Consultation On Proposed Variation To The Electricity Price Control Order

1.0: SUMMARY

Sark Electricity Limited ("SEL") has requested a variation to the current Price Control Order ("PCO"), which sets the maximum unit price for electricity. If I fail or refuse to vary the PCO, the legislation allows SEL to appeal to the Court of the Seneschal.

The context for SEL's request is the public announcement by Chief Pleas to set up a replacement electricity system in Sark, and its working assumption is that SEL will cease to operate in two years' time.

SEL has requested that the PCO is varied such that: new capital expenditure of up to £512,426 is either approved or disapproved (in whole or in part) and paid for by consumers over the next two years; a provision of £980,370 is accumulated and paid for by consumers over the next two years for de-commissioning and island re-instatement shortly after SEL ceases to operate; an "agreed proportion" of £315,156 of historic legal costs is paid for by consumers over the next two years and the allowance for legal costs over the next two years is increased by £43,000 per year; the dilapidation provision for the power station is increased by £11,941 per year for two years; and the treatment of inflation is changed for fixed operating costs and the Regulatory Asset Base ("RAB").

I estimate that, if I were to accept SEL's request in full, the maximum unit price for electricity would increase to 150 p/kwh over the next two years. This compares to the current maximum unit price of 54 p/kwh.

Under the legislation, I must consult with SEL and I may consult with such other persons as I see fit. The matters arising from this variation request relate to the price, reliability and safety of electricity supply in Sark. Accordingly, before I decide on any variation to the price control order, I consider it appropriate to consult with electricity consumers in Sark.

In this consultation paper, I have analysed and discussed each part of SEL's variation request in some detail and set out my minded-to positions. This would result in the maximum unit price increasing marginally to around 56 p/kwh, or increasing to around 65 p/kwh over the next two years.

Given the significance of the issues which arise from this request by SEL, I am very interested in hearing the views of electricity consumers in Sark, before I reach my final decision. I would therefore welcome responses to this consultation from electricity consumers in Sark as well as from SEL. Please send your response by e-mail to commissioner@epc.sark.gg by 5 pm on Tuesday the 24th of September 2024. I am required by legislation to give SEL the opportunity to make representations on any consultation response. I also intend to publish an overall summary of the points made in consultation responses on the office website. Please make it clear in your response if you wish that your name, or the name of your organisation, is not disclosed.

Any variation to the PCO would take effect from 1st October 2024 or as soon as possible thereafter.

2.0: INTRODUCTION

Pursuant to section 15 of The Control of Electricity Prices (Sark) Law, 2016 ("the Law"), a price control order ("PCO") was set by my office for the period 01 April 2023 until 31 March 2025. This PCO regulates the maximum unit price that Sark Electricity Limited ("SEL") can charge for electricity.

SEL recently requested that my office vary this PCO such that: there is a different treatment of inflation; new capital expenditure of £512,426 is either approved or disapproved (in whole or part) and recovered over the next two years; the balance of its historic investment is recovered over the next two years; a provision of £980,370 is accumulated over the next two years for de-commissioning and island re-instatement; an "agreed proportion" of historic legal costs of £315,156 is recovered over the next two years; the allowance for future legal costs is increased by £43,000 per year; and the dilapidation provision for the power station is increased by £11,941 per year.

I have included a copy of SEL's variation request letter at Annex A of this paper. This letter sets out the context in which its request is made as:

> *"The PCO was made and operates in a set of circumstances that are globally unprecedented. Specifically, in a market comprising approximately 500 customers only, with limited growth potential, proposals have been made to set up a second electricity grid."*

To help clarify some aspects of this variation request, I have held a conference call with SEL and its legal advisors and received further written correspondence from them.

Pursuant to section 20 (1)(e) of the Law, SEL has the right to appeal to the Court of the Seneschal if my office fails or refuses to vary a PCO when requested to do so. I estimate that, if I were to fully approve SEL's variation request, electricity prices would increase to around 150 p/kwh over the next two years.

Pursuant to section 16(2) of the Law, before varying a PCO, I must consult with SEL and I may consult with others as I see fit in relation to the matters arising. The matters arising from this variation request relate to the price, reliability and safety of electricity supply in Sark. Accordingly, before I decide on any variation to the price control order, I consider it appropriate to consult with electricity consumers in Sark.

I would welcome responses to this consultation from SEL and from electricity consumers in Sark. Please send your response by e-mail to commissioner@epc.sark.gg by 5 pm on Friday the 20th September 2024. I am required by section 16(3) of the Law to give SEL the opportunity to make representations on any consultation response. I also intend to publish an overall summary of the points made in consultation responses on the office website. Please make it clear in your response if you wish that your name, or the name of your organisation, is not disclosed.

This paper begins by setting out some over-arching considerations for this PCO variation request. Next, each aspect of the variation request is considered in turn, together with my minded to position, and the likely impact of both on the maximum unit price. A results section is then provided setting out the likely impact on the maximum unit price from both the request and my minded to position. Finally, several consultation questions are posed.

3.0: OVER-ARCHING CONSIDERATIONS

There are several over-arching considerations relating to this PCO variation request.

First, when making or varying a price control order, section 16(1) of the Law requires my office to take all material considerations into account, including those referred to in section 13(2) of the Law. These include, without limitation, the cost of acquisition and maintenance of any plant and equipment; the replacement cost of any plant and equipment; labour costs; and a reasonable return on investment. I have included the full text of section 13(2) of the Law in Annex B.

Second, it is important to note that SEL did not appeal to the Court of the Seneschal against the existing PCO, the December 2019 PCO, nor the January 2021 variation. A variation request cannot be used to simply revisit issues already determined and accepted in past PCOs or variations.

Third, it is, however, in my view, reasonable to consider a variation to a PCO if new material considerations or information arise after the PCO came into effect. In this regard, I note however that Chief Pleas had announced its intention to tender for a completely new electricity system long before the existing PCO came into effect. Therefore, one could take the view that no new consideration or information has arisen. Nonetheless, during the term of the PCO, Chief Pleas approved public expenditure for design work on the new system and this could be viewed as increasing the probability that a new system will be constructed.

Fourth, in my view, it is also reasonable to consider a variation to the PCO if an unintended manifest error is discovered after the PCO has taken effect.

Finally, it is important to note that, pursuant to section 15(6) of the Law, the current price control is only valid until the 31 March 2025, and that a variation during the term of the PCO does not extend this date. My office can only introduce a new PCO if, after a period of investigation and consultation, it determines that the price charged by SEL is not fair and reasonable. In any such investigation, consideration would be given to any analysis developed for this variation request.

4.0: APPLICATION OF INFLATION

4.1: SEL's Request

SEL has requested that Inflation is applied annually to (a) fixed operating costs and (b) the allowed rate of return on assets and/or the Regulatory Asset Base ("RAB"). I will now consider each of these in turn.

4.2: Discussion on the Application of Inflation to Fixed Operating Costs

Utility price controls typically account for annual inflation, over the term of the price control, when setting the allowance for fixed operating costs. This allowance is also often designed to encourage operational efficiency. For many years utility regulation in the UK was based on the (RPI-X) regime whereby allowances for fixed operating costs were increased annually by less than inflation to achieve both objectives.

The PCO determination for SEL was based on an allowance for fixed operating costs of £325,000 for the year beginning on 1 April 2023. However, this determination makes no reference to increasing this allowance in the second year of the PCO to account for inflation.

As SEL rightly points out, however, the earlier consultation paper for the PSO determination stated:

> *"In the October 2022 determination my office concluded that an efficient operator would require £300,000 in 2023 for fixed operating costs and a further provision of £5,307 for*

dilapidations at the power station. I am proposing to use these values for this price control for calendar year 2023, ***and to inflate them by Guernsey inflation for the calendar years thereafter."*** (my emphasis)

The same consultation paper, however, goes on to state that:

"*Fixed operating costs* ***ma****y also need to be re-considered annually to take account of the impact of inflation*" (my emphasis)

Nonetheless, on further reflection, I recall that, having considered the consultation responses, my intention was to indeed take account of inflation in the allowance for fixed operating costs. I therefore consider that this represents a manifest error in the PCO. Furthermore, given the operational challenges that SEL faces at present, I do not consider it appropriate to expect efficiency gains in fixed operating costs in the second year of this price control. The allowance of £325,000 for fixed operating costs in the PSO should have been increased by 6.3% from 01 April 2024 (reflecting Guernsey inflation in 2023).

It is usually not considered to be good regulatory practice to retrospectively adjust a price control, except in circumstances where this intention was signaled, or an unintended manifest error has occurred.

SEL's request to apply Guernsey inflation to fixed operating costs in the second year of the PCO would increase the allowance of £330,307 by £20,809. This would need to be recovered over a six-month period from 1st October 2024 – 31 March 2025. Given that assumed demand over this period is 700,000 kwhs, this would increase the maximum unit price by 2.97 p/kwh.

4.3: Discussion: Application of Inflation to the Allowed Rate of Return and/or the RAB

In its variation request letter, SEL states:

"....the EPCC has set prices and updated the RAB in a manner which goes not meaningfully address inflation in any way, shape or form" and,

"We understand the return on the RAB in 2024 is roughly £5,000 less than in 2023; hardly reflective of an inflationary increase".

In utility regulation, the acquisition costs of assets are typically paid for by consumers in annual installments over the expected remaining lives of the assets. These payments are often referred to as depreciation payments. The overall RAB is adjusted downwards annually to account for these payments, and upwards each time a new asset is added. The utility also receives a regulated rate of return based on the average RAB value during the year.

There are typically two approaches to inflation in utility regulation. The rate of inflation can either be added to the real rate of return or the RAB can be increased by inflation annually[1]. For this price control inflation was added to the RAB from 1 April 2024 and SEL's allowed return was based on a real return of 5%.

Therefore, contrary to SEL's assertion above, the RAB was updated and the allowed return calculated to take account of inflation. SEL was provided with a summary of the changes to the RAB and the allowed rate of return from 1 April 2024, together with a copy of the updated RAB model. The allowed rate of return was reduced by £4,485, for 2024-25, simply because the average value of the RAB in 2024-25 also reduced (even after the application of inflation).

The two approaches described above result in different cash flow profiles. Applying inflation to the real rate of return, instead of to the RAB, tends to accelerate cash flows. Given SEL's request (see below) to also accelerate the recovery of its past expenditure on existing assets, it would be consistent to also apply inflation to the real rate of return going forward, rather than to the RAB.

4.4: Minded-To Position

I am minded to retrospectively increase the allowance for fixed operating costs for 2024-25 by Guernsey inflation in 2023, and to allow recovery of this in the second half of 2024-25.

I am minded to apply inflation to the allowed rate of return, rather than to the RAB from 1st October 2024.

5.0: NEW CAPITAL EXPENDITURE

5.1: SEL's Request

SEL has presented capital expenditure proposals and requested that these are expressly approved or expressly disapproved. These proposals total £573,898 and SEL has requested that this investment is paid for by consumers over a two-year period, in equal monthly installments, beginning in October 2024. The proposals consist of the replacement of generators, cables, switchgear and transformers. They also include a fuse upgrade and the erection of fencing at generation and distribution sites. Full details of these proposals can be found in Appendix C.

SEL has also clarified the following regarding its proposals:

1. It is unable to provide an indicative program for the replacement works prior to a tendering process,

[1] The attached article explains the effect of both approaches

2. It is confident that all the replacement works can be completed in the two-year period,

3. It would not be possible to reduce the scope of the replacement works because it is all necessary to maintain safety and reliability (as identified in previously commissioned reports by the EPCC Chief Pleas),

4. It would not be willing to facilitate an independent technical review of its proposals, and

5. It will provide evidence of actual capital expenditure after it has occurred.

5.2: Discussion on SEL's Proposed Capital Program

Of the above proposals, £36,472 has already been approved for a replacement generator and added to a new RAB. SEL's remaining proposals would increase prices, over the two-year period, by c19.2p/kwh.

The issue of new capital expenditure, in the context of Chief Pleas announcement of its intention to tender for a replacement system, was already considered in the current PCO, as follows:

> "*SEL also provided me with outline proposals for new capex. I have asked SEL to urgently review and re-submit these proposals, prioritised based on critical expenditure needed to ensure safety and reliability for the next few years. I will then review and grant approval for immediate expenditure that I consider appropriate.*
>
> *Given that Chief Pleas has announced its intention to tender for a completely new electricity system, it seems reasonable to me that a separate RAB with accelerated depreciation for new capex should be created for SEL. Consideration also needs to be given to the appropriate rate of return on investment for this new capex. I consider it appropriate to wait until I am presented with SEL's revised proposals before setting values for accelerated depreciation and return on investment. I also consider it appropriate that depreciation and return payments to SEL should begin as soon as the expenditure is complete rather than waiting until the start of the next year. It will also be necessary to adjust the maximum unit price to allow for this cost recovery".*

SEL committed to providing me with its revised proposals, prioritised on the basis of safety and reliability. However, after many reminders, these were not provided until earlier this summer. This submission, however, was very similar to the original submission in March 2023. There was no prioritisation and no works program. The latest submission, presented with this variation request, appeared to be a repeat of the earlier submission.

SEL's variation request is based on a working assumption that its remaining operational life is only two years. Nonetheless, SEL appears to be arguing that all the replacement works in its original proposals are still necessary and a priority, to maintain safety and reliability. SEL points to the need for these replacement works being identified in previous technical reports commissioned by the EPCC and Chief Pleas.

However, the conclusions in these reports were not based on an assumption that SEL would cease to operate two years after the assets were replaced. I would therefore not expect that the same capital program would be necessary in a scenario where the remaining life was only two years. Furthermore, as set out later in this report, SEL has also requested an additional provision of £980,370 such that it can de-commission and remove its equipment from the island after it ceases to operate in two years' time. This would suggest, for example, that cabling and fencing would be installed over the next two years at an estimated cost of £281,363, only to be removed again shortly after that period. This does not seem to me to be a sensible course of action or use of consumer's money.

In my view, and based on my experience, a prudent and competent operator of an electricity system should be able to review its capital expenditure program and identify critical expenditure to ensure safety and reliability for the remaining years of its life. For example, it would seem to me that replacement or repair of the cable across the Coupe is critical, at an estimated cost of £52,000. However, I am not yet convinced that it is necessary to erect fencing at an estimated cost of 99,000, for a two-year period.

I would also expect SEL to be able to come up with an indicative work program and then refine this after the tendering process. It is disappointing that SEL has not done any of this to date and will not facilitate an independent technical review of its proposals.

It is also my view, and based on my experience, that SEL is perhaps too optimistic about its ability to complete all the work in its proposals over the next two years. I say this because there can be significant lead times for the delivery of some equipment in the electricity industry, the island of Sark poses additional logistical challenges, and, to the best of my knowledge, SEL has not yet commenced any tendering process.

During the term of this PCO, my office has already approved £36,472 of capital expenditure for a replacement generator, based on invoices presented by SEL after installation. A new RAB has been established, and depreciation (over 3 years) and a return on capital are included in the maximum unit price. This approach is consistent with what was set out in the PCO, although SEL did not seek approval prior to incurring the expenditure.

I once again invite SEL to re-submit its capital expenditure proposals and to agree to facilitate an independent technical review of these proposals. If this is not forthcoming in the coming weeks, I will commission an independent technical desk-top review. Having considered the recommendations of this review, I will then decide what works to approve.

In the meantime, I will also immediately consider for approval any individual asset replacements that SEL considers needs to happen urgently.

5.3: Discussion on Financing the Proposed Capital Expenditure Program

SEL has also requested that the capital expenditure program is paid for by consumers by accumulating a provision in equal monthly payments over the two-year period. SEL has confirmed that it will provide evidence of actual capital expenditure after it has occurred.

This approach requested by SEL is different to the approach currently used in the PCO. For example, under the PCO, a new RAB was created for the replacement generator and the investment cost (together with a return) is recovered over a three-year period from receipt of invoices.

The issue of consumers pre-funding capital expenditure has been considered before. For example, in the PCO of 20th December 2019, my predecessor stated, when referring to capital expenditure:

> *"I do not believe it is necessary for Sark Electricity Limited to raise prices in order to accumulate a fund to do this."*

The approach requested by SEL also raises the issue of an appropriate financial incentive. Under the current PCO arrangement, for each item of new capital, SEL receives an allowed annual rate of return on the average annual RAB value, and the investment is recovered over three years. Under SEL's proposal, given that customers may be essentially pre-funding investments, it does not seem to me that SEL should enjoy any return on these investments. However, this would mean that SEL has little incentive to carry out the investments.

SEL's proposals also include a project management fee of £25,000 over two years. It seems to me that, in the circumstances, it would be more appropriate to treat this as a monthly operating cost.

5.4: Minded-To Position

I am not minded to accept SEL's request to approve an additional £537,426 capital investment program, funded by customers in equal installments over two years. If I were to do so, ignoring any allowed return on investment, this would increase the maximum unit price by c19.2 p/kwh.

In my view, it will be about three years before there is any new replacement electricity system in Sark. It is obviously very important that SEL has sufficient incentive to operate the existing system, safely and reliably in the intervening period, and to carry out necessary investments.

I am therefore minded to allow SEL a project management fee of £31,250 over a three-year period. This would however need to be subject to periodic reviews, to ensure that SEL continues to operate prudently and is working on delivering the approved investments.

I am also minded to approve any investments recommended by an independent technical review of SEL's proposals. In some cases, as identified earlier, approval may be granted prior to such a review. These investments would be included in the RAB for new assets alongside the replacement generator.

On a working assumption that the capital investment might be in the order of £150,000 together with the management fee, over a 3-year period, this would add c4.3p/kwh to the maximum unit price.

6.0: DECOMMISSIONING AND RE-INSTATEMENT PROVISION

6.1: SEL's Request

SEL has requested that the PCO is varied such that it is allowed to accumulate an additional provision of £980,370 over the next two years for de-commissioning of its equipment and re-instatement of the island after it ceases to operate. SEL has requested that this provision is funded by consumers in equal installments over the next two years and that a further allowance is made for inflation between now and 2027. Full details of SEL's costing are provided in Appendix D.

SEL's legal advisors also made a submission citing examples of regulators in the UK and Europe allowing for pre-funding of de-commissioning costs, including the de-commissioning of Sizewell C nuclear power station in the UK.

6.2: Discussion On SEL's Request

I estimate that SEL's request, if it was accepted, would add c35 p/kwh to the maximum unit price over the next two years.

The issue of decommissioning and reinstatement costs has been considered before by my office. For example, paragraph 26 of the January 2021 variation states:

> *"In its representation to my Office on 15th December 2020, SEL suggested that it has contingent liabilities on account of Mr Moerman successfully challenging SEL's right to leave equipment on his property. These were estimated by SEL to amount to £4m although no support for this was provided by SEL. I regard the likelihood of SEL being asked to remove and replace the existing distribution system as being very remote".*

*T*o the best of my knowledge, SEL has not been asked by any other landowner in Sark to remove its equipment. I am also not aware of any legislation in Sark which would require SEL to remove its equipment.

Furthermore, given the magnitude of SEL's estimated costs and the island-wide impact, I would expect SEL to discuss the issue with Chief Pleas, prior to making any requests to my office. Such discussions may well result in other options, if required, for addressing this issue.

There is however already a provision within the existing PCO of £5,641 for dilapidations at the power station that may arise from the conditions of the lease.

6.3: Minded-To Position

For the reasons set out above, I am not minded to accept SEL's request to accumulate a provision of £980,370 ver the next two years, funded by consumers in equal monthly instalments.

I am however minded to allow SEL to accumulate the outstanding provision for dilapidations at the power station over the next three years, rather than until 2030.

I estimate that the provision would increase by £7,960 per year and this would increase the maximum unit price by 0.19 p/kwh.

7.0: ACCELERATED RECOVERY OF EXPENITURE ON EXISTING ASSETS.

7.1: SEL's Request

SEL has requested that the PCO is varied such that it recovers its outstanding investment in its existing assets over the next two years.

The current PCO model uses a Regulatory Asset Base (RAB) as a basis for determining the value of SEL's outstanding investments, an allowed annual depreciation charge and a return on investment. This PCO model was established in 2019 after work by technical consultants WSP. The opening value of this RAB was set as the total estimated depreciated replacement value of the existing assets at that time. The RAB is then decreased each year by depreciation and increased to account for inflation.

A second RAB was also established as part of the existing PCO to account for new capital investments and these are depreciated over three years.

The maximum unit price includes allowances for annual depreciation and a return on capital, based on the average RAB value over the year.

SEL points to the fact that the PCO model allows for recovery of investment in new assets over a much shorter period than the recovery period for existing assets. SEL argues that all assets, both new and old, should be treated in the same way, and that distinguishing between the two situations is irrational in that, if this is not the case, the inevitable conclusion is that SEL will lose the value invested.

SEL state that the current PCO model seems to require SEL to simply write off these costs and potentially face significant additional losses immediately upon launch of the new grid. SEL claims that the announcement of the proposed new grid has not crystallised these losses, and that they remain potentially recoverable through the application of a fair and reasonable unit price in the intervening period.

SEL's legal advisors also made an additional submission about the valuation of SEL's assets. SEL's legal advisors argued that: (1) changing the approach for the RAB valuation was likely to be disruptive to the regulated company and would lead to tariff instability that was not in the consumer interest; (2) using a market value to determine the RAB is flawed as this would create a circularity, and (3) the value of SEL's assets is significantly higher than the price paid for its holding company in 2020 because this price was reduced to reflect significant debt, risk and an acknowledgement of the need to spend additional sums and restructure the business. SEL's legal advisors also provided market-to-asset ratios for several UK water and energy utilities which ranged from 1.1 - 1.5 x.

7.2: Discussion On SEL's Request

I estimate that SEL's request, if it was accepted, would add c25.4p/kwh to the maximum unit price.

Chief Pleas' announcement about its intention to build a replacement system was known about when the current PCO took effect. SEL did not, at that time, object to the different treatment of new and old assets and did not appeal to the Court of the Seneschal. It could, therefore, be argued that no new material considerations have come to light to merit a variation to the PCO.

However, since the PCO took effect Chief Pleas has approved expenditure on a high-level design study for a replacement system. It could therefore be argued that the probability of a new system proceeding has increased.

In the PCO, the depreciation period is accelerated for new assets because, in my assessment, any existing operator would be unlikely to accept a longer recovery period in the context of the statement by Chief Pleas. This lack of investment would in turn be likely to result in a risk to the reliability and safety of the SEL system in the interim.

I do not agree with SEL, however, that it is irrational to distinguish between the treatment of old and new assets. This is because the potential stranding of historic investments is less likely to pose the same degree of risk to safety and reliability.

Nonetheless, it is widely accepted that investors in regulated assets should expect to get their investment back together with a regulated rate of return, provided they operate efficiently. In my view, this expectation should be no different in Sark.

SEL has requested that its outstanding investment in its assets is recovered over the next two years. SEL argues that this should equate to the current value of the RAB based on the WSP model, and that the current value of the RAB should not be changed to reflect the acquisition cost of the assets in 2020. I will now consider this issue in more detail.

When making or varying a PCO, pursuant to sections 16(1) and 13(2) of the Law, my office must take into consideration, amongst other things, the acquisition and maintenance cost of any plant and equipment. This is a specific requirement of the Law.

An allowance for maintenance costs for plant and equipment is already included in the fixed cost component of the maximum unit price.

I interpret the Law to mean that I must take into account the actual acquisition cost of plant and equipment. This is distinctly different from what value someone might put on these assets at any time.

Determining an appropriate allowance for the acquisition cost of plant and equipment has been problematic for past PCOs and variations. In setting the first price control in 2019, my office found it impossible to establish what the original acquisition cost of the assets were and how much consumers had already paid back. In the absence of this information, my office commissioned consulting engineers WSP to try, as far as possible, to estimate depreciated replacement costs for the assets and their remaining useful life. This estimated RAB value has been used in both the 2019 and the 2023 PCOs. It has been adjusted to account for inflation, depreciation and retirement of plant and equipment since 2019. Other additions have also been made to the RAB not included in the WSP report.

SEL was acquired by a new owner in March 2020. Using the actual acquisition cost of the assets at that time, rather than estimated costs by WSP, would clearly be much more representative and consistent with my requirement under the Law, for the purposes of making or varying a PCO. Again, however, in varying the PCO from the 1st January 2021, my office was unable to determine what this acquisition cost was.

I noted in the 2023 PCO paper that I had recently been informed what the acquisition cost of the SEL assets was in 2020 and the basis for this at that time. However, in early 2003 I did not consult on using this cost for setting the RAB opening value, depreciation and return on capital. I therefore decided to continue using the costs derived from the WSP report, although I made it clear that I was not bound to use this same approach in future price controls or variations.

I now wish to address the arguments made by SEL's legal advisors about asset valuation.

First, it is important to note that the Law requires me, when varying a PCO, to take into consideration the acquisition cost of the plant and equipment. This is different to what someone might consider the value of the assets to be at any time.

Second, SEL's legal advisors argued that the value of its assets was significantly higher than the price paid in 2020, because the price was reduced to reflect significant debt, risk and the need for additional expenditure. I am aware of what was paid to address current liabilities at the time, and I have included this in my analysis shared with SEL. Risk is typically taken into consideration in most valuations, and, for a regulated utility, this risk is reflected in the allowed rate of return. Therefore, SEL is already given an allowance for bearing risk. The maximum unit price in the PCOs has also included fixed allowances for efficient expenditure.

Third, SEL's legal advisors argued that changing the approach for determining the RAB value is likely to be disruptive to the regulated company and to lead to instability in tariffs that is not in the consumer interest. Furthermore, changing the RAB value to reflect the latest market valuation is flawed because it creates circularity.

I would agree with the generality of these arguments. However, what is relevant here is how the opening value of the RAB is established in the first instance. In the UK, the opening RAB values were based on the government proceeds when the utilities were privitised. Effectively, they were based on the acquisition cost of the assets at the time of privitisation. However, the opening RAB value for SEL was not based on the acquisition cost of the assets in 2020, simply because my office was unable to obtain this information. Now that this information is available to my office, it seems appropriate to me that it is used. My office has also made it clear in the past that it was not bound to continue using WSP estimates for the RAB. This approach is consistent with the requirements of the Law and regulatory precedent in the UK.

Finally, the market-to-asset ratios for the UK water and energy utilities, presented by SEL's legal advisors, demonstrate that many of these utilities have been sold at multiples to the RAB ranging from 1.1 - 1.5. However, these multiples were typically paid for on-going businesses with long remaining lives, and where the market judged that the regulatory allowances could be outperformed. The context in which SEL has made this variation request is very different. The working assumption is that SEL will cease to operate in two years' time. SEL has also consistently argued that it is underperforms against the regulatory allowances.

7.3: Minded-To Position

I am minded, on balance, to accept SEL's request to accelerate depreciation for existing assets. However, this would be over three years, consistent with the treatment of new assets, rather than over the two years requested by SEL. I am also minded to use the 2020 acquisition cost for the assets rather than costs estimated by the WSP model.

The information which I received about the acquisition cost of the SEL business in 2020, relates to the price paid for the assets and outstanding current liabilities. I have used this information to derive a maximum and minimum effective acquisition cost for the assets. I have then calculated the current RAB values and the impact on the maximum unit price. I have shared a spreadsheet with SEL that sets out these calculations, and I intend to discuss this with SEL further as part of my consultation, before I decide what value to use for the 2020 acquisition cost.

I estimate that SEL's request would increase the maximum unit price by c25.4 p/kwh over the next two years. Using the maximum 2020 acquisition cost would increase the maximum unit price over the next three years by c5.8 p/kwh and using the minimum 2020 acquisition cost would reduce it by c1.6 p/kwh.

8.0: RECOVERY OF LEGAL COSTS

8.1: SEL's Request

In its variation request letter, SEL refers to the actions of Chief Pleas and states that the challenges created by the unique situation arising have led to SEL requiring significant legal advice. SEL claims that the PCO makes no provision or allowance for legal fees expended by SEL and requests that the fixed cost proportion of the PCO be amended to consider the reasonable legal costs of addressing the legalities of the current situation.

In subsequent e-mails SEL stated that its legal costs since it acquired SEL in 2020 amounted to £315,156. SEL stated that £93,798 of this cost was incurred since the commencement of the current PCO and claimed that it was directed covered by this PCO. SEL also argued that it was a manifest error that the earlier legal costs were not covered by the previous PCO. SEL have requested that an "a*greed percentage figure*" of these historic legal costs is reimbursed over the next two years via the maximum unit price.

8.2: Discussion on SEL's Request

Based on information provided by SEL, its average annual legal costs are £63,031. If, for example, the annual allowance in the PCO was to be increased to this amount, this would increase the maximum unit price by 3.1 p/kwh. Furthermore, if 50% of SEL's historic legal costs were to be recovered over the next two years, this would increase the maximum unit price by a further 5.6 p/kwh.

The issue of legal and regulatory costs has been considered before by my office.

For example, in the draft determination on the 1st October 2019, at paragraph 20, my office referred to section 13 (2)(c) of the Law, and its requirement to consider the economy with which the supply of electricity is generated and distributed. My office interpreted this as meaning the costs that a reasonably efficient and cost-conscious supplier would incur in order to provide the supply of electricity. My office concluded that legal costs incurred trying to stop the implementation of the Law intended to protect customers should not be recoverable through the electricity tariff. At paragraph 65 however, my office accepted that reasonable legal costs incurred during the process of responding to determinations and PCOs could be recovered from consumers.

I too accept that reasonable legal and regulatory costs incurred during the process of responding to determinations, PCOs, or variations should be recovered from consumers. However, to the extent that professional support is needed, I would have expected SEL to use a consultant with experience in economic regulation more so than legal support. The current owner of SEL now has over four years' experience of operating in a regulatory environment and I note that he was able to write SEL's response to the last PCO consultation.

SEL has requested that the fixed cost portion of the PCO is amended to take account of the reasonable legal costs of addressing the legalities of the current situation. I understand that this refers to addressing the announcement by Chief Pleas to set up a replacement electricity system. Whilst I can understand that a replacement electricity system, if it ever occurs, would have an adverse effect on SEL's business, I am not convinced that consumers should fund any challenge to government policy. I do accept however that the announcement by Chief Pleas creates a rather unique situation for SEL for the next few years that may well require some additional legal support.

SEL claims that the current PCO makes no provision or allowance for legal fees expended by SEL. This is not correct. The 2019 PCO included an allowance of £20,000 for legal and regulatory costs and, in the 2023 PCO this allowance was set at £17,395.

SEL has also requested that an "agreed percentage figure" of £315,156 of historic legal cost is recovered from consumers over the next two years. SEL state that £93,798 of this cost was incurred since the commencement of the current PCO and argue that it was directed covered by this PCO. SEL also argue that it was a manifest error that the earlier legal costs were not covered by the previous PCO.

SEL is incorrect with both of its arguments. The current PCO does not "directly cover" a legal cost of £93,798. Furthermore, there was not a "manifest error" in the previous 2019 PCO regarding the recovery of the remaining £221,358 of legal costs. SEL appear to believe that all its legal costs can be recovered ex-post and on a pass-through basis. This is not how the PCO works. SEL is given an allowance for legal and regulatory costs, and it is then up to SEL whether it spends more or less than this amount.

My office has commented before on SEL's incurrence of legal costs. For example, in the Determination on the 26th October 2022, my office stated:

> *"The form of price regulation my office has established for Sark, i.e. setting a price cap, provides SEL with the opportunity to enhance its profitability by managing its costs effectively, such as those for professional services. Unfortunately, in my view, Mr. Whitney-Price has not, to date, displayed much cost consciousness in regard to legal costs. For example, his "direction" on 7th July 2021, that all communication from my office to SEL be directed through his Advocates, I regard as a waste of expensive legal expertise. SEL's decision to instruct Carey Olsen on two occasions to request an extension for receipt of submissions to the recent Draft Determination was, in my view, unnecessary. Similarly, I see no reason why SEL's submission should be prepared by Advocates, rather than by the company itself. Given the rates charged by firms of Advocates in Guernsey, it is, in my opinion, particularly cost inefficient to use Advocates as a non-legal resource, particularly in the case of a company of SEL's size".*

Unfortunately, I have also experienced what, in my view, I consider to be an unnecessary and inefficient use of legal resources by SEL. For example, the current PCO and the variation to the 2019 PCO contain a monthly correction mechanism. This is designed to protect SEL against movements in market fuel prices and the demand for electricity in Sark. SEL did not object to this mechanism and did not appeal the variation to the 2019 PCO or the current PCO. Yet SEL's legal advisors wrote to be earlier this year claiming that the correction mechanism was not permitted by the Law and was invalid. However, despite this earlier claim, this variation request does not seek to have this monthly correction mechanism removed or amended. Therefore, SEL accepted the correction mechanism, then instructed lawyers to challenge it, and then did not seek to have it removed or amended in this variation request. In my view, the legal costs associated with such a course of action should not be paid for by consumers.

8.3: Minded-To Position

The PCO already contains an allowance for legal and regulatory costs which will be increased by inflation each year. In my view this allowance remains sufficient to cover reasonable legal and regulatory costs incurred during the process of responding to determinations, PCOs, or variations.

In this variation request, SEL's working assumption is that it will cease to operate in two years' time. My expectation is that it will be closer to three years before any replacement electricity system is in place in Sark. I do accept however that the announcement by Chief Pleas creates a rather unique situation for SEL for the next few years that may well require some additional legal support. It seems to me that, at this stage, there is still a significant amount of uncertainty about what the exact nature and purpose of that additional legal support might be. Rather than increasing the allowance for legal support therefore by a fixed amount, I am minded to consider proposals made by SEL on a case-by-case basis. I should add however, that I would not expect the total allowance for legal and regulatory costs to exceed £30,000 per year. I estimate this to increase the maximum unit price by 0.9 p/kwh.

For the reasons set out above, I am not minded to allow the reimbursement of "a*n agreed percentage figure*" of SEL's historic legal costs (above the PCO allowance) over the next two years.

9.0: OVERALL IMPACT ON THE MAXIMUM UNIT PRICE

9.1: Maximum Unit Price Formula

The 2003-2005 PCO set a maximum unit price at 53 p/kwh. The formula below sets out how the maximum unit price is calculated. This cap is adjusted (monthly or annually) for movements in fuel prices and demand, new capital expenditure, depreciation and inflation.

MUP (p/kwh) = [AFCC –OR] / D + [VFCC] + K

Where:

MUP =Maximum unit price (p/kwh),

AFFC = The allowed fixed cost component (p),

OR = Other Revenues (p),

D = SEL Demand (kwhs),

VFCC = Variable fuel cost component (p/kwh), and

K = Correction factor (p/kwh)

I have analysed the impact on the maximum unit price resulting from the various considerations in SEL's variation request, and from my minded-to positions. I have shared this detailed analysis with SEL and provided a summary below for this consultation paper.

9.2: Modelling Scenarios

1. SEL's variation request using an opening RAB value derived from WSP estimates.
2. EPPC's minded-to position using an opening RAB value derived from the 2020 asset acquisition cost.

9.3: Key Modelling Assumptions

1. Annual demand is 1,400,000 kwhs,
2. The variation takes effect from 01st October 2024,
3. Fuel prices remain at 24.95 p/kwh,
4. SEL's other revenues remain at £75,760 per year,
5. Fixed operating costs are indexed annually by Guernsey inflation,
6. Guernsey inflation is 3%, and
7. SEL receives an allowed return of 5% (plus inflation) on acquisition assets and 5.2% (plus inflation) on new assets.

9.4: Modelling Results

The maximum unit price resulting from the above scenarios are set out in the tables below. Further details of the modelling results can be found in Appendix E.

Maximum Unit Price (p/kwh)

Period/ Scenario	**Oct 24 - March 25**	**April 25 - March 26**	**April 26 - Sept. 26**
WSP Estimates	152.7	148.3	147.8

Period/ Scenario	**Oct. 24 - March 25**	**April 25 – March 26**	**April 26 - March 27**	**April 27 - Sept. 28**
Maximum 2020 Acquisition Cost	66.8	64.6	64.3	63.3
Minimum 2020 Acquisition Cost	57.2	55.9	56.0	55.3

10.0: CONSULTATION QUESTIONS

I have set out below a few consultation questions that readers may find helpful in responding to this consultation. However, readers should not feel constrained by these questions. I am interested in hearing all your views.

1. Should the PCO be varied on the assumption that the remaining operating life of SEL is 2-3 years?

2. Should SEL be allowed, over the next 2-3 years, to recover its outstanding investment?

3. Should SEL's outstanding investment be based on its 2020 asset acquisition cost, or on estimates by consultants WSP of the depreciated replacement cost of its assets?

4. Should SEL be allowed to spend and recover up to £512,426 on asset replacements over the next two years?

5. Should SEL be allowed to build a provision of £980,370 for de-commissioning and island re-instatement shortly after it ceases to operate?

6. Should SEL be allowed to recover an "agreed percentage figure" of its historic legal costs of £315,156?

7. Are there any other issues you want to raise in response to this consultation?

Appendix A: SEL's Variation Request Letter

Sark Electricity Ltd

By Email to:
Mr Shane Lynch
Price Control Commissioner
Office of the Sark Electricity Price Control Commissioner

26th June 2024

Dear Shane

Further to our conversation in respect of the ongoing determinations made by your office please see the attached for your reference.

1 Introduction

1.1 This letter is a formal request from the regulated supplier of electricity, Sark Electricity Limited (**SEL**), for the Electricity Price Control Commissioner (**EPCC**) to exercise their powers of variation arising under s.15(6) of the Control of Electricity Prices (Sark) Law, 2016 in respect of the Price Control Order made on 1 April 2023 (**PCO**).

1.2 We set out in more detail the requested variations and the justifications therefore in more detail below. By way of introduction however SEL requests the PCO is varied as follows:

(a) to properly reflect the impact of inflation since the PCO was made;

(b) to approve and facilitate capital expenditure;

(c) to permit accelerated recovery of expenditure in light of Chief Pleas proposals to destroy the Company; and

(d) to permit recovery of legal fees.

1.3 The PCO was made, and operates, in a set of circumstances that are globally unprecedented. Specifically in a market comprising approximately 500 customers only, with limited growth potential, proposals have been made to set up a second electricity grid.

1.4 SEL has significant concerns that these proposals from Chief Pleas may have been developed not for the purpose of being put into place but rather as a means of applying commercial pressure to SEL, seeking to devalue it commercially or potentially drive it out of business to allow nationalisation at a reduced price.

1.5 The EPCC has over the course of correspondence with SEL and in making the PCO made reference repeatedly to standard regulatory practice, however the proposed position of having a second grid is (for good reason) so unique that standard regulatory practice is not only inappropriate but wholesale damaging to SEL.

1.6 By limiting recovery and expenditure in its current fashion, the PCO damages SEL's ability to invest in its own grid and services. This lack of investment only serves to strengthen the claims a new grid is necessary. A new grid which would of course, require massive cost to be passed onto SEL's current customer base on an ongoing basis in one fashion or another.

2 Inflation

2.1 As noted in correspondence between SEL's lawyers and the EPCC, the PCO states as follows regarding inflation:

"In the consultation paper I asked if it was fair and reasonable to have an annual correction mechanism to account for inflation and changes to the RAB arising from depreciation, inflation and any new capital expenditure.

I did not receive any views from electricity consumers in Sark on this question and SEL was largely supportive.

In April 2024 the RAB will be updated to account for Guernsey inflation in 2023 and for depreciation of existing assets, derived from the WSP model."

2.2 Page 3 of the PCO Consultation issued in February 2023 contained the following wording:

"Fixed Operating Costs:

In the October 2022 determination my office concluded that an efficient operator would require £300,000 in 2023 for fixed operating costs and a further provision of £5,307 for dilapidations at the power station. I am proposing to use these values for this price control for calendar year 2023, and to inflate them by Guernsey inflation for the calendar years thereafter."

2.3 Notwithstanding the above wording, in operation, the EPCC has set prices and updated the RAB in a manner which does not meaningfully address inflation in any way, shape or form.

2.4 SEL's real world annual fixed cash costs have gone up by circa £27,000. Notwithstanding the apparent application of a mechanism intended to reflect inflation we understand that the return on RAB in 2024 is roughly £5,000 less than in 2023; hardly reflective of an inflationary increase.

2.5 At present either the PCO or the manner in which the PCO is applied is deficient in reflecting the increased cost of doing business. Unlike any other business, SEL is being prevented from recovering increased costs by way of adjusting its pricing model. The inherent unfairness of this should be obvious.

3 Approval of Capital Expenditure

3.1 The PCO provided the commentary below regarding new capital expenditure.

"SEL also provided me with outline proposals for new capex. I have asked SEL to urgently review and re-submit these proposals, prioritised based on critical expenditure needed to ensure safety and reliability for the next few years. I will then review and grant approval for immediate expenditure that I consider appropriate.

Given that Chief Pleas has announced its intention to tender for a completely new electricity system, it seems reasonable to me that a separate RAB with accelerated depreciation for new capex should be created for SEL. Consideration also needs to be given to the appropriate return on investment for this new capex. I consider it appropriate to wait until I am presented with

SEL's revised proposals before setting values for accelerated depreciation and return on investment."

3.2 SEL disputes that its originally provided expenditure proposals required review and prioritisation and maintains its long-held position that the proposals originally provided were suitably prioritised focussed as they were upon safety issues and addressing, as they did, the various issues raised in respect of Sark's grid by EIS Ltd in the report they undertook in the manner required by Chief Pleas published October 2021.

3.3 Notwithstanding this alongside this variation SEL is providing an updated budget reflecting the request made by the EPCC in relation to budgeting for future capex in correspondence with SEL's lawyers. We would request that the proposed expenditure is expressly approved (or expressly disapproved) and depreciation rates and returns on investment are specified and built in to the revised PCO.

3.4 The EPCC has (correctly) pointed out on numerous occasions that SEL could simply spend the money in advance and the EPCC's role is simply to address recovery through the unit price. This overlooks SEL's limited means however and the fact that any major capital expenditure would need to come by way of an injection of fund from the shareholder. In the current circumstances, with SEL's continued existence seemingly outside the contemplation of Chief Pleas and the EPCC, such an injection can only take place with comfort around the unit price taking this into account.

4 Accelerated Recovery of Expenditure

4.1 We request that the PCO is varied to properly take into account the proposed "replacement" of SEL with Chief Pleas' own grid.

4.2 The EPCC's own calculations utilise a 3-year depreciation period for the recently commissioned generator beginning in June 2024. This figure reflects the EPCC's own statement that "in my judgement, it could be as long as 3 years before any replacement system is fully commissioned."

4.3 By contrast the PCO treats different assets differently. Many of SEL's assets are being depreciated on the basis of a lifespan significantly exceeding that they will have if SEL is, to use the preferred euphemism, "replaced." At the time SEL acquired those assets it did so on the basis they would have an extended life. Cutting short that life penalises SEL.

4.4 We understand the EPCC views expenditure made prior to Chief Pleas announcement of its purported intention to build a new grid to be "sunk costs". Whilst this is superficially correct they were sunk on the basis of a belief that recovery of them would be permitted through a fair unit price in the longer term.

4.5 It is the EPCC in conjunction with Chief Pleas who have determined there will be no longer term not the consumer and not SEL. In our view, depreciation should be accelerated for all of SEL's assets, both new and old – distinguishing between the two situations is irrational in that, to the extent depreciation is not accelerated, the inevitable conclusion is that SEL will lose the value invested.

4.6 Whilst some value may be recovered by the on-sale of some used assets, the bulk of SEL's assets will not be suitable for resale – buried cabling for instance – and in some cases will increase in future cost should the grid actually be replaced due to the cost of removal or decommissioning.

4.7 The current PCO model seems to require SEL to simply write these costs off and potentially face significant additional losses immediately upon launch of the new grid. However the announcement of the proposed new grid has not crystallised these losses. They remain potentially recoverable through the application of a fair and reasonable unit price in the intervening period.

4.8 We fail to see how any other approach is fair and reasonable to SEL and would ask that an accelerated depreciation approach be applied consistently across all SEL's assets moving forwards.

5 Recovery of Legal Fees

5.1 At present the PCO makes no provision or allowance for legal fees expended by SEL. As the EPCC is aware, the actions of Chief Pleas and the challenges created by the unique situation arising have led to SEL requiring significant legal advice. SEL is entitled to protect its legal rights through the use of outside counsel and should not be forced into a choice of losing its legitimate rights or bearing the weight of legal fees necessary to defend them. SEL requests that the fixed cost proportion of the PCO be amended to take into account the reasonable legal costs of addressing the legalities of the current situation.

6 Conclusion

If you fail or refuse having been so requested to vary the price control order to address these inequities the Company may exercise its rights under s.20(1)(e) of the Law to appeal such failure or refusal.

Regards

Alan Witney-Price
Managing Director – Sark Electricity Limited

Appendix B: Section 13(2) of the Law

Determination of fair and reasonable price.

13. (1) Following completion of an investigation under this Law, the Commissioner shall, determine whether a price which is charged by a regulated electricity supplier for the supply of electricity is, or is not, fair and reasonable.

(2) In determining whether a price is, or is not, fair and reasonable the Commissioner shall take all material considerations into account, including without limitation the following matters -

(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,

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

(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,

(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,

(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

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

Sark Electricity Ltd

By Email to:
Mr Shane Lynch
Price Control Commissioner
Office of the Sark Electricity Price Control Commissioner

1st June 2024

Dear Shane

Further to your recent communications with our legal representative in respect of our budget request issued in April 2023 which you have yet to approve.

I am advised that your difficulty lies in determining those matters within our budget that are, expressly, safety and reliability related. I confess I am confused by this uncertainty on your part. There are only four conceivable reasons that we would ever spend money; *where it is not already captured within the RAB mechanism*:

- Safety;
- Reliability;
- Cost Reduction; and,
- Operational Expenditure.

In an effort to assist with clarification I have laid out in broad terms, as disclosed previously within the various SETP' previously provided the background to works in Sark where they are '*non-disruptive*' and '*disruptive*' (these are new terms for what I hope will improve clarity between us). I apologise if my assumptions on your level of local knowledge as regulator were unrealistic. I have added a new column *'Works Type'* under 24 & 25 Consolidate Capex of the revised Technical 2024 Sark Budget (attached).

Non-disruptive Works (NDW)

Works under this category essentially mean that they are handled by the team in part or in whole and, with the exception of pre-planned breaks in electricity supply pre-notified to the relevant customer group, would not impact tourism, travel, transport links or require any input or consideration by Chief Pleas in terms of planning and / or approval.

They may require wayleaves with a customer, which could include Chief Pleas as a customer if applicable, or they may require negotiation to access equipment on their site at a time that suits the customer, given the works are not emergency works.

Disruptive Works (DW)

Works under this category essentially mean that they will have an impact on tourism, travel or transport links and will require notification to an outside agency including Chief Pleas such as telecoms or harbours. They may further require permission such as Planning Approval (IDC) or Douzainne depending on the works.

Where works are disruptive on Tourism and Transport Links (roads and bridges etc.) the standard practice is to do the work in the off season. For electrical work this can be problematic as the off season tends to mean rain and high winds when you are 300 ft off the ground as we are on Sark.

The approach of SEL is to immediately obtain permissions required with an open timeframe and instruict contractors for roadworks immediately, again with an open time frame. Some roads that require trenching can be done during the season depending on the width of the roadway. Some can be done in part. Standard practe for cable is to trench and trunck with rope installed at the trench phase to enable us to pull the cable through when we are ready to connect. Trenching is done in phases of 25 to 50 meters at a time to minimise disruption so we:

- Trench;
- Install trunking;
- Install rope;
- Back fill and reinstate the roadway.

Rinse and repeat until the trunking is in situ from start to finish.

Once the trunking is in place we will evaluate the customer impact. If there is a hotel or tourism related business in the affected area we will automatically wait till the off season. If there are a few houses / sheds we will reach out to the customers and discuss the potent5ial works with them first.

Once the work is ready we will prep as much as possible at the station and calculate the best window of opportunity based upon the weather to effect the works.

Why are the Works Required on The Items Listed on the CAPEX Schedule

I am presuming that you are already familiar with the EIS Report, The Energy People Assessment, Dr Whites views on matters such as over capacity and site specific concerns around fencing and visitor access to electrical equipment etc. For this reason I have not quoted the reports and refence numbers.

ANTICIPATED FINAL COSTS (AFC) OF RELATED CAPITAL EXPENDITURE NOT ATTACHED TO SPECIFIC EQUIPMENT

£500	Apprentice tools and other equipment
£2,500	IT Hardware to retire the old server – Spent already
£7,785	IT Project Costs to retire the old server – Spent already
£25,000	Project Management Costs for Generation and Distribution system improvements across 2023 and 2024 - Est. – Being Incurred at this time.
£35,785	***Total (estimate in 2022) costs have now increased substantially)***

SWITCH CAPEX

£5,000	Cider Press Switch to be reconditioned to meet standards required under EIS Report.
£2,000	Exchange to Lighthouse Change Over to LV
£2,000	Island Hall Change Over to LV
£2,000	Barracks Change Over to LV

£5,000	Plaisiance Switch to be reconditioned to meet standards required under EIS Report.
£5,000	Seigneurie Switch to be reconditioned to meet standards required under EIS Report.
£2,000	Vaurocque change over to LV
£5,000	Chappel Switch to be reconditioned to meet standards required under EIS Report.
£1,000	Boulangerie Prep
£31,000	***Total (estimate in 2022) costs have now increased substantially)***

TRANSFORMER CAPEX

£750	Rue Lucas (Pre 1987 - PCB risk) 100 rating – Removal and Reinstate site
£750	Lighthouse (Pre 1987 - PCB Risk) 25 rating – Removal and Reinstate site
£750	Les Laches (Pre 1987 - PCB Risk) 150 rating – Removal and Reinstate site
£750	Barracks (Pre 1987 - PCB Risk) 25 rating – Removal and Reinstate site
£750	Avenue (Pre 1987 - PCB Risk) 100 rating – Removal and Reinstate site

£3,750 Total (estimate in 2022) costs have now increased substantially)

CABLE CAPEX

£52,500	HV Plaisance to Cider Press – To replace the aging cable across the Coupe.
£32,450	HV Cider Press to Sablonnerie - To replace the aging cable extending from the Coupe.
£26,010	LV Exchange to Lighthouse – To enable removal of pre 1987 Tranformer
£12,788	LV Carrefour to Island Hall – To enable removal of pre 1987 Tranformer
£27,875	LV Sablonnerie to Barracks – To enable removal of pre 1987 Tranformer
£16,840	LV Mill to Vaurocque – To enable removal of pre 1987 Tranformer
£13,900	LV Boulangerie to Avenue – To enable removal of pre 1987 Tranformer
£182,363	***Total (estimate in 2022) costs have now increased substantially)***

DISTRIBUTION SITE FUSE UPGRADE PROGRAMME

£18,000	12 sites across 24 / 25. This work has been asked for since I arrived. This corresponds with GEL recommendations from incident in 2023 at the harbour.
£18,000	***Total (estimate in 2022) costs have now increased substantially)***

DISTRIBUTION SITE FENCING PROGRAMME

£87,000	29 sites to be fenced to meet the safety concerns raised repeatedly by Chief Pleas, The OPC, EIS and The Energy People.
£12,000	Site Fencing at the Station - fenced to meet the safety concerns raised repeatedly by EIS and The Energy People.
£99,000	***Total***

ENGINE UPGRADES

£42,000	Engine 9 replacement - USED
£42,000	Engine 10 replacement – USED – Spent already
£84,000	***Total***

INVESTMENT PLANNED NOT YET COSTED

£80,000	Replacement Station Switchgear - to meet the safety concerns raised repeatedly by EIS and The Energy People.
£40,000	Replacement Step up Transformers to meet changes needed to Switchgear.
£120,000	***Total***

ISLAND RE-INSTATEMENT PROGRAMME - ESTIMATED

£900,000	Cable & Equipment removal Programme – Est.

As can be seen, the budget submitted for approval in April 2023 meets the requirements of the parameters that you laid out to our Advocates in late April 2024. As indeed they would have in April 2023.

This budget was prepared and submitted following long conversations, sometimes difficult conversations, with your predecessor; with the exception of Island Re-instatement Programme. This has been included to accommodate your need to consider the impact of the new Chief Pleas grid.

Should you require any further details please reach out.

Regards

Alan Witney-Price
Managing Director – Sark Electricity Limited

Appendix D: SEL's De-Commissioning and Re-Instatement Proposals and Costs

Sark Electricity Ltd

By Email to:
Mr Shane Lynch
Price Control Commissioner
Office of the Sark Electricity Price Control Commissioner

10th August 2024

ISLAND DECOMISIONING COSTS - PRIVATE & CONFIDENTIAL

Dear Mr Lynch

Further to your request for a breakdown of the estimated *Island Decommissioning Costs* please see the below.

Project Scope

The project will require that the historical impact of SEL operations on Sark will need require:

- environmental assessments;
- equipment removal;
- affected areas be reinstated;
- the Power Station be reinstated as prior to operations, under the new lease terms;
- obsolete components be decommissioned and transported for disposal / re-conditioning;
- the company entities be closed down;
- the insurance costs, *in an amended form*, be maintained to allow the works to be undertaken;
- Project Management & Director costs for the ongoing company obligations during the execution of this project.

It is *estimated* that the project will take 24 months from transition of operations across to the new supplier.

NOTE: Given that the station itself will be decommissioned at the same time as the island wide decommissioning, its costs are captured within the project scope. However, the funds for this component of the project are captured within the existing CPO and these do not factor into the £900,000 cost estimate for the Island Wide De-commissioning.

Further, in accordance with regulatory practice, the RPI effect on these costs estimates must be captured within the cost recovery process. The estimate of £900,000 is based on if the works are being undertaken today. These works will in fact not begin until circa 2027. RPI increases on these costs must be factored in accordingly.

Underlying Components

There are a number of identifiable components to this project that will need to be removed and the surroundings reinstated. In addition to this a small allowance has been made for out-of-scope components.

Type	Qty	Weight in Imp Tons
Cables to remove	25,738 mtrs	62.9
LV Dist. Components	244	8.4
HV Dist. Components	41	18.1
Transformers	34	21.8
Meters	523	0.4
Out of Scope	?	5.0
Station		
Engine 10 Dead as at 2026 close	1	4.4
Engine 12, 14 & 15 Resale Value	3	13.2
Sound-Proof Cabinets	4	11.8
Control Systems	12	3.5
Cooling Systems	6	3.5
Fuel Tanks	7	6.9

Approach

Given that, at the time of decommissioning, the equipment will no longer be live; the engineering expertise required for the bulk of works will be minimal.

General engineering expertise will be required to ensure the safe removal, storage and shipment of the HV distribution components, the transformers and the resold engines to retain their re-sale value. This has been costed into the project.

Costings

Project Stage	Station Decom	Island Decom	Cost
Environmental Assessments *1	£25,000	£58,500	£83,500
Remove & Reinstate (Agricultural & Roadway)	£0	£557,712	£557,712
Remove & Reinstate (landscaped Areas)	£0	£100,000	£100,000
Station Reinstatement *2	£90,000	£0	£90,000
Transportation *3	£4,667	£20,682	£25,349
Legal & Regulatory (Co.)	£0	£8,000	£8,000
Ongoing Insurance Needs	£0	£30,000	£30,000
PM & Director Costs	£0	£120,000	£120,000
Recoverable' *4	*-£964*	*-£43,731*	*-£44,695*
Contingencies	£0	£45,000	£45,000
Total	**£118,703**	**£896,163**	**£1,014,866**

**1 Environmental assessment decommissioning costs for the station are captured within the existing station decommissioning costs contained within the current PCO. Therefore, these costs are not carried into overall Island Decommissioning Cost estimate.*

**2 Station Reinstatement costs for the station are captured within the existing station decommissioning costs contained within the current PCO. Therefore, these costs are not carried into overall Island Decommissioning Cost estimate.*

**3 Transportation costs for the station are captured within the existing station decommissioning costs contained within the current PCO. Therefore, these costs are not carried into overall Island Decommissioning Cost estimate.*

**4 Recoverables for the station are captured within the existing station decommissioning costs contained within the current PCO. Therefore, these costs are not carried into overall Island Decommissioning Cost estimate.*

The intention remains, where at all possible, to undertake these works utilising sark suppliers to complete the work.

Regards

Alan Witney-Price

Managing Director – Sark Electricity Limited

c.c. Collas Crill

Appendix A – Breakdown of Underlying Components

Category	Quantity	Transit Costs	Estimated recoverable sums nett delivery to purchaser.
High Voltage Cables	10,922	£6,401	£3,925
Low Voltage Cables	14,816	£4,671	£2,406
LV Distribution - Active	244	£2,076	N/A
HV Distribution - Active	40	£2,162	£8,000
HV Distribution - Inactive	1	£460	£200
Transformers - Active	29	£2,247	£8,700
Transformers - Inactive	5	£384	£1,500
Meters (plus 10 decommissioned)	533	£173	N/A
Out of Scope	5	£346	N/A
Station			
Engine (10) – end of life as at 2026 *1	1	£588	£286
Engine (12) – Resale Value	1	£588	£3,000
Engine (14) – Resale Value	1	£588	£8,000
Engine (15) – Resale Value	1	£588	£8,000
Sound-Proof Cabinets *2	4	£1,730	N/A
Control System *3	12	£692	N/A
Cooling System *4	6	£692	£230
Fuel Tanks (Inc. Headers) *5	7	£976	£448

Appendix B

Cost Category	Qty of Units	*Ave.* cost per unit
Project Management	2	£30,000
Skip Hire From Guernsey	97	£60
Skip costs IOSS	97	£113
Components Shipping Sark to Gsy (Class 5)	64.5	£95
Heavy Equipment Hire	30	£200
Remove & Reinstate (Agricultural & Roadway)	23,238	£24
Remove & Reinstate (Landscaped)	2,500	£40
Station Environmental Survey (*1)	1	£25,000
Site Environmental Survey (*2)	39	£1,500
Rental Accom		*tbd*
Directors Fees	2	£30,000
Accounting Costs 2027 & 2028	2	£4,000
Ongoing Insurance Needs	2	£15,000

Appendix E: Modelling Results

Scenario: SEL Variation Request and Using the WSP RAB

Cost Item	**Oct 24-Mar 25**	**Apr 25-Mar 26**	**Apr 2 – Sept 26**	**Total**
Fixed Operating Costs	175,558	361,650	186,250	723,458
Back-Dated Inflation Increase	10,238	0	0	10,238
Depreciation of Acquisition Assets	208,931	417,862	208,931	835,725
Depreciation of Approved New Assets	8,387	16,774	7,964	33,125
Provision For Additional New Assets	128,107	256,213	128,107	512,426
Project Management	6,250	12,500	6,250	25,000
Return on Capital for Acquisition Assets	41,316	33,429	8,357	83,102
Return on Capital for New Approved Assets	1,664	1,341	156	3,161
Return on Capital for Additional New Assets	0	0	0	0
Increased Allowance for Legal Costs	21,516	43,031	21,516	86,062
Recovery of Historic Legal Costs	78,789	157,578	78,789	315,156
De-Commissioning Provision	245,093	490,185	245,093	980,370
Increased Dilapidations Provision	5,971	11,941	5,971	23,883
Allowed Fixed Cost (p/kwh)	127.71	123.34	122.79	
Allowed Variable Cost (p/kwh)	24.95	24.95	24.95	
Maximum Unit Price (p/kwh)	**152.66**	**148.29**	**147.74**	

Scenario: EPCC Minded-To Position Based on the Maximum Asset Acquisition Cost

Cost Item	**Oct 24-Mar 25**	**Apr 25-Mar 26**	**Apr 26–Mar 27**	**Apr 27-Sept 27**	**Total**
Fixed Operating Costs	175,558	361,650	372,499	191,837	1,101,544
Back-Dated Inflation Increase	10,238	0	0		10,238
Depreciation of Acquisition Assets	71,756	143,511	143,551	71,756	430,534
Depreciation of Approved New Assets	6,079	12,157	12,157	2,873	33,266
Provision For Additional New Assets	25,000	50,000	50.000	25,000	150,000
Project Management	6,250	12,500	12,500	0	31,250
Return on Capital for Acquisition Assets	22,298	22,962	11,481	4,305	61,046
Return on Capital for New Approved Assets	1,738	1,731	734	34	4,237
Return on Capital for Additional New Assets	2,108	6,123	3.061	383	11,675
Increased Allowance for Legal Costs	6,000	12,000	12,000	6,000	36,000
Recovery of Historic Legal Costs	0	0	0	0	0
De-Commissioning Provision	0	0	0	0	0
Increased Dilapidations Provision	3,980	7,960	7,960	3,980	23,883
Allowed Fixed Cost (p/kwh)	39.26	38.73	38.39	37.42	
Allowed Variable Cost (p/kwh)	24.95	24.95	24.95	24.95	
Maximum Unit Price (p/kwh)	**66.82**	**64.58**	**64.25**	**63.28**	

Scenario: EPCC Minded-To Position Based on the Minimum Asset Acquisition Cost

Cost Item	**Oct 24-Mar 25**	**Apr 25-Mar 26**	**Apr 26–Mar 27**	**Apr 27-Sept 27**	**Total**
Fixed Operating Costs	175,558	361,650	372,499	191,837	1,101,544
Back-Dated Inflation Increase	10,238	0	0		10,238
Depreciation of Acquisition Assets	20,089	40,178	40,178	20,089	120,534
Depreciation of Approved New Assets	25000	50,000	50,000	25,000	150,000
Provision For Additional New Assets	6,667	37,333	37,333	18,667	100,000
Project Management	6,250	12,500	12,500	0	31,250
Return on Capital for Acquisition Assets	22,298	22,962	11,481	4,305	61,046
Return on Capital for New Approved Assets	1,738	1,731	734	34	4,237
Return on Capital for Additional New Assets	2,108	6,123	3.061	383	11,675
Increased Allowance for Legal Costs	6,000	12,000	12,000	6,000	36,000
Recovery of Historic Legal Costs	0	0	0	0	0
De-Commissioning Provision	0	0	0	0	0
Increased Dilapidations Provision	3,980	7,960	7,960	3,980	23,883
Allowed Fixed Cost (p/kwh)	29.58	29.99	29.64	29.48	
Allowed Variable Cost (p/kwh)	24.95	24.95	24.95	24.95	
Maximum Unit Price (p/kwh)	**57.15**	**55.85**	**55.50**	**55.34**	