



## Town Hall Meeting of 28<sup>th</sup> November 2019

### *Note by the Electricity Price Control Commissioner*

I have been asked by the Sark Energy User Group to comment on some of the information presented by Sark Electricity Limited at the recent Town Hall meeting and on answers posted on its web-site to questions raised at the evening which Rowena MacNeil was unable to provide at the time.

#### *Profitability*

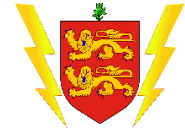
David Gordon-Brown complained that Sark Electricity Limited makes very little profit from providing electricity on Sark. He mentioned a return of 1%, which he compared to the dividend yield of 7% for energy companies on mainland UK.

The valuation Sark Electricity Limited uses for its calculation is either based on assuming all the equipment is brand new, or based on a report by Mr Isaacs, an independent professional valuer. He provided the valuation in July 2018 and had assumed that the combined entity of Sark Electricity Limited and Sark Electricity Holdings Limited (SEL&H) would continue to make the same level of profits as it had in the past. He was not aware that, following the introduction of the Control of Electricity Prices (Sark) Law, 2016, it would be an offence to sell electricity at an unreasonably high price. When informed of the Law Mr Isaacs agreed with me that “the valuation produced a figure that reflected the value of SEL&H to its shareholders, rather than to a potential purchaser.” It is my view, subsequently confirmed by WSP, the independent consultant engineers, that the value of the company, once electricity prices are restricted to fair and reasonable levels, is a great deal lower. My estimate of the actual dividend yield is well over 20% for 2016, the most recent year for which I have audited information, based on a realistic view of the equity value of the combined company.

#### *Director’s requirement not to trade unprofitably.*

David Gordon-Brown was correct to say that, under Guernsey company Law, a Director may not operate an insolvent company. However, he has not explained why Sark Electricity Limited could be in such a position. Sark Electricity Limited pays its parent company, Sark Electricity Holdings Limited (SEHL), a “lease payment” of £240,000 each year for using the generators, transformers, switches and cables needed to supply electricity on Sark. SEHL uses these funds to pay the shareholder loan interest and the dividend, as well as to pay the Director and support services. The lease contract sets this payment at 8% of the value of SEHL, as judged by SEHL. SEHL currently judges the value to be the replacement cost of all the assets, *no matter how old they may be*. I am not aware of any other utility company that values its assets in this way and, in my view, Sark Electricity Limited is over-paying for the use of SEHL’s assets. This is one reason why Sark Electricity Limited is loss making. Others include providing for the Director’s travel and accommodation, the additional costs of operating two companies rather than one, and the large legal fees incurred by the Director.

The current predicament has arisen on account of the shareholders’ and Director’s decisions. When commercial companies make decisions that have the potential to place that company into an insolvency situation, the directors of that company either put the company into administration / liquidation, or they raise additional funds from either their shareholders or from the market. They do



not, automatically, raise prices to their customers unless the market could withstand such an increase. Having regard to Control of Electricity Prices (Sark) Law, 2016, SEL may not charge prices that are not fair and reasonable. In the event of SEL raising its prices to a level that is not fair and reasonable, as I have found to be the case, the charge being levied may become unlawful as it becomes necessary for a Price Control Order to be made.

#### *Collusion*

David Gordon-Brown has accused me of colluding with Chief Pleas to bankrupt the company, with the aim, he claims, of enabling Chief Pleas to purchase the company at an unfairly low price. I deny this claim. Furthermore, the notes of the meeting in January 2018 do not support it. The notes record a meeting where I reported to the Committee that, having reviewed the accounts of Sark Electricity Limited and SEHL, I had come to the *preliminary* conclusion that the company had an unsustainable business model, had over-valued its assets by valuing them as new, that I was likely to set a lower price than that being charged at the time and that there was a possibility that Sark Electricity Limited would decide to switch off supplies. Such a possibility was something that Chief Pleas needed to be made aware of in order to ensure there was a contingency for the supply of electricity and other essential services that rely on electricity. There was no collusion and nothing unlawful in me informing Chief Pleas of my preliminary views.

#### *Cables (web-site)*

David Gordon-Brown contends that, because plastic bottles last for centuries in land-fill sites, there is no problem leaving buried cables. I agree that there may be no problem arising from the decommissioning of the cables, as long as they are buried sufficiently deep that they will not interfere with other use of the land, such as ploughing. However, the reply reveals one reason why Sark Electricity Limited has landed itself in such a predicament. I have written to David Gordon-Brown explaining that Cross-Linked Polyethylene (XLPE) cables do not have unlimited useful lives. Plastic bottles in land-fill sites are not in close proximity to large electromagnetic fields that are created when cables carry alternating current at high voltages. The insulation eventually deteriorates when exposed to these fields. That is why electricity utilities around the world depreciate these networks over 50 years or so. The misplaced belief that these cables effectively last forever is the reason why Sark Electricity Holdings Limited does not depreciate its network assets. This has led the company to overstate its profits and so over-distribute dividends to shareholders, thereby exhausting its reserves.

Anthony White

10<sup>th</sup> December 2019