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25, West Street,
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England
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The Conseillers
Chief Pleas
La Chasse Marquette
Sark
Channel Islands

21st September 2020

By email

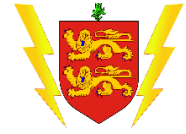
Dear Conseillers,

SEL's Commercial Viability

1. I have seen Mr Jackson's emails to you of 14 and 16 September, as well as his recent announcement on Island FM that "SEL is commercially unviable without land access law", and as a result of other factors. This all raises concerns about the security of the supply of electricity. I write at some length to provide some information and analysis which will I trust enable you to reach a balanced conclusion about the reality which I suggest is rather different.

The PCO

2. Mr Jackson complains of a shortfall in electricity consumption against the forecast in the Price Control Order (PCO) and that this is causing SEL to lose money. The estimate I used in the PCO was based on data provided to me by SEL and its lawyers. Mr Jackson now claims that these figures were incorrect because Mr Gordon-Brown had made some errors in his calculations and also mistakenly added the consumption of his own equipment to that of all the customers. The figures are said to have been too high.
3. The PCO contains an annual adjustment mechanism to allow for differences between forecast and actual consumption levels. This means



that any "under-recovery", caused by the consumption being lower than I had forecast, would be recovered through an adjustment to the price for the following year. The PCO also incorporated another mechanism to adjust for diesel fuel prices being higher or lower than anticipated. Taken together my provisional calculations suggest that SEL is currently out of pocket by about £47,000.

4. Any under-recovery could take effect in January 2021. I suggest that many companies would be relieved to be entitled to an under-recovery correction in the present very difficult economic circumstances with the Covid virus causing financial havoc.
5. I have indicated my willingness to SEL to consider an earlier adjustment. Any correction needed can be made by my Office carrying out a "variation" to the PCO.
6. With this in mind, I have been requesting information from SEL which would enable me to review the operation of the PCO. Since July, SEL has persistently declined to provide this information until legally forced to do so by my Office serving a section 5 notice under the Control of Electricity Prices (Sark) Law 2016.
7. On 16 September I finally received most of the requested information which I am now analysing with a view to drafting a variation to the PCO, if necessary. This draft will then be circulated for consultation.

The Shortfall

8. Mr Jackson has provided you with the Profit & Loss account for SEL for January to July 2020. It shows that SEL made a loss of £6,365. Compared to the forecasted PCO profit, this would represent a shortfall of around £75,000. However, the operating loss was achieved after a depreciation charge of £39,513 which remains in SEL's bank accounts. This indicates that SEL still managed to generate cash over the period of over £33,000.
9. When Mr Jackson took control of SEL, he stated that his views on pricing aligned very much with those of my Office and I note that, for the first seven months of 2020, SEL's costs have been consistent with my estimates.



10. Accordingly, I believe that SEL is able to maintain its operations within the tariff cap of 54 p/kWh, though I recognise that the level of return the company is currently enjoying has been affected by the reduction in consumption. Again, many companies would be happy to be "cash positive" during such an unusual period.

The cash shortage

11. Mr Jackson also said that he intended to introduce green technologies to the SEL system. Mr Jackson must have been aware that this would require substantial investment. The previous owner of SEL left the company in a poor financial state. My draft Determination of 1st October 2019 described how SEL had been drained of its cash reserves since 2007.

12. The company paid large dividends and interest payments to its shareholders, over-generous salaries and expenses to the Director, as well as incurring the unnecessary expenses of splitting the company in two and legal costs. Any serious and prudent purchaser of the company would have carried out careful and thorough due diligence enquiries and examinations, and consequently could and should have been aware of those realities and other problems facing the Company, such as the absence of reserves and relatively old equipment requiring replacement.

13. This information was available to me. Presumably, all of these matters were taken into consideration by Mr Jackson when deciding how much to pay for the company.

Capital expenditure

14. Mr Jackson claims in his 14 September letter that there is no allowance in the PCO for capital investment. This is not correct. The PCO sets a cap on the unit price the company may charge for electricity. It does not direct the company's expenditure. That is the role of the directors. I do not believe it is fair to demand that customers pay "up front" for capital expenditure.



15. The December 2017 Consultation Paper described how the company should be able to enjoy a return on new, justifiable, capital expenditure, but after it has been made. The return is not guaranteed. That is why the current rate, 7.3% per annum, is higher than that available from banks for risk free deposits.
16. Mr Jackson is now claiming that there are no reserves to fund capital expenditure and some of the equipment urgently requires replacement. However, there is nothing to stop SEL raising funds externally, from shareholders or banks, to fund capital expenditure. Mr Jackson is choosing not to do so. He is advising you that he "will no longer underwrite SEL's operational or capital expenditure" and warning that he may reduce supply to 19 hours a day.
17. You may ask how reasonable such a threat is when SEL has the opportunity to raise funds and chooses not to do so.
18. In relation to this matter, as with other matters taken into account for the purposes of the PCO, I would of course be prepared to re-consider in the event that an appropriate case were made out to me. However, I have not as yet received any material representations in relation to the matter.

Wayleaves

19. Mr Jackson's reluctance to commit funds to SEL appears to be related to his concern over the lack of statutory wayleaves. He argues that, without the ability to maintain his equipment on others' property, SEL is rendered commercially unviable. It is perhaps surprising that the absence of such legal permissions was not apparent during due diligence enquiries.
20. This has, however, come to light following the decision by Mr Moerman to generate his own supply of electricity and his subsequent demand that SEL remove its equipment from the tenement of La Tour. The original owner of the electricity system on Sark, Mr Robson, negotiated wayleaves with the landholders on Sark on a voluntary basis. In return for annual payments of around 6d (75p in today's money) per pole per annum, Mr Robson was given access to maintain his equipment. Mr Gordon-Brown allowed these agreements to lapse. It is clear that SEL prospered during the 2010's and was commercially viable during the 2010s despite the absence of wayleaves.



21. There is nothing to stop Mr Jackson seeking to negotiate wayleaves with any customer where a wayleave is required. I am sorry to have to say that his estimate of £175,000 for the legal costs of establishing the wayleaves is absurd. The old wayleaves could serve as a template for new agreements. The website of Scottish and Southern Electricity has templates which are available. It is simple and uncomplicated legal work which does not require the services of highly paid partners of Guernsey legal firms.
22. Mr Jackson's belief that Sark residents would hold SEL to ransom does him a disservice and belies past experience. Based on the charges paid by UK utilities, the annual costs would be around £1,600 per annum in total for all SEL's cables. So, Mr Jackson's assertions on wayleaves costs are without foundation.

The consequences of self supply

23. The reason Mr Moerman decided to self-supply was a consequence of SEL's high prices. If he had remained connected to the SEL system, the company's terms for "own generators" would have forced Mr Moerman to sell to SEL all the electricity he produced at the SEL purchase tariff of 15 p/kWh, and "buy-back" from SEL all the electricity he consumed, even if he had generated himself, at 54 p/kWh. As a result, it is not surprising that he asked to be disconnected. On 24th June, two weeks after Mr Moerman had asked SEL to remove the equipment, Mr Jackson asked whether my Office would allow the legal costs of challenging Mr Moerman's request to be passed onto electricity customers through the tariff, since its removal would affect supplies to other customers. I explained that I would only consider such a cost after evidence that other attempts to resolve the issue by agreement had been exhausted.
24. On 3rd July, I told Mr Jackson that four actual or potential own generators, including Mr Moerman, had informed me that they would rather stay connected to the SEL network, on the basis of a fair arrangement with SEL, rather than through the "buy-back" arrangement. It appears that Mr Jackson did not discuss the feasibility of reaching such a mutually beneficial solution with his customers. Mr Jackson claims that his engineering consultants advise that the SEL system cannot cope with any more generation by customers. Yet on 2nd



July, at the Island Hall meeting, Mr Jackson had asked residents to “rent their roof” to SEL, so that solar PV panels could be installed on them. No mention was made of a limit to the capacity available. Furthermore, the SEL web-site still advertises the service of allowing own generators to remain connected, as long as they use the “buy-back” arrangement. There is no suggestion that SEL’s system has no remaining capacity to accept renewable generation.

Tariffs and Conclusion

25. In April, Mr Jackson and I discussed the introduction of a new tariff structure which, if appropriately designed, could discourage ‘own generators’ from disconnecting from the SEL system as well as ensuring that owners of infrequently occupied buildings make a fair contribution to the costs of electricity supply. This was presented, in outline, at Island Hall on 2nd July. I have now been informed that SEL no longer wishes to pursue this option and wishes to stay with the current tariff arrangement. This is a disappointment to me. It seems that SEL is on a path that will lead to a fragmentation of the system and would lead to higher unit costs. Nevertheless, as Commissioner and as I explained in the November 2019 Determination, I do not think it would be fair to ask customers to pay a higher unit price for their electricity on account of decisions by SEL's directors that encourage customers to generate their own power.

26. I should be very grateful to hear your views on:

- a) The timing of adjustments to the tariff to account for the “under-recovery”.
- b) Whether I should reconsider the position I have taken on the funding of capital expenditure by way of "up-front" payments to be paid by customers
- c) The reasonableness of SEL’s insistence on the “buy-back” arrangement, which encourages own generators to disconnect from the SEL system.
- d) Whether the resulting higher unit costs caused by the loss of the own generators’ consumption should be passed on to customers in the form of higher prices.
- e) Any other issues that occur to you given the contents of this letter.



27. All these issues were raised in the Determination of November, 2019 last year. I would like to know if you support my conclusions expressed in the Determination.

Yours sincerely

A handwritten signature in black ink that reads "Anthony White". The signature is written in a cursive style with a large initial 'A' and 'W'.

Anthony White