,000 kWh as forecast in the Proposed Variation. SEL however believes that it would be prudent to use a consumption forecast of 1,150,000 kWh for 2021.
13. The “under-recovery” due to SEL on account of the consumption in 2020 being lower than forecast in the PCO will be calculated according to my latest forecast of electricity consumption for the whole of 2020. This is currently 1,150,000 kWh. The consumption forecasts for both 2020 and 2021 will be updated once the November figures are available in early December. The updated figures will form the basis of the maximum prices that will be set in the final variation.

² I am grateful for additional consumption figures from Mr Moerman, the Seigneur and Stocks Hotel



Figure 1
Island-Wide electricity Consumption



Rate of Return

14. Most of the respondents to the Proposed Variation thought the suggested range of 2-4.5% per annum was reasonable. Witney Price Holdings (Witney Price), as owner of SEL, has stated that it had always regarded the purchase of SEL as a community endeavour. As such, SEL's Board has been recommended to accept a voluntary reduction in RoR from 7.3% to 3.7% for the years 2020 to 2021. I infer from this, that SEL's management is recommending to Witney Price that it does not seek to fully recover the "under-recovery" of 2020. I estimate that this will amount to around £85,000 by 31st December 2020. I intend to allow SEL to recover this amount in the maximum tariff I will set. I believe it would be unfair to SEL to do otherwise. Of course, SEL may set a lower price if it so wishes.
15. SEL argues that any reduction from the 7.3% per annum rate used in the PCO would be arbitrary and has informed my Office that its owner, Witney Price, may switch investment into a "save to spend" arrangement, which is described below.
16. SEL has not provided any justification to support their claim that such a change would be arbitrary. I should not, under section 13(2)(f) of the 2016 Law ignore the fact that economic conditions have changed. I have taken note of the reductions in the rates of return proposed for other network utilities in the UK³. I believe the range I have proposed is appropriate for SEL's system.
17. Furthermore, SEL's suggestion of adopting the "save to spend" approach to capital expenditure is a concern to me. This form of funding was used for capital expenditure by Guernsey Electricity until 2010. According to this scheme, SEL would only embark on capital projects after sufficient funds had been accumulated from customers' bills. The scheme was abandoned by the regulating

³ OFGEM, Draft Determinations, 9th July 2020; CMA, Provisional Findings, September 2020.



authorities on Guernsey because it did not, in the Regulator's view, encourage efficient management of the island's resources. I also believe that such a means of financing is not currently suitable for Sark for the following reasons:

- The risk to quality of supply whilst the funds are being accumulated. In particular, SEL is very concerned by the condition of its diesel generators. They are in urgent need of replacement.
 - There is an urgent need to connect the 19 residences in the north of Sark.
 - It would require higher electricity prices for a short period and, possibly, encourage more "own generation".
18. The delays in investment in the new generators and cabling threaten the security of Sark's electricity supplies. I do not know whether Witney Price or SEL's capital reserves are sufficient to finance these investments or whether they are able to obtain appropriate funding. However, one would expect that in conducting its due diligence in advance of its purchase of SEL, Witney Price would have been alerted to the poor condition of the engines and ensured that it had sufficient financial capacity or adequate access to third party funding. In any event, I do not think it would be reasonable to expect customers to essentially pay "up front" for capital projects.
19. I recognise that investors ascribe higher risk factors to new projects. I therefore suggest that a distinction is made between SEL's existing assets and new ones. This is a common procedure for regulated utility companies, especially after a change in ownership. I propose that the existing assets should earn a real rate of return of 2-4.5% per annum nominal on the Regulated Asset Value, depending on the operational performance. New assets should earn the higher rate of 7.5% per annum. The return and associated depreciation allowance will accrue once the equipment is commissioned. Plans for such new assets will require prior approval by my Office, in common with procedures adopted in other jurisdictions.

Own generation

20. SEL maintains that it will only allow customers' generation to be connected to its network if the owner agrees to a "buy-back" arrangement. The Proposed Variation, the 2019 Determination and the PCO explained why I believe that such an arrangement is unfair to customers and it would appear that respondents agree. Stocks Hotel has explained that, if it had to pay SEL's previous high prices, it would go out of business. The hotel has, in the circumstances, elected to generate its own electricity. The rise in own generation has meant that electricity distributed by SEL's network will fall. Such disconnected "own generation" is currently contributing about 1.2% to the island-wide consumption and I estimate that the currently disconnected customers in the north of the island represent a further 1.7%. With the imminent commissioning of Stocks Hotel's generating system and disconnection from SEL's network, consumption through SEL's system is likely to fall by over 10%.
21. As reflected in the Proposed Variation, the 2019 Determination and the PCO, my view remains that it would not be fair for less wealthy customers to suffer from higher electricity prices that would result if the unit price were to be adjusted to take account of the resulting reduction in



consumption. The consultation responses received support this view. SEL argues that a feed-in tariff arrangement, which would allow the own generators to stay connected, would not be appropriate for SEL. However, SEL mistakenly believes that there would not be a significant “standing charge” for these own generators. The own generators would be willing to pay a fee (connection charge) to SEL in order to remain connected. The ability to be able to sell to SEL when they are in surplus and buy from SEL if they are short could be valuable. Similarly, there could be benefits to SEL to be able to buy electricity cheaply and, at other times, use the batteries that these customers’ systems include to improve the running regime of SEL’s generators. This is clearly a win-win situation. I do not believe it is logical for SEL to ignore this possibility. I accept that, consequently, SEL’s margins may not be as large as if the customers had not installed their own generation and capabilities – but they have done so. If these customers remain disconnected, SEL will receive no margin at all.

New Tariff Arrangement

22. As part of its response to the Proposed Variation, SEL has suggested that all customers should pay a minimum monthly charge, no matter how much electricity is actually consumed. SEL’s proposals for next year’s tariffs are set out in Table 1 below.

Table 1
SEL’s Tariff Proposal

Customer classification	Monthly Minimum Charge	Unit rate (p/kWh)
Residential	£40	54
Commercial	46	52
Commercial Medium	100	50
Commercial Large	150	50
Commercial Extra Large	250	49
FCC ¹⁺		FCC + 100%
Buy back ² - Grandfathered	£5/kW	FCC - 10%
Buy back	£5/kW	FCC – 10%

Source: SEL

Notes:

¹FCC refers to Fuel Cost Component. SEL is proposing a tariff for new consumption at a rate linked to the diesel fuel cost. FCC is currently around 13 p/kWh but would be adjusted monthly.

²My Office has no authority to control the price at which SEL “buys back” electricity from own generators.

23. I welcome SEL’s proposals and my Office will, if adopted, set a maximum price for these monthly charges under the power granted under Section 15 of the 2016 Law.
24. The monthly minimum charge of £40 means that the bill of a customer who consumed 100 units (kWh) during the month would have a bill of £54 (100 x 54p). There will be no change. However, the bill of a customer who consumed only 30 units would pay the minimum, i.e. £40. This means that infrequently occupied premises in Sark would now make a contribution to the fixed costs of electricity supply. My assessment of the impact of this new arrangement on different customer classifications if this had been in place for the month of May 2020, is shown in table 2.



Table 2
Impact of SEL's Tariff Proposal

	No. premises	Min. Charge per month	Customers <Min Charge	Additional income pm
2nd Home	55	40	47	1,788
B&B/Residential	9	40	0	-
Business/Residential	11	40	1	41
Commercial	47	46	26	995
Commercial Med	5	150	1	59
Commercial Lge	7	250	2	46
Commercial X Lge	1	500	0	-
Other	40	0	11	45
Residential	224	40	38	714
Self catering / B&B	20	40	14	418
Vacant Commercial	18	46	16	613
Vacant Residential	60	40	59	2,177
	497		215	6,896

Source: SEL and EPC calculations

25. The table shows how the 497 premises on SEL's customer data base have been classified. The Table indicates that there would have been no change to the bills of 186 of the 224 residential customers. However, 47 of the 55 "2nd Homes" would have paid a higher bill. In all, I calculate that SEL's income for the month would have been almost £7,000 higher with this scheme in place. This implies that the overall price to the remaining customers may be lowered.
26. As much as I welcome the proposal, I am concerned that the overall bill to less wealthy full-time residents on Sark should not rise as a consequence of this new arrangement. As such, I have contacted the Procureur of Sark. I understand that none of the residents currently being supported by the Procureur's Office would suffer an increase in their bills, assuming their normal consumption pattern continues.
27. If SEL is to move away from a single price tariff, my preference would have been for a slightly different arrangement. This would have recovered all the fixed costs of electricity supply through the monthly fixed charge, leaving the unit charge to cover the fuel costs. Among other benefits, this would have had the effect of discouraging own generators given that the unit rate would be much lower. However, SEL has opted for a minimum monthly charge and this decision belongs to the management team at SEL.



Deposits

28. SEL has proposed that it will require customers to provide a deposit of £250 in respect of their electricity supplies. This is common practice for utilities around the world. I do not believe that the 2016 Law provides my Office with any powers to control the size of these deposits. However, I do not believe that SEL should be allowed to earn a “return” on the associated cash, which is, after all, customers’ funds. This has not been taken into account in my assessment of the £140,000 working capital I have included in my estimate of SEL’s Regulated Asset Base.
29. I understand that SEL intends to collect the deposit over the coming months. I do not believe that my Office has the power to insist on a particular form of control for these funds.

Setting the maximum prices

30. The Proposed Variation described my consideration of the material issues relating to the setting of maximum prices for electricity in Sark, under Section 13(2) of the 2016 Law. The previous sections of this note have described my consideration of the various consultation responses to the Proposed Variation. In arriving at my proposals for the new tariff arrangement, I need to estimate the amount SEL is likely to have “under-recovered” during 2020 and the additional revenue, on top of the revenues resulting from the unit charge, that result from the new “Minimum Monthly Charge”. In order to do so, I have made the following assumptions:

Consumption kWh	2020: 1,150,000 2021: 1,150,000-1300,000
Fixed Monthly Charges	As Table 1; Residential £40, Commercial £46, Larger Commercial £100-250
Fuel Prices 2020:	Eurostat/BEIS 41.8 p/l. 2021: 37 p/l delivered to Sark
Annual Fixed Cash Costs	£373,680 (as per the Proposed Variation)
Depreciation	£60,830 (as per the Proposed Variation)
Rate of Return pa	2 – 4.5% on RAB (£23,200 - £52,200)
Under-recovery (2020)	£82,344 calculated according to paragraphs 26 & 28 of the December 2019 PCO. SEL has suggested that this amount could be spread over 1 or 2 years. I am proposing it is recovered in full during 2021.
Additional annual income	£82,750. This is based on May 2020 bills. It is not clear how representative this May’s consumption will be for the whole year of 2021. This estimate will be updated in December.

31. The above assumptions suggest that the maximum unit price may be in the range 48 to 55.5 p/kWh as shown in Table 3 below, based on SEL’s proposed monthly charges. The actual price will depend on the final numbers used for the consumption forecast for 2021, the monthly charges, the allowed return and the estimate of the additional amount that will be captured by the minimum monthly charge. The level of return adopted will be related to the expected performance of the SEL system.

Table 3
Range of Maximum Unit Power Prices for 2021 (p/kWh)

		2021 Consumption (kWh)	
		1,150,000	1,300,000
Return	2%	52.5	48
	4.5%	55.5	50.5



Adjustments

32. SEL is proposing a novel pricing structure which I believe is better suited to the economic conditions in Sark than the previous “basic unit price” form of tariff. However, the effect of this minimum monthly charge on SEL’s revenues cannot be known precisely at this stage. SEL’s revenues are likely to be less sensitive to changes in consumption levels and I will examine the relationship between consumption and profitability in more detail over the coming weeks, as SEL provides more historic information. The adjustment process is likely to involve calculating the additional funds that SEL will collect from customers who would have paid little but now pay the minimum monthly charge. I will compare this sum with a projection of this “additional revenue” and SEL’s unit sales. If the funds SEL collects through this mechanism and unit sales of electricity differ from the projection, then I propose the difference will be identified and assigned to a “balance”.
33. SEL’s profitability will remain sensitive to changes in underlying diesel costs. Under section 13(2)(a)(ii) and 13(2)(f) of the 2016 Law, this is a material issue and I intend to retain the calculation of the price adjustment mechanism for fuel prices in the PCO. This will be calculated, as:

*under/over-recovery (£) = ((Actual average fuel price - 37) / (100 * 3.20⁴) * actual consumption (in kWh)*

where the actual average fuel price is in p/litre.

34. This under/over recovery will be added to the “balance” each month. If the balance exceeds, I propose, £10,000, the balance will be recovered from, or returned to, customers through an adjustment to the unit tariff over the following six months. I recognise SEL and its customers’ wishes for price stability, but I would rather avoid the need for a variation in order to “correct” the operation of these new arrangements. I would like to set this Variation for a two-year period.

Next Steps

35. I am pleased to accept representations from SEL, residents and other interested parties by noon on 7th December 2020 on the contents of this proposed Variation. These may be sent by post or by email to commissioner@epc.sark.gg. These representations will be shared with SEL. Respondents should indicate if they do not wish their communications to be published on the EPC web-site (www.epc.sark.gg). SEL will be given two weeks to respond to any representations I receive, so I should be grateful for prompt responses if the new arrangements are to commence on 1st January 2021. I would be particularly interested to hear respondents’ views on:
- the consumption forecast of 1,150,000 kWh as the basis for the under-recovery calculation for 2020 and the 1,150,000 to 1,300,000 kWh forecast for 2021.
 - the concept of the “minimum monthly charges”.
 - one or two year duration for the Variation.

⁴ The 100*3.20 factor converts prices from p/litre into £ per kWh delivered, taking into account the losses in generation and distribution.



- d) using a different rate of return for new assets of 7.5% per annum, nominal.
- e) the recovery of the “under-recovery” in two years, rather than one.
- f) the introduction of the “balance”, the trigger for adjustment of £10,000 and the period over which the adjustment will be made to the unit charge.
- g) deposits.
- h) any other matters relating to electricity pricing respondents would like to raise.

Once I have received and considered these representations, I will issue a Final Variation.

Anthony White
Commissioner
20th November 2020

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