

## Office of the Sark Electricity Price Control Commissioner

### Electricity Prices – Price Control Order

20<sup>th</sup> December, 2019

#### *Summary*

1. On 14<sup>th</sup> November, 2019, I sought views on a proposal to set a maximum price for sales of electricity on Sark for 2020 of 53 p/kWh. I received 15 responses. Collas-Crill, acting on behalf of Sark Electricity Limited, has suggested that I should not proceed to setting a Price Control Order under section 15 of the Control of Electricity Prices (Sark) Law, 2016 (the “2016 Law”). I have considered Collas-Crill’s arguments and have concluded that they are without merit, as described in paragraphs 5 to 24 below. As such, having previously determined, under section 13 of the 2016 Law, that neither the current price of 66 p/kWh, nor the earlier rate of 85 p/kWh, are fair and reasonable, I am now using the power granted to my Office under section 15 of the 2016 Law, to set a maximum price of 54 p/kWh for sales of electricity on Sark from 1<sup>st</sup> January, 2020 to 31<sup>st</sup> December 2021. The price for 2021 may be adjusted, depending on the consumption of electricity on Sark and movements in diesel fuel prices, as set out in paragraphs 26-29 below.

#### *Background*

2. The proposed Price Control Order<sup>1</sup> (PCO), published on 14<sup>th</sup> November 2019, suggested that the maximum price for electricity on Sark should be 53 p/kWh for 2020 with adjustments described in paragraph 16 to 19 of the Proposal. I have shared this proposal with the Policy & Finance Committee of Chief Pleas and Sark Electricity Limited. The document is also generally available on my Office’s web-site; [www.epc.sark.gg](http://www.epc.sark.gg). Consultees were given until 3<sup>rd</sup> December 2019 to respond.
3. I received 15 responses, 13 were from residents of Sark, though one was out of time, and one resided on Jersey. 13 welcomed the introduction of a maximum price. Only six responses answered the specific questions raised in paragraph 21 of the proposed PCO. Of these six
  - 1) Five suggested the PCO should be set for two years and one respondent for one year only.
  - 2) Six said the threat of own generation was real and already starting. One said he will self-generate even at a price of 53 p/kWh.
  - 3) No strong feelings were expressed on the timings of adjustments.

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<sup>1</sup> Office of the Commissioner, [www.epc.sark.gg](http://www.epc.sark.gg), 14<sup>th</sup> November 2019.



- 4) One said that 30-40% of Sark Electricity's Limited's business could be lost to own generation. One said that customers should not suffer if they cannot self-generate – electricity should always be at a reasonable price as it is an essential service. One said the EPC should contemplate a lower return to Sark Electricity Limited if necessary. One said there should be no alleviation to Sark Electricity Limited from people going off-grid, as *“it is entirely due to SEL's irresponsible management practices”*. Two suggest measures should be taken to dissuade people from going off-grid, such as a fixed charge paid by all.
- 5) Other matters that were raised by respondents that were unrelated to the questions posed in the proposed PCO include:
  - i. legal costs unrelated to the cost of generation and supply should not be allowed to be added to the tariff.
  - ii. renewable energy is the way for the future,
  - iii. one asked if SEL could be nationalised,
  - iv. three suggested that 1<sup>st</sup> January was not a good date to start the PCO,
  - v. self-generation will cause fuel poverty,
  - vi. the situation needs stabilising before renewable energy can be implemented,
  - vii. SEL's business model is unsustainable,
  - viii. the island needs to own the system so as not to be held to ransom,
  - ix. demand could increase due to a new law allowing electric bikes, slaughterhouse and dairy.
4. Collas-Crill, who act on behalf of Sark Electricity Limited, argue that it would not be within my powers, as set out in the 2016 Law, for me to set a Price Control Order because the Determination itself was flawed, and therefore, invalid. The Proposed Control Order explained my grounds for dismissing Collas-Crill's belief that I was not being fair and reasonable in coming to my Determination. Collas-Crill still holds that the Proposed Control Order is invalid on account of the alleged flaws in the Determination and because of my alleged bias in assessing the fair and reasonable price. I consider Collas-Crill's arguments to this effect in the following and demonstrate why I believe they are without merit.

*Sark Electricity Limited's arguments as articulated by Collas-Crill*

5. Sark Electricity Limited holds that my Office's proposed Price Control Order will be invalid. It argues that:
  - a) the Determination itself is flawed, and, in any case:



- b) the cost estimates used to derive the maximum price in the proposed PCO “bear no resemblance to actual fiscal reality”. In particular, I had failed to allow for legal costs to be recovered through the tariff.
- c) I am biased, not independent, and have:-
  - i. tried to bankrupt the company in collusion with Chief Pleas,
  - ii. not provided an allowance for capital expenditure to build renewable technologies,
  - iii. over-estimated the likely electricity consumption on Sark in 2020,
  - iv. overstated the risk of people going off-grid,
  - v. not considered interest on the shareholders’ loan,
  - vi. not allowed for the full lease payment, even though it is below market rates.

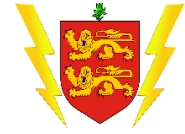
I will answer these charges in turn.

*(a) Flawed Determination*

- 6. Sark Electricity Limited contends that the Determination is flawed on account of my treatment of Sark Electricity Limited and Sark Electricity Holdings Limited (SEHL) as a single, combined, entity. I have been consistent in this approach since December 2017 when I set out, in the Consultation Paper of December 2017, how I intended to determine whether Sark Electricity Limited’s prices were, or were not, fair and reasonable. My reasons for so doing were set out in Paras 19 to 25 of the Determination of 8<sup>th</sup> November 2019. Over the period November 2017 to February 2019, Sark Electricity Limited did not raise any concern that I did not have the power to require the provision of documents or information related to the assets used for the purpose of electricity generation, distribution and supply. Sark Electricity Limited now argues that, since the assets are owned by a different company, i.e. SEHL, its parent company, which is not regulated under the 2016 Law, it does not have to provide the relevant information. Sark Electricity Limited also argues that it cannot be compelled to produce information that it does not have and has no right to obtain.
- 7. I explained in paragraphs 19-25 of the 8<sup>th</sup> November Determination why I believe that Collas-Crill’s arguments are without merit. Collas-Crill’s response to the proposed PCO did not contain any new material on this matter and I still judge that the prices charged by Sark Electricity Limited are not fair and reasonable.
- 8. Indeed, as I explained in the Determination of 8<sup>th</sup> November, I arrived at the same conclusion when, following Sark Electricity Limited’s suggestion, I considered only Sark Electricity Limited alone. I examined the nature of the lease between Sark Electricity Limited and SEHL and found that the lease price is far in excess of a commercial rate. This is one reason why the prices charged by Sark Electricity Limited are not fair and reasonable.

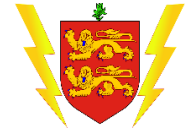
*(b) Fictitious cost estimates*

- 9. I described how I arrived at the maximum price of 53 p/kWh that Sark Electricity Limited may charge for electricity in the draft Determination in paragraphs 18 to 50. In a confidential annex



to the Determination of 8<sup>th</sup> November, I also set out how I arrived at a similar result from repricing the lease between Sark Electricity Limited and SEHL at commercial rates. Collas-Crill contend that my cash cost estimate used to derive a price is “flawed and devoid of any economic reality”. My analysis of the accounts of Sark Electricity Limited and SEHL for 2016 and 2017 is set out in Table 1 below. These accounts were provided freely by Sark Electricity Limited and are not covered by a Non-Disclosure Agreement. I have decided to publish this Table, rather than confine it to a Confidential Annex, in order to assist residents to understand the areas of disagreement between my Office and Sark Electricity Limited more completely. This has become necessary, in my judgement, on account of statements Mr Gordon-Brown made in a video at the “Town Hall Meeting” of 28<sup>th</sup> November 2019 and in a response to correspondence arising from that meeting posted on Sark Electricity Limited’s web-site. Mr Gordon-Brown claims that the 53 p/kWh price I proposed would force the company into bankruptcy. The analysis described below shows that it is the decisions of the directors and shareholders to incur unnecessarily high costs, and seek to recover them from electricity customers, that has led to the current situation.

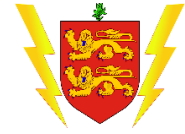
10. In deriving an estimate of a fair and reasonable price for electricity, I considered costs under four headings, Director & Management, Wages, Operations, Services and Administration. The estimate (EPC) for Director & Management (travel & living expenses) is considerably lower than the costs reported by the two companies in the accounts. It may be seen that Director’s fees amounted to around £110,000 in both years and management expenses around £70,000. I have assumed that the company will continue to operate with a part time Director but whose remuneration is reduced to market levels but also appoint a part time Chairman and Finance Director. I have not allowed for any costs associated with the Director’s travel and living expenses. The services figure has been inflated recently on account of legal expenses.
11. Collas-Crill also contend that my use of the untaxed diesel price published by Eurostat is invalid as fuel at such a price “.... is not even available to SEL on Sark”. This misses the point. I believe it is important for Sark Electricity Limited to have an incentive to purchase fuel economically, as I explained in paragraph 23 of the proposed PCO of May 2018. In order to set a fair market price for Sark, I have used the published Eurostat price for UK untaxed diesel, as described in paragraph 49 of the 2019 draft Determination. Trading of fuel using the price of a heavily traded market is commonplace in the energy industry. Contracts are often struck at a price reported at a particular location, such as ARA (Amsterdam, Rotterdam & Antwerp) plus a premium, say \$2.50, to reflect the additional cost of delivery elsewhere. So, if the world price, of, say, \$60/tonne, rises by \$1/tonne, the contract price would rise from \$62.50 to \$63.50/tonne. It is worth noting that Sark Electricity Limited’s purchasing costs were consistent with the adjusted market-based level for the first six months of 2019, the latest period for which I have partial, unaudited, financial information for Sark Electricity Limited.
12. My estimates are therefore based on the “reality” of Sark Electricity Limited and SEHL’s accounts, which were prepared by its accountants, Clelland & Co, coupled with my own experience, discussions with industry experts and publicly available information.



**Table 1**  
**Sark Electricity Limited as a combined entity with SEHL**

Income (£)		2016(A)	2017(D)		2020 (EPC)
	Sales	859,766	909,183		795,000
	Cost of Sales	206,397	242,893		278,600
	Gross Profit	653,369	666,290		516,400
<b>Overheads (£)</b>					
<i>Salaries</i>	Chairman				20,000
	Finance Director				25,000
	Director	81,044	78,520	}	51,000
	Director Holding	30,000	30,109		
	Mgmt expenses	37,542	27,649	}	9,000
	Mgmt Holdings	34,079	29,024		
	Wages & SI	161,561	128,901	}	165,000
	Wages & SI non d	22,080	22,160		
	Pensions	17,153	15,068		
	Pensions non direct	1,325	1,330		
	<b>Staff total</b>	<b>384,784</b>	<b>332,761</b>		<b>270,000</b>
<i>Administration</i>	Telephone	820	930		
	Adv. Post, Stationery	4,265	2,504		
	Computer	5,607	4,587		
	Sundries	1,283	1,540		
	<b>Admin total</b>	<b>11,975</b>	<b>9,561</b>		<b>10,000</b>
<i>Services</i>	Insurance	8,647	8,732		
	Rent & Rates	9,017	9,141		
	Heat light water	749	1,259		
	Audit fees	12,000	10,875		
	Audit Holding	12,000	10,000		
	Legal & Prof	4,115	5,449		
	Prof fees Holding	16,351	14,832		
	Dealing with regulation	38,016	24,000		
	Bank charges	669	647		
	Bank charges Holding	686	417		
	Bad debts	8,298	24,906		
	<b>Services total</b>	<b>110,548</b>	<b>60,446</b>		<b>30,000</b>
<i>Operations</i>	Motor expenses	660	671		
	Repairs & Renewals	16,898	25,505		
	Tools & Equipment	-	-		
	<b>Ops total</b>	<b>17,558</b>	<b>26,176</b>		<b>40,000</b>
	Depreciation	15,070	13,688		64,063
	<b>Operating Profit</b>	<b>113,434</b>	<b>223,658</b>		<b>102,337</b>

*Note: EPC revenue based on 1,500,000 kWh at 53 p/kWh. If £15,000 allowance for regulatory & legal costs are included, Services would rise to £45,000 and the price would be 54 p/kWh*  
*Source: SEHL and SEL Accounts for 2016 (Final) and 2017 (Draft), EPC.*



13. I explained how I intended to consider legal costs at paragraph 35-39 of the 8<sup>th</sup> November Determination and paragraph 15 of the draft PCO. The Company, on advice, have yet to waive legal privilege and allow the scrutiny I require in order to assess the amount I believe it would be reasonable for customers to pay. I am not persuaded that Sark Electricity Limited requires more legal and regulatory support than my Office, so I will allow the legal costs my Office has incurred during 2019 to be included in the 2020 tariff. I do not believe that such an approach is unfair. My interactions with Sark Electricity Limited have been requests for information that a Director of a reasonably well managed company would have to hand and be able to supply.

*(c) Bias*

14. Collas-Crill contends that I am biased against Sark Electricity Limited's interests. I am simply carrying out my duties under the 2016 Law. I have no agenda other than carrying out my duties under the Law in a fair way. Collas-Crill dismisses the contributions from all of the respondents to the proposed Determination as they "... have a vested interest in seeing prices reduce". If those who have read my analysis support the conclusions, they should not be criticised for accepting and supporting it. Collas-Crill fails to appreciate that, conversely, Sark Electricity Limited has a vested interest in keeping prices at current levels. This does not mean that I automatically dismiss their arguments out of hand. Rather, I seek to understand their points and take them into account during my investigations. Indeed, I have copious evidence of my even-handedness in my dealings with Sark Electricity Limited, which is listed in paragraph 14 of the 8<sup>th</sup> November 2019 Determination.

*(i) Attempt to bankrupt the company*

- a) I approached the task as Commissioner with an open mind. It was only after I had sight of the companies' accounts that I realised that the prices charged were not fair and reasonable. I then proceeded to discharge my duties as Commissioner.
- b) I have not set prices so low as to force Sark Electricity Limited into bankruptcy. I showed in the draft PCO that the combined entity of Sark Electricity Limited and SEHL could make a reasonable profit at a price of 53 p/kWh. I noted that, In order to achieve this level of profitability, the Director's remuneration package would need to be lowered to a rate commensurate with the role and the company's shareholders to finance the cost of optional legal actions and of splitting the company in two.
- c) Alternatively, considering Sark Electricity Limited alone as the regulated supplier, a price of 53 p/kWh would enable the company to enjoy a reasonable profit margin for an "asset light" retailer, but only if the lease payment to SEHL were reduced to a market rate that reflected the actual value of the assets, rather than pretending that they are all brand new. In addition, the Director's remuneration package would require adjustment as described above. If the Director and shareholders take decisions to pay high lease payments and do not take steps to reduce expenditure, then any distress caused will be a result of their actions, rather than the Determination.



*(ii) Capital Expenditure*

- a) I have noted that the introduction of some generators employing renewable technologies would lower Sark Electricity Limited's generating costs<sup>2</sup>. I do not believe it is necessary for Sark Electricity Limited to raise prices in order to accumulate a fund to do this. The problem is that Sark Electricity Limited has spent its reserves on unreasonably high costs and excessive dividend distributions. The analysis presented in the 2018 Proposal to make a Price Control Order (paragraphs 15-19) showed that the full cost of deploying these technologies, including financing, would be lower than the marginal cost of running SEHL's existing diesels. It seems to me that Sark Electricity Limited could raise funds, either from its shareholders or from new sources, as do other companies, in order to install this equipment.

*(iii) Electricity demand forecast 2020*

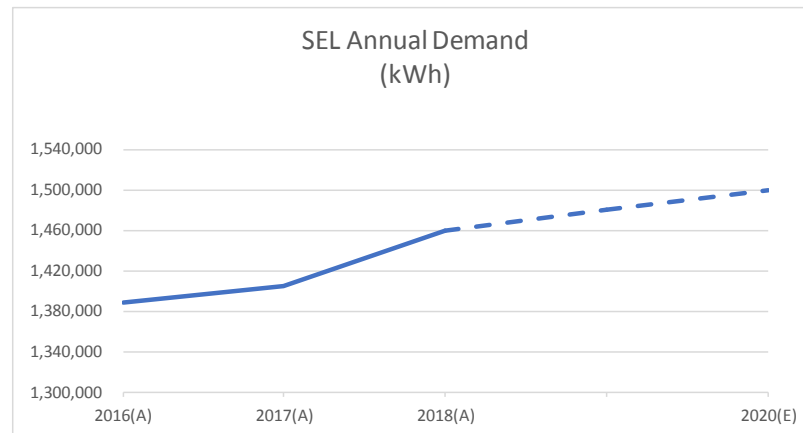
- a) In order to determine a fair and reasonable price for electricity on Sark, I have made estimates of the cost of producing the power. Some of these costs are overheads and do not vary with demand. In order to derive an average cost, an estimate is required of the likely annual demand. Since 2016, demand has risen slowly, as shown in Figure 1 below. In assuming demand would be around 1,500,000 kWh for 2020, I have assumed that demand will continue roughly in line with the growth of the past few years, as indicated by the dashed line in Figure 1.
- b) Sark Electricity Limited has informed me that demand for the first six months of 2019 was only 600,000 kWh, or 14% lower than the same period in 2018. Sark Electricity Limited suggests that it is unlikely demand will reach 1,500,000 kWh and believes that it was disingenuous of me to base my assessment on such a high figure.
- c) I do not believe it is prudent to ignore the responses I have received to the consultations on the extent to which the high electricity prices are stifling consumers' electricity consumption and the health of the economy itself. I do not know exactly how consumption will respond to the lower price and that is why the pricing mechanism I am introducing includes an adjustment mechanism, as described in paragraphs 16-19 of the proposed PCO of 2019. This would allow Sark Electricity Limited to recover a revenue shortfall caused by a fall in the demand for electricity. Sark Electricity Limited has not responded to the suggestion that the adjustment could be made sooner than January 2021, as I invited in paragraph 21 of the proposed PCO. I am also willing to consider requests for a variation to the price cap, in accordance with section 15(6) of the 2016 Law.

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<sup>2</sup> See, for example, paragraph 58 of the Determination of 8<sup>th</sup> November 2019



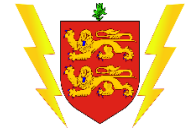
**Figure 1**



*(iv) Risk of customers self-supplying*

- a) In the Consultation paper of December 2017 and in subsequent documents, I warned of the risk high electricity prices represented to Sark Electricity Limited's future viability. I forecast that wealthier customers would choose to supply themselves at lower cost by using their own generation equipment. I warned in the consultation on the Policy Statement that this might exacerbate fuel poverty on the island. Were there such a reduction in demand, Sark Electricity Limited, following past practice, would raise prices to its remaining, less affluent, customers in order to maintain its profitability. Sark Electricity Limited dismissed this risk as unlikely but "self-generation" seems to be coming to pass. Stocks Hotel, which says it accounts for 18% of the island's electricity consumption, has announced its intention to disconnect from SEHL's network if prices remain at the level of 66 p/kWh. It will install batteries to supplement its existing on-site diesel engine and may go on to install solar PV panels.
- b) Setting the price at 54 p/kWh would lead to an increase in electricity consumption, as customers make more use of electricity. However, even at this price, some customers may still decide to disconnect from the network and self-supply. I do not believe that it would then be appropriate simply to reset the revenues according to paragraph 28 below with the consumption through SEHL's network alone as being the defining variable. This would, in effect, be protecting the company's shareholders from the consequences of its own pricing decisions which led to the loss in demand in the first place. This issue was raised by a respondent to the proposed PCO, as reported in paragraph 4 above.





*(v) Shareholder Loan*

- a) Collas-Crill argues that, in arriving at a fair and reasonable price, I “ignored the fact that the conflated company has a £1,268,000 loan from the shareholders on which it is legally required to pay £101,447 in interest payments annually”. I described this shareholders’ loan in the 1<sup>st</sup> October Draft Determination at paragraphs 59-63. I have set the maximum price at a level that would allow a reasonably efficient company to enjoy a reasonable profit, calculated as a return on investment commensurate with the associated risk. The choice of financing, whether by debt or by equity, is for the management and shareholders to make. As such, Collas-Crill’s argument is not relevant. However, as I noted in paragraph 63 of the 1<sup>st</sup> October 2019 draft Determination and indicated in Table 1 above, the company would be able to pay the interest charges on this loan, at an electricity price of 53 p/kWh, were it operated in an efficient manner. If £15,000 of regulatory and legal costs are included, it would still be able to meet the interest payments on the shareholders’ loan at a price of 54 p/kWh.

*(vi) Lease payments*

- a) Collas-Crill has argued that, in arriving at my assessment of a fair and reasonable price, I have ignored the costs Sark Electricity Limited incurs from leasing the assets from SEHL. This is denied. I explained in paragraphs 28-29 of the 8<sup>th</sup> November Determination that I considered the costs of generating, distributing and supplying electricity on Sark by two methods. In one, I considered the two entities as one, as recommended by David Gordon-Brown. In the other, I assumed that the two companies operate as separate entities, with Sark Electricity Limited leasing the equipment from SEHL. Collas-Crill describes the actual lease payments as “This amounts to 3% over 20 years at nearly £300,000 per year”. Collas-Crill also advise that, “of this amount, SEHL actually only receives £176,012.40 per year, which is the bare minimum to keep SEHL solvent. The balance is then added to a loan from SEHL to Sark Electricity Limited which continually increases.”
- b) This description of the lease is remarkable for a number of reasons:-
- I. Sark Electricity Limited has provided my Office with an unsigned copy of the lease. Nowhere is the figure 3% to be found.
  - II. The annual payments from Sark Electricity Limited to SEHL for the use of the equipment are set at “8% of the value of the Equipment, as calculated by the Supplier... “.
  - III. The method by which the value is to be calculated by the Supplier (SEHL) is not defined. As a consequence, I am advised that such a contract would not be enforceable in Guernsey, or anywhere else for that matter.
  - IV. There is no term defined, certainly not 20 years. The contract may be terminated by the Supplier.
  - V. The lease does not describe the asset management strategy, covering matters such as the decision to repair or replace a piece of equipment.



- VI. The “balance” of outstanding lease payments to SEHL attracts interest at 8%.
  - VII. SEHL’s outgoings in 2017 consisted of the payment of the shareholders’ loan interest (£101,000), the director’s remuneration package (£59,133 for SEHL only), audit fees (£10,000), bank and professional fees (£15,249) and dividends. I struggle to understand how £176,012.40 may be considered as “the bare minimum to keep SEHL solvent”, given these insupportably high charges.
- c) The definition of “value” is too vague for commercial purposes. However, a note to the draft 2017 Accounts states that “the company receives 8% per annum on the replacement value of the assets”.
  - d) I have never encountered a lease for equipment priced in this way. I believe that ignoring the effect of accumulated depreciation of the assets is flawed and leads to an unreasonably high annual charge. A commercial lease charge would be based on the value of the assets, i.e. the replacement cost of the assets less the accumulated depreciation. Once this correction is made, it becomes evident that the annual lease payment from Sark Electricity Limited to SEHL is unreasonably high since most of the assets are well through their expected lives. As a result, the claim that the current lease is favourable to Sark Electricity Limited is misleading.
  - e) Sark Electricity Limited is the wholly owned subsidiary of SEHL. David Gordon-Brown is the sole Director of both companies. As such it would be easy for the companies to renegotiate both the lease and the shareholders’ loan, make them consistent with market rates and thereby ensure the profitability of both Sark Electricity Limited and SEHL.

#### *Setting a Maximum Price*

- 15. Paragraphs 5 – 9 of the proposed Price Control Order, 14<sup>th</sup> November 2019, describe how I considered how to set an electricity price that would enable the combined entity of Sark Electricity Limited and SEHL to earn a return that I judged to be reasonable, based on an understanding of the risks and the returns made by other enterprises. I described the assumptions I had made concerning the variable and fixed operating costs of the combined business of Sark Electricity Limited and SEHL. Collas-Crill have complained “Your cash cost estimate is flawed and devoid of any economic reality which is again symptomatic of goal seeking and bias”. This complaint was not supported by any evidence. Indeed, Table 1 above indicates that it was unfounded.
- 16. Table 1 above shows how I derived the fixed cash costs estimates used in Table 1 of the proposed Price Control Order, from the draft accounts for 2017 and the audited accounts for 2016<sup>3</sup>. These are the most recent annual figures that Sark Electricity has provided to my Office.

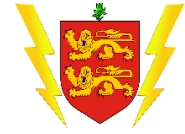
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<sup>3</sup> These are shown as 2017 (D) for the draft accounts of 2017 and 2016(A) for the final, audited accounts of 2016



The Table shows that all items in the EPC 2020 forecast are based on the companies' accounts but that, where I believe that the items are unreasonably high for electricity customers to pay, such as the "Dealing with regulation" or the additional costs of auditing two companies, I have excluded them from my forecast.

17. I have assumed far lower management costs and Director's fees for both companies but I have allowed for higher expenditure on repairs and renewals and for the appointment of a part-time Chairman and Finance Director. Table 1 demonstrates that the combined companies would enjoy an operating profit were the tariff 53 p/kWh, even if a more realistic depreciation charge is included for the network, as indicated. Mr Gordon-Brown's claim, that Company Law would require the Director to stop operating the company because it would be at risk of going insolvent, solely on account of a 53/4 p/kWh price control, is misleading.
18. Collas-Crill argues that the way in which I have set prices is invalid, because of my treatment of the two companies as a combined enterprise when, in fact, Sark Electricity Limited is a separate legal entity from SEHL. As I explained in the Determination of 8<sup>th</sup> November 2019, I have also considered Sark Electricity Limited as a separate entity and assumed that it purchases the use of the assets from SEHL under a lease arrangement. However, following the description under paragraph 14 (vi) above, I have assumed a lease priced on commercial terms, where the annual fee is a percentage of the value of the assets. I take this value as the **depreciated** replacement cost of the assets. Such a method to value the lease was confirmed by Collas-Crill in a letter to me of 29<sup>th</sup> August 2019. Under these circumstances, the annual lease fee would be in the region of £105,000 to £135,000, say £120,000, per annum.
19. Figure 2 shows forecast profit & loss statements for both companies in 2020, assuming that the average electricity price is 53 p/kWh, UK untaxed diesel prices remain at 52 p/l and that electricity consumption is 1,500,000 kWh. It does not include the £15,000 legal and regulatory cost allowance. It demonstrates that both companies would be able to operate profitably if the price were 53 p/kWh. The companies would make a combined operating profit of around £80,000. This is lower than the combined entity, owing to the duplication of costs. I note that the profit margin (profit/total costs) implied for Sark Electricity Limited would be in the region of 4-8%, higher than the 1-5% of costs range expected of such an "asset light" enterprise. The current management would show SEHL's profit to be considerably higher, given its policy of not depreciating the network assets.



**Figure 2**  
**Profit & Loss for Sark Electricity Limited & SEHL**

Sark Electricity Limited (2020)			SEHL (2020)	
	£			£
Sales	795,000	→	Income	120,000
Cost of sales	278,600			
Gross Margin	516,400			
Overheads			Overheads	
Staff	270,000		Staff	10,000
Admin	10,000		Services	10,000
Services	30,000		Depreciation	64,063
Operations	40,000			
Lease payment	120,000	→	Operating profit	35,937
Total costs	748,600			
Operating profit	46,400			

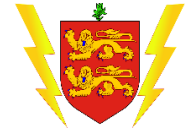
Source: EPC estimates

20. The P&L statements do not show the interest charges on the shareholders' loan. This amounts to £101,447 per annum. This indicates that, unless this loan is renegotiated, the dividend payments to shareholders would be very low, unless electricity consumption were to recover. Alternatively, SEHL could continue to ignore depreciation of the network assets and easily pay a dividend. In any case, neither SEHL, nor Sark Electricity Limited would become insolvent on account of a Price Control Order being introduced. It would become insolvent on account of management and shareholder decisions to arrange a remuneration package that is over-generous to the Director, and incurring the unnecessary additional costs of splitting the company and high legal fees.

#### *Legal & Regulatory Costs*

21. In paragraphs 35 to 39 of the 8<sup>th</sup> November Determination, I described how I consider whether it is reasonable for Sark Electricity Limited to pass on its legal and regulatory costs to its electricity customers. I am still in discussions with Collas-Crill concerning my wish to scrutinise these bills. I have not received any financial information from Sark Electricity Limited that suggests that it has not already recovered the £147,666.06 that it claimed it had spent on legal bills during the Determination and Price Control Order procedures of 2018. In any case, I note that some of these costs relate to advice on Human Rights Legislation. This advice was not, in my judgement, related to the Determination and Price Control Orders, and so was for shareholders to finance rather than customers.

22. I have not yet received any billing information concerning the legal bills for 2019. Sark Electricity Limited has sent me a draft profit & loss account for the company for January to June 2019. It shows legal costs associated with regulation at £63,616. During that period, I received three



letters from Collas-Crill. I do not consider it reasonable for Sark Electricity Limited to expect customers to pay so much for so little without scrutiny.

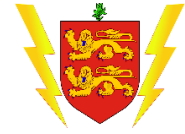
23. I accept that some advice will be required for regulated companies, as long as these costs are incurred on matters related to the provision of electricity, as supported by two respondents to the proposed PCO. However, I believe that these costs should be kept under control. The process of conducting a Determination involves basic information, such as sharing the financial records of a company, budgets and business plans, historic electricity consumption and details of the equipment employed, such as a list of the assets giving the purchase costs and commissioning dates and the operating efficiency of equipment. This is not onerous. Most of the legal fees Sark Electricity Limited has incurred from January to June 2019 relate to legal arguments about my right to obtain information and attempts to hinder the work of my appointed consultant engineer, WSP. I do not believe it is fair to expect customers to continue to support such prodigal and injudicious use of lawyers.
24. Without the ability to scrutinise the billing schedules for 2019, I am allowing an annual amount of £15,000 for legal and regulatory expenses related to the provision of electricity. This sum is more than my Office's bills for 2019 and leads to the increase in the maximum price from 53 p/kWh to 54 p/kWh. If I find, after scrutiny of the billing schedules and more recent audited financial information, that it may be reasonable for Sark Electricity Limited to recover a larger sum from electricity customers, I will, under section 16(2) of the Law, consult on a variation to this Order.

#### *Discussion*

25. None of the submissions I have received have led me to alter my initial view that the current price of 66 p/kWh is neither fair nor reasonable. Furthermore, none of the representations I have received from Collas-Crill have convinced me that either my methodology or assumptions are flawed. As a consequence, under the power granted to my Office under section 15(1) of the 2016 Law, I am setting a maximum price for electricity on Sark at 54 p/kWh for the period 1<sup>st</sup> January 2020 until 31<sup>st</sup> December 2021. I do not believe that customers should continue to over-pay for electricity unnecessarily. This assumes that UK untaxed diesel prices remain at 52 p/l, as reported by Eurostat, and annual demand is 1,500,000 kWh.

#### *Price Adjustments*

26. The cost of electricity generation on Sark is currently directly affected by movements in diesel prices. I do not believe it is fair to expect Sark Electricity Limited to absorb all this associated risk and so the maximum price will be varied accordingly. If the average weekly diesel prices reported by Eurostat over 1<sup>st</sup> December, 2019 to 30<sup>th</sup> November, 2020 are higher than £0.52/l, then the maximum price for 1<sup>st</sup> January 2020 to 31<sup>st</sup> December, 2021 will be adjusted to allow Sark Electricity Limited to recover any shortfall suffered during 2020. The "under-recovery" will be calculated as:



Under-recovery (£) = ((Actual average price - 0.52) / 3.20<sup>4</sup>) \* actual demand (in kWh)

27. The adjustment to the tariff, in p/kWh, will be calculated by dividing the under-recovery by the forecast annual demand for 2021, multiplied by 100 to convert £ into p. Similarly, if the average price is lower than 52p/l, the over-recovery will result in a lower maximum price for 2021, according to the same formula.
28. Similarly, If electricity consumption on Sark is lower than 1,500,000 kWh during the year 1<sup>st</sup> December 2019 to 30<sup>th</sup> November 2020, a similar adjustment will be made to the tariff for 2021. The tariff adjustment will be made by the same procedure as described above. In this case the adjustment will be calculated as:

$$\text{under-recovery}^d(\text{£}) = 0.34 * (1,500,000 - \text{Actual consumption}).$$

29. I am not setting an “over-recovery” adjustment for consumption for the next two years. Therefore, Sark Electricity Limited benefits from selling more power as it would improve profitability. These adjustments would not give Sark Electricity Limited full protection if demand is lower than 1,500,000 kWh on account of customers deciding to generate their own power, since the “Actual consumption” on Sark will include that generated and consumed “on-site” by customers.

#### *Concluding remarks*

30. Collas-Crill has already intimated that Sark Electricity Limited may Appeal this Price Control Order. This is a matter for the Director and shareholders. I hope it will not. I have set out my understanding of the costs of generating, distributing and supplying electricity on Sark in some detail in the draft Determination, the Determination, the proposed Price Control Order and this Price Control Order. My cost estimates have been taken from Sark Electricity Limited and SEHL’s accounts but adjusted where I judge that Sark Electricity Limited’s costs were unreasonably high. There are two additional areas of dispute:-
- a. Financing and lease costs. I believe that the Director holds an unrealistic view of the value of the combined entity of Sark Electricity Limited and SEHL. As a consequence, he believes the shareholders are entitled to a large dividend. I have shown why this is misplaced. In order to arrive at such a valuation, it is necessary to assume all the equipment is new, or assume that the cashflows it enjoyed before the 2016 Law was introduced would continue into perpetuity. I cannot set a price that is based on such unreasonable assumptions.
  - b. Legal Costs. I explained my position on this matter in paragraphs 35-39 of the 8<sup>th</sup> November Determination. Collas-Crill has still not allowed me access to the billing schedules. As a consequence, I have made my own assessment of the reasonable costs for 2019; I judge the reasonable costs for 2018 have already been recovered. All the information I have requested should have been at hand for a reasonably managed

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<sup>4</sup> The 3.20 factor converts prices from £/l into £ per kWh delivered, taking into account the losses in generation and distribution.



company, even one so small. Lawyers have been engaged primarily to advance arguments for the purpose of denying me access to information which I require (and still require) to carry out my duties under the Law.

31. I do not include the issue of whether the Determination was flawed on account of treating the two companies as a combined entity. The Determination showed that the structure was irrelevant to the cost – though the legal costs incurred in constructing and pursuing such an argument would have been large.

Anthony White

Commissioner

20<sup>th</sup> December 2019

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