



Office of Utility Regulation

Publication of Guernsey Electricity Limited's Regulatory Accounts

Consultation Document

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Office of Utility Regulation
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1 Introduction

Guernsey Electricity Limited (“GEL”) is required to submit Regulatory Accounts to the Director General of Utility Regulation in accordance with Condition 16.1 of its Electricity Licence issued under Section 2(1) of the Electricity (Guernsey) Law 2001.

Since commercialisation on 1st February 2002 the framework and apportionment mechanisms for apportioning costs between the company’s main businesses has been under ongoing development. The Office of Utility Regulation (“OUR”) has now received two sets of Regulatory Accounts from GEL for the financial reporting periods for the 14 months ending 31st March 2002 and the 12 months ending 31st March 2003. In accordance with the OUR’s commitment towards transparency and openness the Director General now wishes to consider to what extent the information contained in the 2002/03 Regulatory Accounts should be published.

This document does not constitute legal, technical or commercial advice; the DG is not bound by this document and may amend it from time to time. This document is without prejudice to the legal position or the rights and duties of the DG to regulate the market generally.

2 Structure of the Paper

This paper is structured as follows:

Section 3 - outlines the consultation procedure and timetable for the submission of responses to the consultation;

Section 4 - provides background information on the purpose of Regulatory Accounts in general and the overall format of GEL’s Regulatory Accounts together with best practice in other jurisdictions in order to assist interested parties in responding to the issues under consideration;

Section 5 – sets out the issues being consulted and presents the Director General’s proposals on these issues.

3 Consultation Procedure and Timetable

The consultation is scheduled to run from Friday 5th September 2003 and the closing date for the submission of comments to the OUR is 5pm on Friday 26th September 2003. Comments should be submitted in writing to:

Office of Utility Regulation
Suite B1 & B2,
Hirzel Court,
St. Peter Port,
Guernsey GY1 2NH.

Email: info@regutil.gg

All copies of comments should be clearly marked “Comments on Publication of GEL’s Regulatory Accounts”.

In line with the policy set out in Document OUR01/01 – “Regulation in Guernsey; the OUR Approach and Consultation Procedures”, the Director General intends to make responses to the consultation available for inspection. Any material that is confidential should be put in a separate Annex and clearly marked so that it can be kept confidential.

The Director General regrets that she is not in a position to respond individually to the responses to this consultation, but she will publish a report on the consultation after all comments have been considered.

4 The Rationale for Regulatory Accounts

Regulatory, or Separated, Accounts are a fundamental part of a regulator’s tool kit and are prepared in order to provide financial information about regulated businesses for use by the regulator, the industry, other stakeholders and interested parties.

The information in the Regulatory Accounts should be sufficient to:

- Demonstrate transparently the overall costs and revenues for the core electricity business and contribute to an understanding of what costs are covered by current and future prices; and
- Show clearly that only appropriate costs are being covered by revenue from electricity sales.

In the Regulatory Accounts, the regulated operator’s activities are split for accounting purposes into separate businesses and the accounts specify how financial accounting information should be collected and reported.

Consequently Regulatory Accounts differ markedly from traditional financial statements (“Statutory Accounts”) in that they are focused on the costs and the revenues that accrue from the provision of regulated businesses or activities. Regulatory Accounts also provide accounting information at a greater level of granularity in order to address questions concerning the pricing of individual products and services. Statutory Accounts on the other hand relate to the company as a whole (i.e. including regulated and non-regulated trading activities) and are more focused on the requirements of investors only.

For these reasons accounting separation and the preparation of Regulatory Accounts has a proven track record and is the most common tool used worldwide by regulators to address concerns about potential abuses of dominant positions and market power. For example Regulatory Accounts may assist a regulator in a variety of ways, depending on the market structure and regulatory emphasis, including inter alia:

- Monitoring performance against the assumptions underlying a current price control;
- Informing future price controls;
- Assisting the regulator in the detection of cross subsidies between regulated and/ or non-regulated businesses, or between monopoly and competitive activities;

- Assisting in the detection (or verification of the absence) of various types of anti-competitive behaviour.

Achieving these objectives requires a minimum amount of financial and non-financial information.

For example, in assessing the level of sustainable revenue required by the business in the future, the Regulator requires information on efficient costs and return on capital. Using the efficient cost element as an example, the Australian Utility Regulators Forum¹ suggested that information would be required on, amongst other things:

- Current and forecast costs;
- Benchmark costs (from comparable utilities / businesses);
- An explanation of the cost split between regulated and non-regulated businesses;
- The allocation of common costs between businesses;
- Quality of supply – to ensure that standards of service are maintained within price controls; and
- The impact of efficient cost analysis on business viability and cashflow.

5 Publication of Regulatory Accounts

5.1 Format and Contents of GEL's Regulatory Accounts

This section summarises the format and contents of GEL's Regulatory Accounts.

The Director General requires GEL to prepare separate accounting information for the following main business areas:

- Generation;
- Conveyance and Supply; and
- Non core.

At present, GEL's Regulatory Accounts comprise the following financial statements:

- Profit and Loss Account Summary showing the results for the three main businesses;
- Balance Sheet Summary showing the position with respect to the three main businesses;
- Cash Flow Statement Summary for the three main businesses;
- Profit and Loss Account for each business with comparison with previous year;
- Balance Sheets for each business with comparison with previous year;
- Cash Flow Statement for each business with comparison with previous year.

These financial statements are supported with notes to the accounts.

¹ "Information Gathering for ring fencing and other regulatory purposes" prepared for the Australian Competition and Consumer Commission 1999

The apportioning of costs and revenues between the three businesses is reviewed from time to time by the OUR. GEL's Regulatory Accounts are independently audited in accordance with the relevant rules of Guernsey's legislation and in accordance with international best practice and reconciled to the company's Statutory Accounts.

5.2 Best Practice and International Benchmarks

In assessing best practice in other jurisdictions this section focuses initially on a consultation by Inter Regulatory Working Group in the UK which covered the energy, communications, water, rail and aviation industries (section 5.2.1) and the responses to that consultation before summarising the current position adopted by Ofgem, the UK energy regulator (section 5.2.2). It then concludes by summarising practices in other jurisdictions (section 5.2.3).

5.2.1 UK Inter-Regulatory Working Group

The UK Government's Green Paper on utility regulation 'A Fair Deal for Consumers' suggested that there would be benefits if companies were to produce more standardised Regulatory Accounts. Following the Green Paper, a working group of regulators was set up to identify and develop areas of consistency within published regulatory accounts and the group issued a consultation paper discussing these issues in October 2000².

Two key issues that were raised in the consultation were

- The content of the Regulated Accounts, and
- The method of publication of the Regulatory Accounts.

The issues, responses and final proposals for each of these issues are summarised in turn below.

Content

The consultation paper proposed that, where relevant, a commentary should be included in the Regulatory Accounts on the following issues:

- a) a commentary discussing the results;
- b) a comparison of actual results with the assumptions made in setting price controls for the company;
- c) an explanation of the variances between the actual results, the results of the previous year and the assumptions made in setting price controls;
- d) a discussion of the results against plan and an outline of the forward plans for key business drivers such as principal capital expenditure projects, financing arrangements, organisational shape, operational performance and so on; and
- e) a formal statement from the directors of the licensee that the licensee has complied with licence obligations such as charges being cost-orientated or that the licensee has not unfairly cross-subsidised or unduly discriminated.

² The Role of regulatory accounts in regulated industries – consultation and proposals by the: Chief Executive of Ofgem; Director General of telecommunications; Director General of water services; Director General of electricity and gas supply (Northern Ireland); Rail Regulator; and Civil Aviation Authority; October 2002

The October 2000 consultation paper also considered what information should be included in the published regulatory accounts. The Paper suggested that as well as the primary accounting statements, the associated notes, the directors report and the auditors report it might also be appropriate to include the information listed above (a to e). Furthermore, it suggested that the following information should also be included in the published accounts:

- detailed disclosure of the basis of preparation of the regulatory accounts;
- a note setting out the regulated company's estimate of its Regulatory Asset Value ("RAV"), how the RAV was determined, the return on the RAV, the return on the price control basis and other performance indicators;
- a detailed statement of cost attributions, cost allocations and interbusiness recharges;
- a reconciliation between the information in the regulatory accounts and other relevant information, such as the statutory accounts, the RAV or data on capital expenditure; and
- any other information that the regulator deems relevant such as references to licence conditions or Regulatory Accounting Guidelines.

Comments on UK Consultation

In April 2001 the Inter-Regulatory Working Group published³ its final proposals on the role of Regulatory Accounts in regulated industries which summarised the responses to the October Consultation Paper.

Generally the regulated companies generally did not want to release information that they deemed to be commercially sensitive. They also wanted to ensure that the regulatory requirements were appropriate and reflected the state of competition in their particular industries. Consumer and environmental organizations supported the disclosures as set out in the October Consultation Paper.

It was noted that in some industries the regulator is sent a confidential version of the Regulatory Accounts and another version of the Regulatory Accounts is published by the company concerned. In other industries only one set of Regulatory Accounts is prepared and published but other additional regulatory accounting information is provided to the regulator on a confidential basis.

Respondents from the electricity sector noted that electricity supply was being separated from electricity distribution and that these businesses would become separate legal entities. Consequently they are required to produce separate Statutory Accounts so these respondents questioned whether it was necessary to also publish a set of regulatory accounts for these businesses. The Guernsey electricity market, of course, comprises one vertically integrated company which is the monopoly operator for the conveyance and supply of electricity to its customers and which is also responsible for generation of electricity.

³ The role of regulatory accounts in regulated industries A final proposals paper by the: Chief Executive of Ofgem; Director General of telecommunications; Director General of water services; Director General of electricity and gas supply (Northern Ireland); Rail Regulator; Civil Aviation Authority; and Postal Services Commission. April 2001
www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/219_10april01.pdf

Most electricity companies agreed that the main purpose of regulatory accounts should be to provide information to underpin the regulation of companies subject to price control, provided an appropriate balance could be maintained between the volume of information, its usefulness and the cost of providing it. Nevertheless the electricity companies said that commercially sensitive information should not be disclosed to the public.

The majority of the electricity companies supported the requirements for additional information, particularly on capital structure, the reconciliation between statutory and regulatory accounts and publication of a detailed narrative. However, the publication of detailed information on cost allocations, cost attributions and inter-business recharging of costs was not supported as this might expose commercially sensitive information to competitors. In addition the electricity companies were reluctant for forecast information to be included in the regulatory accounts.

The Inter-Regulatory Working Group concluded that it was clear that a version of the Regulatory Accounts should be published in order to inform stakeholders about the performance of the regulated company. This would usually entail the publication of more information than would be the case for a normal company under UK General Accepted Accounting Principles. This is because the interests of stakeholders in monopoly activities are wider than the interests of shareholders in normal companies. Where there is monopoly power the development of efficient industrial structures is aided by reducing the information asymmetry that exists between the monopoly and the consumer.

The information set out in the October Consultation was deemed by the Working Group to form an appropriate basis for the disclosures to be included in the published version of the regulatory accounts, although it recognised that to some extent this will depend on the precise circumstances prevailing in each industry. If there is commercially sensitive information in the Regulatory Accounts provided to a regulator then each regulator will consider whether this information should be excluded from the published version of the regulatory accounts.

Respondents to the consultation also proposed that the published version of the Regulatory Accounts should contain a note summarising the important features of the attribution, allocation and inter-business recharging of costs.

Publication

With respect to publication the October consultation paper stated that it would be at the discretion of each regulator as to how the regulatory accounts will be published, the options including:

- as a stand alone document;
- as a part of the statutory accounts; and
- as part of another document.

The consultation paper also said that the availability of the published Regulatory Accounts should be properly publicised by the company so that stakeholders and the wider public are made aware that they are available. It would seem appropriate that all companies should be required to make them available on the Internet.

Few respondents commented on the options for publication. Most respondents agreed that the availability of the Regulatory Accounts should be properly publicised and that

they should be available on the Internet. Most electricity companies generally supported the publication of Regulatory Accounts on the Internet.

The Inter Regulatory Working Group proposed therefore that it would be at the discretion of each regulator as to how the Regulatory Accounts will be publicised and published, although it took the view that most regulators would prefer that the Regulatory Accounts were properly publicised, published as stand alone documents and be made available on the Internet.

5.2.2 Ofgem Position

In August 2002, Ofgem, the UK energy regulator, published a set of Regulatory Accounting Guidelines to National Grid⁴. Ofgem stated that one of the main issues was to ensure the regulatory disclosures were transparent to users. The issue of publication was addressed in earlier consultations resulting in an acknowledgement that commercially sensitive items would not necessarily be published. National Grid Company, however, are required to make a convincing case to Ofgem that items are commercially sensitive and would not be of interest of consumers. National Grid's Regulatory Accounts are published as a stand alone document and are available from the company's website⁵.

Ofgem also requires the electricity distribution companies to publish their Regulatory Accounts.

5.2.3 Other Jurisdictions

The approach taken in the North America exists within the context of a rate of return regulatory regime. As the Utility Regulator's Forum paper⁶ notes, this is combined with a due diligence/public disclosure regime. Under this arrangement the regulatory bodies gather detailed information from the regulated utilities, which is then published. The filing requirements adopted by both the Federal Regulatory Commission (FRC) in the USA, and by the Canadian National Energy Board (NEB) include not only profit and loss accounts but detailed breakdowns of costs, assets, revenues and liabilities – these items to be allocated between businesses.

The volume of data gathered (and published) can exceed that which is required by the regulatory bodies in fulfilling their statutory duties as such information may potentially be of interest to wider stakeholders, including customers. It should be noted that such high levels of information disclosure requirements are potentially time and cost intensive – for both regulatory bodies and regulated utilities. As the Utility Regulators Forum noted, there is also a risk that in such an approach, utilities may use their information asymmetry advantage to engage the regulator in protracted discussion on side issues. Clearly, there is a need to consider the appropriateness of the North American regulatory approach in the context of a small island such as Guernsey, where both utility and regulatory resources are limited.

⁴ August 2002 The National Grid Company plc, Regulatory Accounting Guidelines, Working Paper www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/1699_52ngc_rag.doc

⁵ <http://www.ngtgroup.com/investors/indexinvestors.htm>

⁶ "Information Gathering for ring fencing and other regulatory purposes" prepared for the Australian Competition and Consumer Commission 1999

Whilst North America has adopted complex and involved regulatory regimes, other jurisdictions have adopted a more “light handed approach” and may be a more useful comparison. New Zealand is an example of a jurisdiction where a reliance on competition law (in its case the Commerce Act 1986) is the primary tool of regulation. It is noted that this regime included extensive information disclosure requirements on the utilities. It also noteworthy that New Zealand is presently moving towards an industry specific regulatory approach.

Ireland provides another example of an approach that might be appropriate within Guernsey. ESB publishes Summary Regulatory Accounts⁷ which are extracted from the company’s full Regulatory Accounts which are submitted to the Commission for Energy Regulation (CER) as required by Regulation 27 of Statutory Instrument 445 of 2000.

6 Director General’s Proposals

Regulatory Accounts provide an analysis of information derived from financial records to reflect as closely as possible the performance of parts of a business as if they were operating as separate business units. The information in turn is a valuable tool in demonstrating that there is no undue discrimination between the dominant operators’ own downstream arm and competing operators or between one competitor and another when providing similar services. This is relevant in the Guernsey electricity sector insofar as it is possible for there to be new entrants into the generation market, for example the proposed Waste-to-Energy plant.

Furthermore the information in the Regulatory Accounts also assists in demonstrating the existence or absence of any unfair cross-subsidisation of competitive or non regulated services from the monopoly part of the business. This is of importance to a wider group of stakeholders including customers.

Finally, as mentioned earlier, the information underpins prices charged by the regulated entity – a matter of interest to all electricity customers.

The Director General believes that making these accounts publicly available will provide stakeholders other than the OUR with the information to assess these issues and, insofar as new entrant generators are concerned, it will assist in demonstrating the absence (or detecting the presence) of anti-competitive behaviour at levels of disaggregation appropriate to the relevant retail and wholesale markets, thus supporting and promoting the development of a competitive regime.

Furthermore the publication of GEL’s Regulatory Accounts is in line with international best practice and will also assist in demonstrating that GEL’s charges are cost based, transparent and non-discriminatory, and reasonable for a monopoly operator.

However, the Director General is conscious that commercially confidential information should in general not be made available unless this is necessary for the Director General to carry out her functions. As can be seen from the comparisons elsewhere, Regulatory Accounting information has been published in other markets

⁷ Available at www.esb.ie/main/downloads/about_esb/ESB_Summary_Regulatory_Accounts_2001.pdf

and the Director General is not aware of how the situation with regard to commercial confidentiality in Guernsey would differ from those situations, but invites comments on this issue.

In conclusion therefore, the Director General considers GEL's annual Regulatory Accounts and supporting documentation should be made publicly available in their entirety.

Q.1. Do you agree with the Director General's proposal to require GEL to publish Regulatory Accounts in their entirety?

Q.2. If not, then please specify what parts of the Regulatory Accounts should remain commercially confidential and explain your reasons why?

/ENDS