



Office of the Sark Electricity Price Control Commissioner

Electricity Prices - Proposed Determination for the purposes of consultation

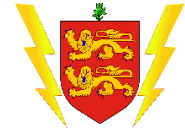
Proposed determination and consultation

1. Under section 3 of the Control of Electricity Prices (Sark) Law, 2016 (the "2016 Law"), my Office is charged with determining whether electricity prices charged by a regulated electricity supplier on Sark are, or are not, fair and reasonable. Part II of the 2016 Law contains various powers enabling me as Commissioner to investigate electricity charges and under Part III of the 2016 Law, following completion of an investigation, the Commissioner is obliged to make a determination as described above.
2. My investigations and discussions concerning electricity prices charged by Sark Electricity Limited¹ (SE) conducted over the period 8th November, 2017 to 10th March, 2018, lead me to a provisional conclusion that the current basic rate of 66 p/kWh, and those rates for larger users, charged by SEL are not fair and reasonable. However, before I make any final determination, in accordance with section 14 of the 2016 Law, I must consult with SEL as the regulated electricity supplier that will be affected by any determination and the Policy and Performance Committee of the Chief Pleas of Sark. I may also consult others as I see fit. The purpose of this Proposed Determination is to enable appropriate consultation to take place in order that I may proceed to make a final determination.

History of investigation

3. On 8th November 2017 I visited Sark in order that I could be sworn in as Commissioner before the Court of the Seneschal . I also used the occasion to meet SEL, and I held a number of meetings to meet members of the public, business owners, Conseillers and various members of the administration of the Government of Sark.
4. Further to the investigations I had carried out, I published a consultation paper in December, 2017 which examined prices for electricity charged by SEL on Sark. It comprised an analysis of the situation on Sark and the supply of electricity by SEL running to 10 pages. The Paper was published on the Commissioner's website and an announcement was made to the press and other media.

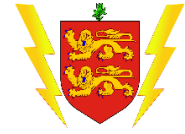
1. The Sark Electricity Company Limited is understood to have been split into Sark Electricity Limited (SE) and Sark Electricity Holdings Limited (SEH) in 2014. The original company's assets were placed in SEH and leased to SE which operates the electricity system. I refer to SEL as the combined company.



5. In the December Consultation Paper, I suggested that the current system of electricity supply by SEL on Sark, namely four diesel engines providing power to customers over a buried electricity distribution network, is expensive because the market is small and because the cables are buried. I also suggested that a supply incorporating newer technologies, solar PV, wind generation and batteries would be far cheaper. Indeed, the consultation paper highlighted the risk that, if prices remain at current levels, some customers would generate their own power using these technologies and disconnect from the network. This would cause prices to the remaining customers to increase, as the power company sought to recover its costs and returns from fewer customers. I proposed that a fair and reasonable price for Sark would be one that reflected the competitive costs of these alternative technologies and that I was proposing to adopt 45p/kWh as a fair and reasonable price for power on Sark.
6. The Paper (which is still available for viewing on the Commissioner's site via the link http://www.epc.sark.gg/assets/price_control_consulation_dec_2017.pdf) concluded by seeking views on 11 specific matters (see paragraph 18) ranging from the importance of the electrical distribution system being buried to performance incentives. It also indicated that a final consultation paper would be written with specific proposals, which are now produced in this Proposed determination document.
7. I also held meetings on and Guernsey and Sark during 8-10th January where I met members of the public, business representatives, financiers, Conseillers and the Policy & Performance Committee. I have also received communications from or on behalf of SEL, Alderney Electricity, Siemens, NaREC-DL, members of the public and businesses, commenting on the various assumptions made in the paper.
8. In the December Paper, I estimated a price that would allow SEL to maintain secure supplies using the current equipment and provide a reasonable return for shareholders. I arrived at a full cost of 55p/kWh. SEL argued that my cost assumptions were too low and that my range of reasonable returns (5-10% per annum plus inflation) were too low. Other correspondents said that the return range was appropriate, whilst others thought that costs of some services on Sark would be higher. I was also advised that, owing to the absence of roads on Sark, the costs of burying cables were lower than on the mainland and were not a cause of the higher costs. There were no challenges to my suggestion that renewable technologies were highly competitive with the current reliance on diesels alone.

Considerations

9. In reaching my Proposed Determination I have taken into account a variety of considerations, many of which are, in effect, set out in the December Paper referred to above. Section 13(2) of the 2016 Law requires me to take into account "all material considerations" including a number of specific considerations which are set out in paragraphs (a) to (g) of that section. I list below each of the specific considerations set out in section 13(2) together with my comments relating to how I have taken them into account:



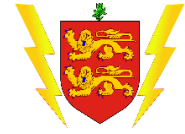
- (a) *the cost of generating and distributing the supply of electricity, including the cost of –*
- (i) *acquisition and maintenance of any plant and equipment,*
 - (ii) *fuel and other consumables, and*
 - (iii) *labour,*
- required to generate the supply,*

I have received copies of SEL's accounts for the years 2009-2016 inclusive, SEL's budget for 2018, together with a copy of a consulting engineer's assessment of the cost of replacing all SEL's electricity supply assets with new equipment. I am not at liberty to reveal the costs revealed in SEL's accounts under the terms of a non-disclosure agreement between my office and SEL. In coming to my assessment of the costs of generating and distributing the supply of electricity, I concluded that it was not reasonable to expect SEL's customers to pay for some of the costs incurred by SEL. These included those associated with travel and the cost of finance. SEL is financed entirely by shareholders. SEL does not have any debt, which could be a source of low cost finance. SEL argues that this is because it is impossible to obtain bank debt without having "wayleaves"², and wayleaves are "not available on Sark". I have ascertained that the original owner of the electricity system on Sark, Mr Robson, did hold such wayleaves, so SEL could have access to cheaper finance. I also discounted the costs claimed for dealing with regulatory issues. To arrive at my estimates of likely fuel costs, I researched the heat rates that should be achieved by diesel engines of the make, age and size of those on Sark and adjusted for likely losses through the distribution system and for station auxiliary equipment, using my own judgement and conversations with other diesel operators. I also contacted the Island of Sark Shipping Company Limited, Channel Islands Fuels and had access to world prices for diesel fuel, specifically those reported by Platts at Amsterdam, Rotterdam and Antwerp (ARA). For labour costs, I considered the number of staff, the required skills and experience and cross checked this with other operators of diesels and distribution networks.

- (b) *the replacement cost of any plant and equipment required to generate and distribute the supply,*

I have already mentioned the consulting engineer's report on SEL's equipment. However, of more relevance to establishing a "fair and

² A wayleave, in this case, is an agreement between a landholder and utility for the latter to have equipment on the landholder's property.



reasonable price” is the cost of purchasing and operating the renewable technologies, i.e. PV, wind, batteries and the required associated control system. I have spent much time researching this matter and have been in communication, and receipt of material, from Siemens, the UK Energy Catapult and NaREC-DL, as well as other material that I found on the internet, such as Eurelectric (The European Association of Electricity Operators). This allowed me to estimate the price needed to ensure that SEL could maintain secure supplies, install the new equipment and provide a reasonable return on its investment.

- (c) *the quality and reliability of the supply of electricity and the economy and efficiency with which the supply of electricity is generated and distributed,*

The gradual displacement of diesel generation with renewables and batteries is now a well-established trend on small systems across the world, stretching from the Faroes Islands to the Philippines, so it is not a matter of the power failing when the sun goes down. See “Towards the Energy Transition on Europe’s Islands”, Eurelectric, January, 2017.

- (d) *the margin of profit obtained by the regulated electricity supplier,*
(e) *the margin of profit obtained by such other electricity suppliers, generating and distributing a supply of electricity in similar circumstances in such other islands, or territories, as the Commissioner thinks fit.*

SEL’s gross profit is determined by the difference between the sales of electricity and its fuel costs. The final profit is determined by subtracting the costs of administration, maintenance and repairs, staff and other overheads from this gross profit, as well as an allowance for “using” the assets, i.e. depreciation. I am proposing that a return on regulated assets (i.e. those used for the provision of power – see the consultation paper for a fuller explanation) should be 5-10% per annum in real terms, i.e. allowing for inflation. This is more generous than that offered to electricity network owners in the UK³, currently [3-4%] real per annum, i.e. adjusted for inflation. I believe this to be an appropriate benchmark, given that the commercial risks are similar and they generate returns in the same currency. Comparisons with companies such as Centrica and SSE, as suggested to me by SEL, are not appropriate, given that investors in these companies are exposed to fossil fuel price risk, which SEL is not, and these companies’ prospects are influenced by other businesses in their portfolios, such as trading in the USA and oil & gas production and development. Moreover,

³ OFGEM; RIIO ED1 – July, 2014 and DPCR, December, 2009



SEL has not used debt markets to finance its activities. In my view, this results in the company incurring higher costs than necessary.

- (f) *the entitlement of the regulated electricity supplier to receive such reasonable return, as the Commissioner thinks fit, on the value of assets (including plant and equipment and working capital) operated or used by the supplier for the purpose of generating and distributing the supply, and*

It is correct that SEL should receive a return on assets. The problem is that, were it to enjoy a return on the replacement value of the current diesels and distribution network, the resulting price would be uncompetitive with PV, wind and batteries. As a consequence, some customers would choose to generate their own power, as discussed in paragraph 5 above. This situation is similar to that encountered by Kodak when its sales of film plummeted after the invention of digital cameras. Kodak could not respond by raising its prices. It seems to me that the “value” of SEL’s assets is considerably lower than that calculated from the replacement costs of its existing assets.

- (g) *any representations made in response to a request given under section 14, or otherwise.*

the Commissioner will consider any representations made by parties interested in electricity prices on Sark.

10. It is reasonable for electricity customers to expect electricity prices to reflect the cost of generating electricity using the most appropriate technologies. As such, under Section 15 of The Control of Electricity Prices (Sark) Law 2016, I anticipate setting a maximum tariff to reflect such costs. This will include a reasonable return on investment.

Next Steps

11. In accordance with section 14 of the 2016 Law, I am sending this Proposed Determination to SEL, the Policy & Performance Committee of Chief Pleas. I would also like to receive responses from any other party interested in electricity prices on Sark. I ask that responses reach my Office by 29th March, 2018, by post or email (commissioner@epc.sark.gg).

Finally, I should be grateful if those who do respond to this Proposed Consultation would note that under section 14(2) of the Law of 2016 the Commissioner must give SEL, as the regulated electricity supplier, an opportunity to make representations to the Commissioner on their responses.

Anthony White 12th March

Commissioner



25, West Street
Long Buckby
Northamptonshire
England NN6 7QF