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Memorandum on draft Legislation to set up a Statutory Electricity Board and to provide for the raising of a loan from the International Bank for Reconstruction and Development

In the 5-Year Development Plan it was envisaged that a long term loan of £2.3 m. should be raised by the International Bank for Reconstruction and Development towards the cost of a new Power Station and Distillation plant which it was proposed to construct at a total cost of £3.15 m. The £2.3 m. represented that part of the total cost which is attributable to off-shore procurements and the balance was to be raised by loans from other sources.

2. An application was made by the past Administration to the International Bank for Reconstruction and Development and a Mission from the Bank visited Malta last February to carry out an investigation on the spot and to process the application by discussions with local Authorities. It is now understood that the Mission has completed its report but they are awaiting for a copy of the draft Legislation to set up a Statutory Electricity Board and to provide for the raising of a loan from the International Bank before they can finalise their recommendations. Before the loan can be made available, it will be necessary for negotiations to be held with the Bank in Washington.

Draft Electricity Act

3. It is one of the conditions of the Bank for making available the loan that the Electricity Undertaking should be hived off from the Government Administration and that an Electricity Board should be appointed with a separate legal identity enabling it to sue and to be sued under the law in its own right.

4. The Board would have to be vested by law with the powers and functions now exercised by Government, which derive from (1) the Electricity Supply Ordinance; (2) the Fixed Electrical Power and Telegraphic Communications Ordinance; and (3) the Rules and Regulations issued in terms of the Electricity Supply Ordinance. Its functions and duties generally would be:-

(a) to generate electricity;

(b) to supply energy to any persons requiring it on payment at approved rates subject to the ability of the Board to do so and to a suitable undertaking by consumers, acceptable to the Board;

(c) to maintain and work any Board installation;

(d) to secure the supply of electricity; and

(e) to advise Government on all matters concerning Electricity supply.

5. The Board is also given power to operate a merchandising and repair Department and to do contract work for the wiring of premises. It is exempted from income tax, stamp duties and customs duties. The exemption from customs duties, however, does not apply to goods imported for wiring of premises and for sale to third parties.

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6. The Electricity Board will be vested with legal ownership of the assets of the present Electricity Undertaking, the value of these assets being reckoned on vesting date according to the book values as written down on account of depreciation. The Board would pay to the Government the sum of £300,000 a year representing the interest on the capital assets which would be transferred to it by the Government at the rate of 6%.

7. The Electricity Board would be empowered to borrow money by the issue of debentures, debenture stock or other securities, subject to the approval of the Minister charged with the responsibility for matters pertaining to electricity. The Minister is in this respect the representative of the Government entrusted with the operation of the Electricity Act and any approval which may be given by him for the raising of such loans, would no doubt have to be concurred in by Government before it is given.

8. The Board would have powers to fix its own tariff for energy supplied and for services rendered to consumers. It would however be the duty of the Board to fix all such charges at such rates that the revenue derived by the Board would be sufficient to meet all its working expenditure and all other out-goings properly chargeable to income in that particular year, taking one year with another.

9. Initially the staff requirements of the Board will be met from existing personnel in the Water and Electricity Department. However some 50 employees of the Installation Section of the Electricity Undertaking will have to be transferred to the Public Works Department as installation work in Government Departments will no longer be the responsibility of the Board. It is expected that the Board will provide work for practically all the remaining employees now serving with the Electricity Undertaking. Provision is made in the draft Legislation to safeguard the vested rights of the employees who are on the permanent establishment and to ensure that temporary employees who will receive notice of discharge from the Government and be re-engaged by the Board are offered employment by the Board on the same conditions as applied to them during their employment with the Electricity Undertaking. In point of fact the Board will in no case grant employees less favourable terms and conditions of service than those which they enjoy in Government Service. In this connection it is pertinent to point out that the Legislation provides for the Chairman of the Public Service Commission to certify that the terms and conditions offered to any pensionable officer detailed for duty with the Board are not less favourable than those enjoyed by such officer at the date of such offer. If a pensionable officer so detailed does not accept the offer of permanent employment made to him by the Board he will remain seconded for duty with the Board for as long as the Minister so directs.

10. The Board will consist of the Chairman, the Deputy Chairman, and not less than four or not more than six other members as the Minister charged with responsibility for matters of electricity may from time to time determine. The Chairman of the Board will be given the same powers now vested in the Manager of the Electricity Department.

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Draft Electricity Loan (International Bank) Act.

11. The Legislation gives power to the Minister responsible for Finance to enter into an agreement with the International Bank for Reconstruction and Development to borrow from the Bank such sum or sums as may be required. The money so raised will be applied to the capital expenditure of the Electricity Board for the development, expansion, transmission and distribution of electricity in Malta and for such other purposes as may be set out in the loan agreement. Where in the opinion of the Minister it is not possible in respect of any part of the money raised under the authority of the Act to apply it for the purposes so set out, that part of the money may be applied for such other purposes as may be approved by the Minister, by the Secretary of State with the concurrence of H.M. Treasury in the United Kingdom and by the Bank. The approval of the Secretary of State is required because any loan made by the Bank is guaranteed by H.M. Government and it is therefore quite proper that should the monies be required to be used for other purposes than those specified in the loan agreement, the approval of both the Secretary of State and of the Bank would have to be sought before such use is made of them.

12. The Act also provides that all sums borrowed and all interests and other charges thereon will be a charge upon and payable out of the general revenue and assets of the Government of Malta which are thereby appropriated to the purpose.

13. Before a copy of both the draft Acts are forwarded to the International Bank for Reconstruction and Development, Hon. Ministers are asked to give their approval to the principles embodied in the proposed Legislation. This is required because once the Draft Legislation is forwarded to the Bank, the inference would be that the Government agrees in principle with the terms of such legislation.

14. A copy of the draft legislation and of a Memorandum prepared by the Law Officers to explain in detail the provisions made therein is attached.

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Ext. Memo. 2.5.

<u>Memorandum on the negotiations carried out by the Maltese Delegation with the International Bank for Reconstruction and Development for a loan to finance the Power/Water Distillation Project</u>

The Delegation which left Malta on the 12th November to negotiate a loan with the International Bank for Reconstruction and Development for the financing of the foreign procurement element of the Electricity/Water Distillation project arrived in Washington in the evening of the 13th November and had its first meeting with the World Bank officials the following morning.

2. Meetings were held with the World Bank negotiating team daily, the two teams sometimes breaking up into working parties for discussion and reporting to a General Meeting of both sides periodically. Our team was treated with the greatest courtesy and consideration throughout. A representative of the British Embassy was present at sittings of the General Meeting.

3. The first phase of the negotiations, which lasted about a week, was confined to the representations made by the Malta Team for the financing of the project by a soft loan (i.e. low-rated long term loan) from the International Development Association (I.D.A.) of the World Bank. Mr. Cope, Director of Operations, Europe of the Bank as well as the World Bank Team who conducted the negotiations with the Malta Team, gave careful consideration to the economic and financial position outlined by the Delegation. This was aimed to show that the anticipated rundown of service disbursements in Malta was expected to bring about a substantial drop in personal incomes which would be reflected (a) in a reduction of National Income and a consequential lowering of living standards and (b) a decrease in consumption expenditure which would cause a drop in Government revenue particularly in receipts from customs duties. It was also stressed that a declining economy coupled with a large number of unemployed would bring about social unrest and thus prejudice the industrialization drive, the pivot on which the success of the development plan depends.

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4. The World Bank representatives whilst appreciating the position presented by us remarked that the funds available for disposal by I.D.A. were now rather limited and only countries with a standard of living much below that existing in Malta were eligible for such assistance. They took some pains to explain that the Bank has not found it possible to grant soft loans to countries with a per capita national income comparable to ours but whose "reserves" were definitely less favourable than those of Malta. In their view Malta has still a high credit worthiness, and the national income has up to now continued to show a rate of growth even though admittedly less than that registered in 1960, adding that such changes in the rate of growth were not uncommon features even in more developed economies. Although National Income and investment statistics supported the Bank's point of view, we tried to make the point that the declining trends shown in 1961 would become much more pronounced in the next few years when the full impact of the rundown in Services spending would be felt and the resultant substantial increase in unemployment would materialize. The Bank's negotiating team stated that as our forecast of the economic and financial situation in the next few years was based on several imponderables the Bank had to base its assessment on the economic performance of the country during the last eighteen months during which the economy still showed a rate of growth and the credit worthiness of the country was still strong. The present standard of living, the National Income, the national savings and the absence of any foreign debt for the time being prevented Malta from qualifying for a soft loan under I.D.A. terms. The project 'ut sic' was moreover viable.

5. We then produced a statement showing that the supply of water for domestic and industrial consumption was being run at considerable loss and on this basis we argued that the water distillation project 'per se' could not be considered as viable and the cost of the water distillation unit seemed, therefore, eligible for I.D.A. financing. The Bank could not accept this line of reasoning as they considered the Power/Water Distillation

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Project as one scheme. They argued that even after taking into account that no profit could be made on the water side, the project as a whole was still viable. Our application for a soft loan to cover the foreign procurement element of the water distillation unit could not, therefore, be accepted by the Bank. This closed the first phase of our negotiations.

6. In the second phase we discussed the terms and conditions of the loan and the legislation proposed for the institution of an Electricity Board.

7. The original application was for a loan of £2.3m. which was meant to cover the foreign procurement element of the project. It was estimated at the time that the loan would be for a period of twenty years and would bear interest at 6% per annum, but no interest would be charged during its first three years of operation when construction works would be in progress. It was also provided that the Electricity Board would have to pay by way of interest on the transferred assets a sum of £300,000 a year representing the net "profit" of the Electricity Department which was accruing yearly to Revenue. When the World Bank Team visited these Islands in January 1962, to carry out the economic and financial survey of the project, their financial analyst held the view that (a) the stock to be issued by way of compensation for the transferred assets should be in the nature of subordinated debentures; (b) the estimated book value of assets which was fixed by Government at £5.2m. was somewhat on the high side - a fairer assessment was of the order of £4.2m.; and (c) even allowing an interest rate of 6% on such assets, the amount accruing annually to Government would not exceed £255,000 on the basis of the revised value of assets.

8. It was made clear to the Bank at the time that the financial position of Government did not permit it to lose to revenue some £45,000 a year. It was, therefore, essential for the Electricity Board to pay to Government, by way of interest on the transferred assets, a total of £300,000 per annum. When we met the Bank Team in Washington it was evident that they were still of the view that the dividend on the transferred assets should not

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more than £255,000 a year and their assessment of the project had taken this figure as a working basis. Representations were therefore made to the effect that the financial position of Government had somewhat deteriorated since their visit to Malta and Government could only balance its Budget for 1962/63 by deferring all new services or the expansion of approved services and by reducing to essentials the recurrent services. Under the circumstances, Government had to raise the estimated interest to be paid by the Board to £365,000, representing the estimated credit balance of the Electricity Department during the Financial Year 1962/63. On a reassessment of the financial position of the proposed Board, the Bank's Team was advised by their financial analyst that unless electricity rates were increased immediately by some ½d per unit, the Board would not be able to meet such a relatively high annual charge. After protracted negotiations as a compromise the Bank's Team agreed, subject to certain conditions referred to later in this Memorandum, to fix the value of the transferred assets at £5.2m. made up as follows and to allow a rate of interest of 6% on such sum:-

Fixed permanent assets	£4.9m.
Other assets	.3m.
Total transferred assets	£5.2m.

9. In the original plan for this project it was also estimated that Government would have to find, out of its own loan moneys or other sources of finance, a sum of £872,500 to meet local currency expenditure required for the project. As such funds were to be found from loan moneys, a charge of 6% interest was to be made on the Board.

10. A more recent assessment of the project revealed that the cost of the local procurement element of the scheme would come to about £525,000. The Bank accepted this revised estimate and agreed to the interest rate of 6% to be paid by the Board.

11. The financial analysis of the project confirmed, however, the Bank's original stand that the Board would not be in funds to meet all these charges before the

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new Power Station would be in operation unless the electricity rates were revised. We submitted to the Bank, however, that Government's policy at the present moment was not in favour of any immediate increase in the electricity rates in view of the fact that the population in general was already faced with the prospect of hardships as a result of the Services discharges and of the impact the reduced Services disbursement was bound to have on personal incomes. Nor, for financial considerations, could we agree to waive our claim for payment of interest during the 3 years initial period of the new Authority. The Bank's Team fully appreciative of the difficulties facing the Administration in this crucial period, as a compromise proposed to raise their loan from £2.3m. to £2.6m. This would enable the Board to meet the dividend and interests, due to Government before the new station comes into operation, out of its capital funds without the need of increasing its tariffs immediately although it might be necessary to increase such tariffs by some 5% equivalent to ½d. per unit in 1965/66. This arrangement was in the interest of both Government and the Board as (a) World Bank Loans are currently bearing interest at 5½% inclusive of service charge; (b) it would relieve Government of the need of obtaining a corresponding Exchequer Loan for which we shall have to bear the cost of a sinking fund as such a loan would not be repayable by the Board; and (c) the increase in electricity rates will be postponed to a later date. Under the circumstances we agreed to advise Government in favour of the Bank's proposal.

12. As both the transferred assets - £5.2m. - and the abovementioned local investment of £525,000 are to be a permanent debenture, the Board will have to pay annually to Government by way of interest £349,000, made up of £317,000 interest on the value (£5.2m.) of the assets and £32,000 on the local procurement element of £525,000.

13. The Bank held the view that in order that the Board may be in a position (i) to meet all its operating expenses and debt service, (ii) to set aside a sufficient reserve for future expansion and (iii) to remain, at the same time, credit worthy for other possible loans in respect of the next phase of the present Power/Water

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Distillation project (i.e. to raise the ultimate capacity of the plant to 100 megawatts and 6,000,000 gallons of distilled water a day), it was essential that the Board should maintain an operating ratio which shall not exceed 67% calculated on a three-year moving average. It was also considered that depreciation of the assets of the Board should be computed on a straight line basis at the rates set forth in the depreciation schedule attached to one of the side letters referred to in paragraph 20 hereof. If the value of the transferred assets and the other Government capital contribution to the Board were to be included in the debt service requirements on the Board's long-term indebtedness, the operating ratio would rise above the 67% rate considered essential by the Bank. To meet this contingency it was proposed that the interest on the debenture stock (£5.2m.) to be created and issued by the Board in favour of Government and that on any other permanent capital contribution to be made by Government shall be payable by the Board in any financial year only after the Board has paid or made adequate provision for payment of all other debt service requirements on long-term indebtedness of the Board for such financial year. By this method the Bank would be able to exclude such interest from the debt service requirements with the result that the required operating ratio would be maintained. After going through other agreements made by the Bank we were satisfied that a subordinated permanent debenture stock was the usual characteristic of such loans and that a 67% operating ratio was an accepted yardstick. As Government had a direct control of the Board's capital spending and tariff adjustments it was felt that the conditions proposed by the Bank could be accepted. As a result of negotiations, the Bank agreed with our view that the arrangements for "subordination" should be limited to the value of the transferred assets and to the value of the works to be carried out by the investment of the £525,000 referred to earlier in this memorandum. Should it be found necessary to pump more money into the undertaking for an expansion of the current project or for other works not contemplated in this scheme, the terms and conditions of such loan or loans would be negotiated at the particular time.

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14. As to the period of the loan we referred to loans made by the Bank to some other countries in which the maturity date was of 25 years and asked the Bank for an increase of the maturity period from 20 to 25 years. The Bank's team, however, could not agree with our proposal as it was the accepted principle of the Bank that the repayment period be related to the life of the plant and equipment to be covered by the loan and we were satisfied that it was usual for the Bank to fix a period of 20 years in respect of loans financing the construction of a thermal Power Station. A 25 year period was usually allowed for hydro electric Power Stations.

15. Provisional agreement was therefore reached on a loan of £2.6m. (7,500,000 dollars) at 5½% for a period of 20 years. The interest rate to be reviewed if by the time agreement is reached the current market rates of interest undergo any change.

16. Such loans are invariably subject to a negative pledge clause by which the Borrower undertakes that, except as the Bank otherwise agrees, if any lien is created on any assets of the Borrower as security for any national debt, such lien will rate pari passu with that created in respect of the Loan from the World Bank. This is a standard condition of the Bank, but as a result of negotiations the Bank's team agreed to waive its rights to the lien created by the overdraft arrangements with the Crown Agents for Overseas Governments and Administrations in London under which the Savings Bank is authorized to overdraw from time to time its account with the Joint Consolidated Fund up to an amount of £2,000,000. The purpose of this arrangement is to allow sufficient liquidity to the Savings Bank without incurring losses by the untimely realization of its investments.

17. The grant of the loan by the World Bank is of course subject to the establishment of a statutory independent authority or Board to run the Electricity undertaking. The provisions of the draft legislation for the setting up of the Malta Electricity Board were, therefore, extensively discussed with the Bank's team. The main preoccupation of the Bank in this regard was

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that in their view the measures of autonomy conferred on the Board in the Electricity Bill needed widening in conformity with generally accepted public utility practices. They held that the Board could not be run as a sound commercial corporation unless its independence was statutorily recognised. The main amendments proposed by the Bank to ensure a greater measure of independence for the Board, were the following:-

(a) Members of the Board to hold office for a period of three years, provided that the first members to be so appointed shall hold office on a rotating basis for periods ranging from one year to three years.

This amendment was accepted by us as its aim is to ensure continuity of the policy of the Board.

(b) The Members of the Board to be dismissable during their period of office only for a just cause stated in the law.

We accepted this amendment only after the Bank had, following considerable negotiations, agreed to our counter proposal for the retention of a residual clause, viz: "When a Member is, in the opinion of the Minister, unfit to continue in office or incapable of performing his duties".

(c) The Board should have freedom of action on staff matters except in the appointment of the General Manager who was to be appointed with the approval of the Prime Minister. The General Manager was also to be an ex officio member of the Board and to have absolute powers for appointments, promotions, dismissals and for all other establishment matters.

By going through the laws for the establishment of such Boards in other countries we were satisfied that it is the practice of the Bank to ensure for the Board independence from Government control in the appointment and employment of staff. We could not, therefore, very well object to the first of the two issues. The proposal to grant quasi "dictatorial" powers to a General Manager on appointments and other staff matters was, however, in our view unacceptable.

18. The Bank took a very stiff stand on this and only after representations were made at the highest level was a formula acceptable to both parties found by the insertion of the following new

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paragraph, paragraph 3 bis, after paragraph 3 in the First Schedule of the Draft Bill:-

> 3 bis - Proposals for appointment and employment of persons to the service of the Board shall not be considered by the Board unless submitted to the Board by the General Manager.

19. Another amendment of substance agreed to in the course of the negotiations was proposed by us and this concerned the insertion of provisions in the Bill for the preparation and adoption by the Board of annual estimates of income and expenditure, of supplementary estimates, for the supply of a copy of such estimates to the Minister responsible for the Board and for the publication of such estimates in the Government Gazette. Similar provisions were found in corresponding legislation of other countries.

20. Except, therefore, in so far as the appointment of staff other than the General Manager is concerned, all other Ministerial control provided for in the Draft Bill was accepted by the Bank. The Draft Legislation as amended as a result of these negotiations is attached as Appendix A.

21. It is also the practice of the Bank to cover such loans by:-

(a) A "Loan Agreement" between the Government and the Bank covering the statutory loan regulations of the Bank and any other "special" conditions mutually agreed upon by the two parties;

(b) A "Guarantee Agreement" between the Guarantor (in our case the British Government) and the Bank, specifying the conditions under which the Guarantor accepts to guarantee the loan; and

(c) A "Subsidiary Loan Agreement" between the Government and the Board in which the Board binds itself to comply with all the terms and conditions of the loan.

The loan and subsidiary loan agreements cover the points already mentioned above and generally follow the pattern of similar agreements entered into with

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other countries and Boards receiving loan funds from the Bank. The abovementioned draft agreements are enclosed as appendix B to this Memorandum.

22. To avoid possible future misunderstandings it is also the custom of the Bank to exchange a number of "side letters" with the borrower specifying in more detail the special conditions of the loan. The "side letters annexed at Appendix C to this Memorandum have been agreed to subject of course to Government approval. These also cover the points already referred to above.

23. The Management of the Bank laid stress on the desirability of finalizing this Loan as early as possible, as any delay in this regard would jeopardize the approval of the loan by the Bank's Directors, considering that such approval is subject to the appraisal carried out by the Bank's staff at the time of investigating the application and the Directors would not be in a position to consider any application for a loan where the financial and economic analysis is already outdated. A plan of operation of the steps to be taken by each of the two parties and the approximate timing of each action, has therefore, been prepared by the Bank and is annexed hereto at appendix D. If this plan is adhered to it will be possible to have the loan and other agreements signed by the end of January. This will enable the Board to function as from the 1st April next, i.e. the commencement of the next financial year when the Board will be in a position to receive the first instalments of the Loan.

24. It is now for consideration of Government whether the provisional agreement reached with the Bank should be approved.

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