



# BILLET D'ÉTAT

TUESDAY, 6th MARCH 2012

## Volume 2

11. Public Services Department – Future Business Environment for Guernsey Airport, p. 1199
12. Treasury and Resources Department – Resource Accounting and Budgeting, p. 1309
13. Commerce and Employment Department – Construction of a Replacement Slaughterhouse, p. 1324
14. Public Services Department – Future Business Environment for Guernsey Harbours, p. 1340
15. Commerce and Employment Department – Foundations, p. 1430

V  
2012

**PUBLIC SERVICES DEPARTMENT****FUTURE BUSINESS ENVIRONMENT FOR GUERNSEY AIRPORT**

The Chief Minister  
Policy Council  
Sir Charles Frossard House  
La Charroterie  
St Peter Port

21<sup>st</sup> December 2011

Dear Sir

**1.0 Executive Summary**

- 1.1 Government has a key role in ensuring that public services are delivered. However, it has been suggested in the past by the Advisory and Finance Committee, and more recently by the Office of Utility Regulation and in the context of the Fundamental Spending Review, that government does not necessarily have to be the provider, and indeed may not be the most capable body to run all of the activities which may be necessary to deliver those public services.
- 1.2 Guernsey Airport currently operates as a Business Unit of the Public Services Department. The current structure and the mechanisms by which Airport operations are delivered are complex, with multiple strands of control being exercised by different sections of the States, whilst over-arching objectives that should apply to the operation of the Airport, are not clear. As a result, the business struggles to act in a commercial manner and cannot realise the full potential that should be available in its operations. This report assesses what can be done to change this situation, to improve the efficiency and effectiveness of the business and benefit the community as a whole.
- 1.3 Based on the information available to date, the Department considers that simplifying arrangements by transforming Guernsey Airport into a States-owned Trading Company, which is wholly owned by, but operates at arm's-length from, the States, is the best way forward. With this report, the Department seeks permission from the States to conduct further detailed investigation into this option, with a view to reporting back to the States at a later date.

## 2.0 Introduction and Background

2.1 Prior to the Machinery of Government changes in May 2004, the then Advisory and Finance Committee identified a number of States trading entities (including the Airport) which “*might in future be areas that the States determine should be delivered differently*”. The Fundamental Spending Review, commenced in 2009, identified possible benefits for changing the current structures of Public Services Department Business Units (Summary Opportunity Report PSD\_009):

***“Benefit***

- *Increased efficiency of operations that release funds to deliver greater value or reduce the liability of PSD.*
- *Increased income generating capacity of the activities of the business units.”*

2.2 The Department’s Business Units operate in a commercial environment serving customers who are paying for a service. These customers expect standards of quality, timeliness, response etc which are often difficult to deliver in the context of a political structure. By its very nature, government embraces a wide range of procedures, protocols, corporate governance, consultation processes, scrutiny etc to a degree which is rarely experienced by modest-sized business. The resulting risk is that the business becomes focused on satisfying all of the processes and protocols and not on delivering the key objectives for which it was established in the first place.

2.3 In Billet I of 2011, the Public Services Department reported that it had, with the assistance of the Office of Utility Regulation (OUR), been reviewing the options for changes to the ownership and corporate oversight of the various businesses currently within its mandate. This review had concluded that benefits could accrue from changes to the businesses. The States noted the Department’s ongoing evaluation of the options for several of its Business Units and its intention to report to the States of Deliberation with its recommendations in due course.

2.4 The Department reported back to the States with its recommendations for Guernsey Water and Guernsey Wastewater in January 2012. This report examines the case for changing the business environment of Guernsey Airport.

2.5 It should be noted that, given that some aspects of changing the business environment are the same, parts of this report largely replicate sections that have previously been seen in the ‘Future Business Environment for Guernsey Water and Guernsey Wastewater’ report (Billet III of 2012).

- 2.6 Throughout this report, a number of abbreviations are used. Although these are defined in the text at appropriate points, a glossary is also included for ease of reference (Appendix 1).

### 3.0 Guernsey Airport – Business Environment Review

#### What falls under ‘Guernsey Airport’?

- 3.1 Guernsey Airport functions include provision of terminal facilities, Air Traffic Control, Airport fire service, meteorological services, Airfield services, facilities maintenance, and Airport administration. In providing these services it has 117 full time equivalent employees, whose terms and conditions are set by the Public Sector Remuneration Committee (PSRC). Customs and Police services are provided by the Home Department.
- 3.2 The assets held and operated by the business include the runway, aprons, taxiway, cargo sheds, hangar, terminal building, radar navigational aids, vehicles, ground-keeping equipment, air traffic control systems, baggage conveyor belts, rescue equipment and training simulators.

#### Overarching Aim

- 3.3 As with all of the reviews undertaken of Department Business Units, the main focus in examining the Airport has been **value for the community**.
- 3.4 At the foundation of any desire to deliver better value, is the need for the service to function in a more effective and efficient manner. A factor that can, in turn, have significant bearing on a business’s ability to function effectively and efficiently is the underlying funding mechanism in place – whether it enables expenditure to take place when it is advisable from the perspective of business operations (to accrue operational efficiencies and long-term savings) or, rather, only as and when finances are made available via competitive prioritisation systems.

#### The Review

- 3.5 The 2009 OUR report, which was presented to the States in Billet I of 2011, considered the potential to convert the Airport to a company wholly owned by the States of Guernsey. The report concluded that, without access to additional shareholder funds, converting the Airport as a whole to a States Trading Company (STC), would raise fundamental problems. A different option was suggested as being the potential separation of the Airport into two component parts, namely commercial and non-commercial units. This approach would regard the runway, aprons and other airside capital assets as non-commercial investments. These elements represent essential infrastructure that is critical not only to the Airport itself, but also to the wider economy.

3.6 The Department commissioned a further study from York Aviation to explore options in greater detail. York was asked to examine the scope for:

- Increasing commercial focus at management level whilst ensuring that the States retained strategic control and oversight;
- Transferring operational risks and financial losses to a private sector partner;
- Taking advantage of private sector skills that might not otherwise be available;
- Reducing the risk of conflict between the States as a regulator, air licensing authority, airport owner and owner of an airline.

3.7 York examined a range of business models during the course of their investigations:

- Status quo
  - Incorporate (States funding)
  - Incorporate (independent funding)
  - Incorporate (private management contract)
  - Incorporate, then franchise or lease to the private sector
- } Based on the States Trading  
Company model*  
*} Incorporation followed by  
varying degrees of third  
party (private sector)  
management contracting*

3.8 The subsequent report is attached as Appendix 2. It should be noted that specific issues associated with the operation of Alderney Airport are not addressed in the report, except to note an element of costs incurred at Guernsey Airport to provide management support, and the fact that these are subject to reimbursement.

#### **4.0 Key Points from the York Review**

4.1 During their investigations, York recorded a number of aspirations for the Airport, as expressed by stakeholders, some of which were conflicting.

4.2 Stakeholders also identified a number of issues, or perceived shortcomings, with the existing structure of operations when analysed from a commercial perspective, which through some form of change might be improved upon. These issues included:

- i) Severe constraints on management autonomy, affecting the ability to manage the Airport with any commercial rigour or the ability to react to customer needs swiftly or effectively;
- ii) That around 65% of operating costs are not within management control (i.e. staff costs and working conditions);

- iii) The inefficiency and ineffectiveness of a one-size fits all approach to staff management across all States departments;
- iv) A challenging approach to managing investment in the Airport effectively, with the involvement of multiple stakeholders (sometimes with internally conflicting roles) and layers of approval stages which may inhibit rapid, financially-efficient action. This is exacerbated by the current style and processes of government in Guernsey, which can result in delays or changes to projects which could adversely impact on the Airport's operation or the realisation of its commercial potential;
- v) The constant need to rank capital investment against other States investment priorities, which may mean that efficient, smooth flows of investment (any amount above £25,000) are difficult to achieve and that investment in major maintenance or business development may happen when States funding is deemed to be available rather than when it may be efficient to inject those funds for the business;
- vi) A lack of commercial experience in the management structure;
- vii) A lack of normal management information, especially opaque input costs (particularly where these inputs are supplied but not charged by the States) or a dynamic financial model projecting performance and investment needs under different scenarios;
- viii) A lack of ability to manage quality or speed of technical input from other States departments (i.e. no Service Level Agreements (SLAs) or benchmarked inputs) even if these services are provided free to the Airport;
- ix) A lack of any States stakeholder acting as an 'intelligent shareholder', holding management to account, or benchmarking performance against predetermined objectives.

4.3 York found support for the principle of changing the existing business environment for the Airport. However, based on their investigations, York also firmly believes that there needs to be clarity in both:

- Objectives, which should apply to the Airport, regardless of its mode of governance, and
- Aspirations for changes that could result from a different business environment.

4.4 York concluded that there was no realistic prospect of another airport facility being provided, so the States needed to retain a strategic level of control over the Airport to ensure that it continues to facilitate air service access to the level required to meet wider social and economic objectives.

- 4.5 The options (as listed in 3.7 above) were analysed and evaluated against objectives that York synthesised for the purpose.

## 5.0 York Recommendations

- 5.1 The Department recognises the adverse impacts of the existing structure and governance of the Airport. The Department had, however, wondered whether the Airport could be run more effectively than it is at the moment, with only limited change (remaining within full States control). This was addressed in York's 'Status Quo' model. This suggested that there may be some scope to improve the commercial performance of the Airport through:

- Giving management a clearer mandate to operate on a commercial basis;
- Providing management with additional commercial skills;
- Potentially restructuring the management team.

- 5.2 However, York identified several obvious (and significant) drawbacks, which would mean that the full scope of benefits that could be realised through other options, would not be able to be achieved (see 5.5 – 5.13 in the appended York report).

- 5.3 The recommendations from the York report are listed below. In each case, the first paragraph in *italics* is commentary drawn from the recommendation section in general, whilst the **bold** wording is the recommendation made.

- 5.3.1 *'Our analysis suggests that there would be clear benefits from incorporating the Airport using the provisions of the States Trading Companies Law and Ordinance. This would allow more efficient deployment of staff and easier exploitation of commercial potential of the Airport. This appears to us as an essential first step. The extent to which there would be advantages in moving beyond this first step depends on the precise balance and weighting of objectives. At this stage, there is insufficient consensus to allow the most appropriate model to be precisely confirmed. ....In particular, there needs to be clarity of objectives for the States Trading Company and a clear understanding of the roles of each of the stakeholders.'*

York Recommendation 1: **The Airport be incorporated as a States Trading Company as a first step.**

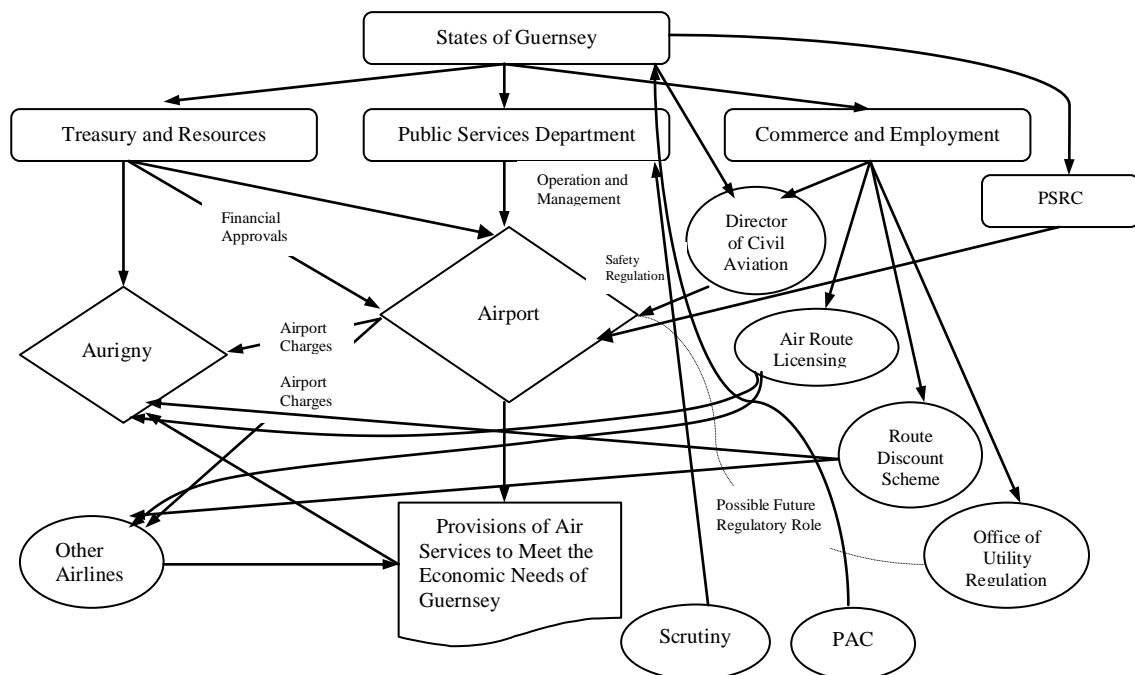
- 5.3.2 *'Our discussions with stakeholders have revealed widespread support for the principle of commercialising the Airport, but far less clarity as to exactly what commercialisation is intended to achieve. Given the vital importance of the Airport, and the air service connections which it facilitates, to the economic and social well-being of Guernsey, stakeholders were able to articulate their aspirations for the Airport but these were not without contradictions, such as between the aspiration to*

*achieve an improved range of air services and that to see users pay directly the costs of airport services, without subsidy from the States.'*

**York Recommendation 2: This will require greater clarity of objectives than is evident amongst stakeholders today, including resolving potential conflicts in objectives as outlined in this report.**

5.3.3 *'The current governance arrangements are complex, with multiple levels of approval needed through various States departments, particularly for capital expenditure. Other departments, such as C&E, hold both regulatory responsibility and, effectively, control route development through the Air Route Licensing system and the Air Route Discount scheme. Coupled with lack of control over staff terms and conditions, airport management has no autonomy to manage the Airport to deliver the most efficient and effective service for Guernsey.'* An illustrative diagram, based on the one produced by York in their report, can be seen below as Figure 1. Within the Department, this has been termed the 'Spaghetti Diagram' in recognition of the convoluted relationships captured within it.

**Figure 1: Airport Inter-relationships**



**York Recommendation 3: It will be important to ensure policy consistency between the various departments and their actions in order to secure delivery of the optimum air service for Guernsey, for which the Airport is an essential component.**

5.3.4 *'We believe that an important issue will be ensuring that appropriate commercial airport management expertise is available to drive the Airport forwards, particularly to maximise its commercial potential and*



*to improve the air service offer to Guernsey. This may be difficult to achieve for an Airport the scale of Guernsey and within the limitations of available expertise on Guernsey. For this reason, we believe that there is likely to be merit in bringing in a private sector partner, either to operate the Airport on a management contract, or through a franchise or lease arrangement. This would allow access to external expertise and help to drive efficiency and fuller exploitation of the commercial potential. The decision between the management contract or franchise route is largely dependent on the extent to which the Airport can attain long run financial autonomy. This does not need to be determined at this stage as incorporation is an essential first step. It will be essential that clear targets and performance measures are set for a private sector partner. This will require a clarity that is not possible under the current governance arrangements.'*

**York Recommendation 4: In parallel with the incorporation process, consideration should be given to the extent which it is desirable to bring in a private sector partner. This will depend on:**

- **The extent to which necessary airport commercial management expertise can be recruited locally or on licence from the UK;**
- **The extent to which the Airport can become financially self-supporting;**
- **The funding for major capital developments;**
- **The precise ranking of objectives.**

**5.3.5 York Recommendation 5: 'On the basis of our initial assessment, bringing in a private sector partner on a management contract basis appears to be most likely to deliver the best outcome in the circumstances where the States will remain as the funder of major capital developments and having regard to the need to balance risk against achievement of optimum efficiency. This needs to be tested through further discussion amongst key stakeholders to confirm the objectives and their weightings on a consensus basis.'**

**5.4** On the information gathered to date, the Department firmly considers that the current arrangements for the Airport are far from ideal, and should not continue. At this stage, it agrees with York's recommendation that the way forward is to form the Airport into a States-owned Trading Company. Whether or not further changes to the structure and governance of the company would then be beneficial (or desirable) would depend on a number of factors, and examination would take place in the light of experience.

**5.5** The Department recognises, however, that creating an STC would be a significant step and believes that the States should be in possession of fuller details before such a strategy could be put forward as a firm recommendation. The Department would propose to undertake further investigation to gather this additional information, with a view to return to the States in due course.

## 6.0 Implications

- 6.1 Were the States to (ultimately) form an Airport STC, there would be a number of issues to be examined and addressed. The following would be explored as part of the proposed additional investigations:

### Shareholder

- 6.2 Under current legislation, the automatic default shareholder for any STC is, in effect, the Treasury and Resources Department.
- 6.3 However, in their report, York stated *'We believe that there may be merit in the shareholder in the Airport Company not being T&R, at least not in its entirety, because of the conflict of interests inherent in common ownership of Aurigny, whether this is perceived or real. PSD as the shareholder or part shareholder would at least offer some continuity of existing operational expertise'*.<sup>1</sup>
- 6.4 The Department agrees with this suggestion and considers that, in further investigations into establishing an STC, consultation should be advanced with the Treasury and Resources Department into the possibilities. The Department understands that matters of corporate governance (which include matters relating to share capital and company membership) may be dealt with by means of an amending Ordinance under the States Trading Companies (Bailiwick of Guernsey) Law, 2001.

### Regulation

- 6.5 In their report, York concluded that *'Provided that clear direction, including objectives and measureable targets, is given to the Airport STC, we believe that separate economic regulation is unlikely to be needed, although the position might change under a full franchise or lease option with the Airport run by the private sector. Economic regulation is less well suited to state run monopolies, where broader consumer interests can be enshrined through the States' shareholder role. This would avoid tensions which have been evident with the commercialisations of post and electricity. However, it will be important that the balance of objectives is resolved at the shareholder level and clearly articulated in targets for the company'*.<sup>2</sup>
- 6.6 The Department agrees with this perspective. It suggests that, given States-wide agreement on the objectives for the operation of the Airport, an Airport STC could be effectively run through a 'Business Plan', which had been submitted to and agreed by the States, and which would be followed by Airport management, with the shareholder monitoring compliance.

### Financial Issues

---

<sup>1</sup> 6.10 of the York Report

<sup>2</sup> 6.9 of the York Report

### **Ports Holding Account**

- 6.7 Currently, the Airport has an unwritten target of achieving a 5% operating margin, although it has struggled to do so in recent years. In the past, any surpluses were paid into the Ports Holding Account (PHA), enabling the Airport and Harbours to largely fund their own capital expenditure.
- 6.8 However, the matter of the Ports Holding Account was considered during the 2009 debate on Capital Prioritisation (Billet IX). At that time, the States resolved ‘That the Ports Holding Account shall not be collapsed in advance of the consideration by the States of a report from the Public Services Department in December 2009 on the options for moving the trading entities of Guernsey Harbours and Guernsey Airport into a different business environment, BUT THAT, in any event, the operating surplus before depreciation shall be transferred to the Capital Reserve from the Ports Holding Account from 2010 until such time as the Ports Holding Account may be discontinued’.
- 6.9 Therefore, from 2010 (and to continue until the States considers a report with proposals on business environment and different financial arrangements are put in place), the Ports’ surpluses have been transferred into the States Capital Reserve. In this interim period, the residual balance in the Account has been available for routine capital expenditure for the Airport and Harbours but, when depleted, they will have to bid for capital in competition with other States bodies, with the risk that the ability to undertake both routine maintenance and advance appropriate developments at these vital locations, may suffer.
- 6.10 In its update report, ‘States Trading Entities – A New Business Environment’, presented in January 2011 (Billet I), the Department explained why it had not reported in December 2009. It also acknowledged that, at the time of presenting its 2011 update, neither it nor the States were in a position to determine the long-term shape of Port finances. It further highlighted that this would have to remain a live issue to be addressed when specific proposals in respect of the future structure of the trading entities were presented for debate.
- 6.11 As indicated earlier in this report, the Department feels that, even now, additional research needs to be conducted before it can present firm proposals for the Airport (and report on the resultant financial implications). However, it is anticipated that the balance of the Ports Holding Account will be exhausted during 2013 and, therefore, under the current arrangements, no funding would be available for routine capital expenditure. This matter is under discussion with the Treasury and Resources Department and it is intended, as part of the 2013 Budget Report, to report back with an interim proposal for funding the Ports routine capital expenditure. This is likely to result in a reduction in the transfer from the Ports to the Capital Reserve (budgeted to be £2.8 million in 2012). In conjunction with the Treasury and

Resources Department, the current accounting and reporting arrangements for the Ports, including the mechanism of the Ports Holding Account, are being reviewed.

- 6.12 The York Report states that *'Our financial analysis suggests that there may be a realistic prospect of the Airport generating sufficient revenue to become operationally self-sufficient, including funding of routine maintenance and refurbishment capex. However, it is unlikely to generate sufficient operating profits to repay the cost of runway rehabilitation works or for future major capital requirements, such as further major works, runway or terminal extension works. Hence there will still be a need for the States to fund or finance major capital development works. The 'save to spend' policy is unlikely to be sufficient to meet such longer requirements and may not be compatible with international conventions on airport charges, which recommend strongly against pre-funding of airport development'*.<sup>3</sup>
- 6.13 *'Incorporation alone will not solve this dilemma and would still leave Airport capital expenditure requirements to compete with other States investments for priority. It appears to us that independent finance-raising is unlikely to be relevant to a publicly-owned Airport company, but that there may be ways of achieving speedier access to States funds under the STC model. This could be explored further as part of the process of incorporation.'*<sup>4</sup>
- 6.14 Longer term, the whole question of funding for Airport capital expenditure may need to be re-examined.

## **7.0 Practical Considerations**

- 7.1 Currently the States, through the Public Services Department, has ultimate responsibility for the provision of services under the departmental mandate and various pieces of legislation. The property and physical resources required to provide the services (the assets), and any contracts/leases and other debts and obligations etc, are ultimately owned by or are binding on the States. The staff required to provide the services are employed by the States under centrally negotiated terms and conditions.
- 7.2 Any change of business environment from the status quo would inevitably present a range of issues for consideration. [Sections 7.3-7.15 largely replicate material previously seen in the 'Future Business Environment for Guernsey Water and Guernsey Wastewater' report (Billet III of 2012).]
- 7.3 Prior to 2001, STCs were unknown in Guernsey. However, a trail was then established by the postal, electricity and telecommunications utilities. The path and steps along it are now well known and understood.

---

<sup>3</sup> 6.6 of the York Report

<sup>4</sup> 6.7 of the York Report

7.4 Should the States ultimately decide to move to a situation where Guernsey Airport was to be transformed into an ‘arm’s-length’ company, this would involve taking a number of steps. Legislation that was developed for the 2001 process for postal, electricity and (initially) telecoms services could be extended for use. Steps included would be as follows:

- Create a new independent body owned by the States (i.e. a States Trading Company (STC)), with a Memorandum and Articles of Association which, via an appropriate mechanism<sup>5</sup>, would be required to follow the strategic direction of the States and whose activities could be adequately scrutinised;
- Transfer to the new body:
  - Responsibility for provision of services;
  - The employment of staff required for the provision of services, without detriment to their terms and conditions, including pension entitlements<sup>6</sup>;
  - The assets required for the provision of services, which would include contracts with other bodies and other rights, debts and obligations.

#### **Human Resource Issues: Protecting the Interests of Employees and Pension Issues**

7.5 The rights and entitlements of a States employee include terms and conditions of employment (and the right to negotiate a change to these); annual leave entitlement; the right to be a member of a union; and redundancy provisions.

7.6 Where the States Trading Company (Bailiwick of Guernsey) Ordinance, 2001 is utilised to create a new States Trading Company, this transfers to an STC any contracts entered into by, and all other assets and liabilities of, the States undertaking being transferred. Special arrangements, however, are required in respect of contracts of employment. The Transfer of States Undertakings (Protection of Employment) (Guernsey) Law, 2001 (TUPE) enables the States to enact Ordinances to transfer a contract of employment with the States to another entity in a way that preserves the above rights and entitlements except in regard to pensions.

7.7 TUPE only applies at the point where the employee moves across to the new employer - it does not apply long-term. TUPE does not give any more protection to an employee than they would enjoy if they had continued to be an employee of the States. The States may itself have sought to renegotiate terms and conditions or to make an employee redundant. TUPE would not prevent the new employer from taking such action but it would ensure that the

---

<sup>5</sup> This could, for example, be set out in the company’s Memorandum & Articles of Association; in a contract/Memorandum of Understanding (MOU) between the States and the company; in legislation; or in licence conditions.

<sup>6</sup> This may require amendment by the States of the 1972 Pension Rules.

employee enjoyed the same rights and entitlements as if they were in States employ. After the change in employer, the STC would assume responsibility for fulfilling, and negotiating any changes to, terms and conditions.

- 7.8 In regard to pensions, the transferring business must provide benefits broadly comparable to those enjoyed by the employee under the Public Servants' Pension Scheme (PSPS). Only employees of specified States or quasi States bodies can be members of the PSPS. In 2001 the PSPS rules changed to:
- Enable employees of those STCs defined in the Rules (namely Guernsey Electricity Limited and Guernsey Post Limited) to remain in/join the scheme;
  - Allow the States body charged with managing the application of the PSPS rules to individual cases to continue to undertake this role for STC employees;
  - Ensure that STCs were obliged to pay in the level of contributions necessary to fund the entitlements of their employees (the contributions then being ring-fenced).
- 7.9 Prior to the transfer of staff to an STC, a decision would have to be taken (in consultation with the workforce) as to whether there would be a transfer of existing employees to a new and comparable pension scheme, or whether arrangements would be put in place whereby existing and new employees would remain in or join the PSPS (which would require the States to approve an amendment to the PSPS rules).
- 7.10 There are, therefore, mechanisms to ensure that States staff transferring to an STC would not be disadvantaged in terms of their rights and entitlement (and pensions).
- 7.11 Initial discussions have previously taken place at officer level with senior representatives of the Public Sector Remuneration Committee (PSRC). Staff at Guernsey Airport are aware of the continued exploration into the potential to change business environment, whilst informal discussions have in the past been held with both the Association of Guernsey Civil Servants (AGCS) and Unite. At this very early stage, until firm recommendations are placed before the States for consideration and the States confirms the direction of its will, taking larger steps in these areas would have been inappropriate.
- 7.12 Initial discussions have also taken place with the Head of Human Resources and Organisational Development over the potential future need for provision of necessary human resources business partner expertise, should the States, in due course, be asked (and agree) to progress further along the STC route.
- 7.13 Should the States ultimately resolve to pursue a changed business environment for Guernsey Airport, the Department would intend to enter into detailed discussions with the workforce, the Policy Council and relevant employee unions at an early opportunity following such decision. When

discussions were either complete, or at least nearly complete, the Department would report back to the States with firm recommendations as to pension provision.

- 7.14 The Department is aware of the concerns in certain quarters about the potential for senior managers to receive significant pay increases should an STC eventually be formed. It recognises that any company needs to have the freedom to hire, fire and remunerate staff in a way that best guarantees productivity. Equally, however, for so long as the States remains the sole shareholder there is a need to introduce safeguards to prevent salaries being excessive. The Department understands that this could be managed through a clear Memorandum of Understanding between the shareholder and the STC. This option will be explored in more detail in advance of the next report to the States on the proposed changes.

### **Business Management**

- 7.15 Any change to a business environment would require that business to have a robust and appropriate management structure. If this was not in place, the viability of the business would be compromised and, at the least, the full extent of potential benefits would not be realised.
- 7.16 Moving to an ‘arm’s-length’ position would be a significant change from the current status. It is suggested that, should such a situation eventually come to pass, the responsible STC Board would be in the best position to review the appropriateness of the management/structure and tailor the business as required to ensure it was able to effectively meet its obligations and demands.

## **8.0 Future Steps**

- 8.1 As stated earlier, the Department would intend to advance further investigation into establishing an Airport STC, before forming its conclusions and placing a firm recommendation on business environment to the States for consideration.
- 8.2 The Department believes that overall ‘Objectives’, which are applicable to the operation of Guernsey Airport and regardless of commercial structure, should be established. As indicated earlier in this report, different stakeholders have different, and sometimes conflicting, aspirations for the Airport, which can only serve to reduce the overall effectiveness as different groups wish to move in different directions. Objectives must be clear and must be agreed by the States as a whole, so that future decisions can be made in a focused and non-contradictory manner. These Objectives should be linked to clear performance monitoring criteria.
- 8.3 Linked to the above, the current complex governance and policy arrangements should also be addressed – the Airport must, wherever appropriate and

practicable, be unchained from the ‘spaghetti’ of multiple department controls, rules, regulations and procedures etc. Consolidating the surrounding structure into one that can support the clear Objectives will give the best chance of success for the Airport and Island as a whole.

- 8.4 As indicated earlier, the future of the Ports Holding Account and potential future funding mechanisms for an STC must be established. As highlighted by York, the capital investment needs of the Airport are unlikely to be able to be fulfilled.

## **9.0 Legislative Implications**

- 9.1 St James’ Chambers have been consulted in regard to the legislative implications associated with the recommendations presented in this report.
- 9.2 Should the outcome of the proposed additional investigation yield a firm recommendation to establish an ‘arm’s-length’ trading company, it would be necessary to designate the company as an STC and address the issues of governance and transfer of relevant assets by means of an Ordinance under the States Trading Companies (Bailiwick of Guernsey) Law 2001. Whilst further investigation will be necessary, it is possible that an amendment to the existing States Trading Companies (Bailiwick of Guernsey) Ordinance, 2001 may be all that would be required in relation to this issue.
- 9.3 It would also be necessary to address the issue of transfer of any relevant contracts of employment by way of an Ordinance made under TUPE (see paragraph 7.6 above).
- 9.4 At this point, in advance of the necessary review to establish Objectives for the Airport, and to simplify the existing interaction structure highlighted in the ‘Spaghetti Diagram’ (Figure 1), it is not possible to predict what degree of legislative change might be required to realise any recommendations that might come out of that review. This aspect would be reported on at the time of bringing the matter back to the States.
- 9.5 Airport operations are governed by a number of pieces of legislation. Were the Airport to become an STC, as part of the transition, responsibility for the provision of appropriate services would need to be transferred to the new company.
- 9.6 It may transpire that, whilst it might be appropriate to transfer certain rights, responsibilities and powers to an Airport STC, it might be appropriate for others to remain vested in the States of Guernsey or some other body.
- 9.7 It would also be necessary to consider whether any additional legislative provision would be required. For example, in 2001, new utility "Sector Laws" to govern the provision of services (and associated matters, such as recovery



of expenditure, technical, safety, environmental and access matters etc) were produced for telecoms, post and electricity services, and came into force at the time that the relevant STCs were established. Whilst at first glance it appears unlikely, a similar Sector Law may be required in relation to the provision of airport services.

- 9.8 At this early stage, many legislative aspects have not been investigated in detail and currently remain undetermined. The proposed detailed investigation into establishing an Airport STC would examine the degree of legislative change that would be required.

## **10.0 Compliance with the Principles of Good Governance**

- 10.1 From a strategic / government perspective, the establishment of a Guernsey Airport STC with set Airport Objectives could be considered to comply with the following Principle of Good Governance:

“Focusing on the organisation’s purpose and on outcomes for citizens and service users”.

- 10.2 Further, converting Guernsey Airport to an STC could support the below States of Guernsey Objectives:

- Wise long-term management of Island resources
- Co-ordinated and cost-effective delivery of public services
- Maintenance and enhancement of Guernsey’s standing in the global community.

## **11.0 Consultation**

York Aviation consulted widely during the review period. A list of their consultees can be found as an appendix to their main report.

## **12.0 Recommendations**

The States are recommended:

- i) To note the report prepared by York Aviation (Appendix 2 to this report);
- ii) To agree that the Public Services Department should undertake appropriate consultation prior to returning to the States with a report proposing clear Objectives for the Airport, and at the same time proposing any appropriate and practical improvements that might be made to the current Airport governance and policy arrangements;

- iii) To note the Public Services Department's current view that establishment of a States Trading Company might present the most effective way forward for Guernsey Airport;
- iv) To agree that the Public Services Department should conduct further detailed investigation into, and consultation concerning, the option to establish a Guernsey Airport States Trading Company, before reporting back to the States, such investigation and consultation to include (but not be limited to):
  - a) Financial issues (costs, savings etc)
  - b) Consultation with employees likely to be affected by any proposals to create a States Trading Company
  - c) Consultation with service users
  - d) Potential for the shareholder role
  - e) Potential regulation mechanism
  - f) Legislative implications;
- v) To note that the funds that will be required to progress additional investigation and consultation, (provisionally estimated not to exceed £50,000) will be funded by Guernsey Airport;
- vi) To note that the Public Services Department, working in conjunction with the Treasury and Resources Department, will be reviewing the current accounting and reporting arrangements for the Ports, including the mechanism of the Ports Holding Account; and
- vii) To note the intention of the Treasury and Resources Department to report, as part of the 2013 Budget Report, with an interim proposal for funding the Ports routine capital expenditure.

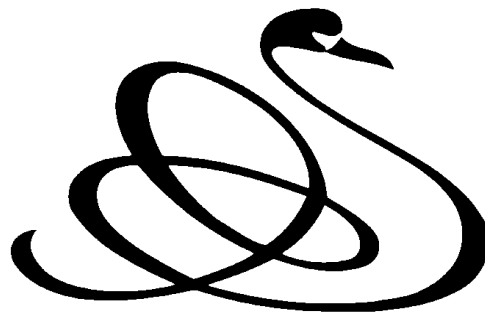
Yours faithfully

B M Flouquet  
Minister

Deputy S Ogier (Deputy Minister)  
Deputy T M Le Pelley  
Deputy A Spruce  
Deputy J Kuttelwascher

**Appendix 1 – Glossary**

|      |  |
|------|--|
| AGCS | Association of Guernsey Civil Servants   |
| C&E  | Commerce and Employment Department   |
| OUR  | Office of Utility Regulation   |
| PAC  | Public Accounts Committee  |
| PHA  | Ports Holding Account  |
| PSPS | Public Servants' Pension Scheme  |
| PSRC | Public Sector Remuneration Committee   |
| SLA  | Service Level Agreement  |
| STC  | States Trading Company   |
| T&R  | Treasury and Resources Department  |
| TUPE | The Transfer of States Undertakings (Protection of Employment) (Guernsey) Law, 2001. |



**York Aviation**

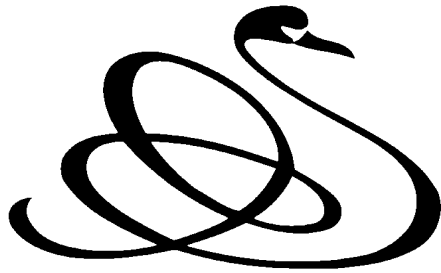


**STATES OF GUERNSEY  
COMMERCIALISATION OF GUERNSEY  
AIRPORT OPERATIONS**

**Final Report**

**September 2011**





**York Aviation**

**Originated by: Louise Congdon  
Richard Tollis**

**Dated: 31<sup>st</sup> August 2011**

**Reviewed by: Richard Kaberry**

**Dated: 7<sup>th</sup> September 2011**

# STATES OF GUERNSEY

## COMMERCIALISATION OF GUERNSEY AIRPORT OPERATIONS

### Contents

|   | <u>Page</u> |
|---|-------------|
| EXECUTIVE SUMMARY.....                            | i           |
| 1    CONTEXT AND CURRENT POSITION.....            | 1           |
| 2    OBJECTIVES AND CONSTRAINTS.....              | 9           |
| 3    CURRENT POSITION OF GUERNSEY AIRPORT .....   | 18          |
| 4    FINANCIAL EFFECTS OF COMMERCIALISATION ..... | 40          |
| 5    OPTIONS FOR ANALYSIS .....                   | 47          |
| 6    RECOMMENDATIONS AND NEXT STEPS.....          | 69          |
| <br>APPENDICES                                    |             |

## EXECUTIVE SUMMARY

### Context

1. York Aviation LLP (YAL) was appointed by the Public Services Department (PSD) of the States of Guernsey to examine the options for the commercialisation of Guernsey Airport operations.
2. The terms of reference for this study were to assess the extent to which the current operational and governance structure of the Airport optimises business efficiency and/or value for money and to examine the scope for:
  - increasing commercial focus at management level whilst ensuring States retain strategic control and oversight;
  - transferring operational risks and financial losses to a private sector partner;
  - taking advantage of private sector skills that might not otherwise be available;
  - reducing the risk of conflict between States as a regulator, air licensing authority, airport owner, and owner of an airline.
3. We assessed potential business models including but not limited to:
  - Status quo;
  - Commercial company, owned by the States;
  - Franchise operation for a fixed term.

We were advised that outright privatisation was unlikely to be favoured in the light of the critical role which the Airport plays in sustaining the economic and social well-being of Guernsey.
4. In preparing this report, we drew on the experience of previous commercialisations of States' trading activities on Guernsey.

## Objectives and Constraints

5. In order to inform our consideration of the options, we spoke to a wide range of stakeholders as listed in Appendix A. We sought to understand more fully the objectives which commercialisation was intended to achieve and any constraints on the options under consideration.
6. Our discussions with stakeholders revealed widespread support for the principle of commercialising the Airport but far less clarity as to exactly what commercialisation is intended to achieve. Given the vital importance of the Airport, and the air service connections which it facilitates, to the economic and social well-being of Guernsey, stakeholders were able to articulate their aspirations for the Airport, but these were not without contradictions, such as between the aspiration to achieve an improved range of air services and to see users pay more directly the costs of airport services but without subsidy from the States. Both may not be simultaneously attainable.
7. Stakeholders identified a mixture of strategic and operational objectives, which we have attempted here to synthesise into a more structured set of objectives in order to provide a framework to evaluate the potential governance options. We have grouped the objectives into three strategic outcomes supported by the tactical or operational measures:

### Security of Supply

- operational safety;
- ability to serve reasonable / appropriate levels of demand;
- robust operations / limited risk of interruption;
- ability to source funding when required / in support of effective development.

### Quality of Service, Support for Economic Development

- appropriate range of routes, quality destinations and frequencies, customer choice;
- good standard of facilities and services.



**Value for Money/Efficiency (of the aviation system as a whole)**

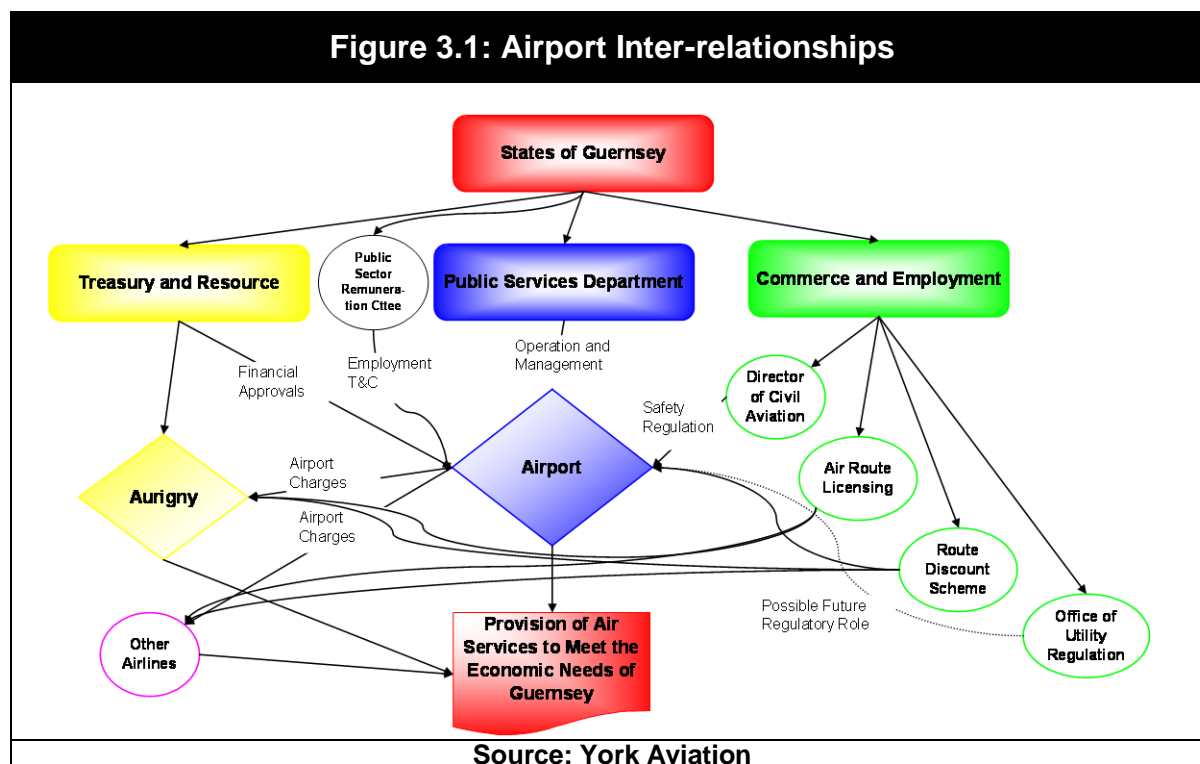
- operational efficiency (operational expenditure, commercial revenues, etc), including efficient and effective decision-making;
- financial efficiency;
- support for investment by non-States actors: transparency, clarity, speedy, rational decision-making;
- operational innovation;
- limited / acceptable / appropriate (financial) risk exposure to States tax-payers;
- limited / acceptable / appropriate environmental impact / externalities.

**Current Performance**

8. The current governance arrangements are complex, with multiple levels of approval needed through various States' departments, such as Treasury and Resources for capital expenditure. Similarly, Commerce & Employment holds regulatory responsibility and, effectively, controls route development through the Air Route Licensing system and the Air Route Discount scheme. Coupled with lack of control over staff terms and conditions, airport management has limited autonomy to manage the Airport to deliver the most efficient and effective service for Guernsey. This is illustrated in **Figure 3.1**.
9. In terms of the organisational structure of the Airport itself, what is striking is the focus on operations with an absence of specialist commercial management. The lack of any commercial and marketing functions is almost unique for an airport of the scale of Guernsey and reflects that of an operating entity only rather than a commercial business.

## Commercialisation of Guernsey Airport Operations

**Figure 3.1: Airport Inter-relationships**



10. Airport staff are employed by the States as department employees, with terms and conditions set centrally. This limits the scope for airport management to vary terms and conditions to better meet the requirements of the Airport and its customers. All budgeting and procurement above £25,000 is subject to multiple layers of States' approval involving other stakeholder departments. This gives rise to complex bureaucratic procedures, even for expenditure which, in an airport context, would be considered relatively minor. The complexities are even greater in terms of major capital projects. A number of activities are provided centrally by other States' departments for which no charge is currently levied on the Airport. Whilst the effect of this is to reduce the operating cost of the Airport, i.e. it is in receipt of an operational subsidy, it also means that the Airport has no control over standards of service.

11. Projecting the financial performance of the Airport forward and comparing it with past performance is a difficult exercise because of the different way in which the historical accounts and the future budgets are drawn up, and the way in which airline discounts are treated. This in itself draws attention to the problems with the current financial structure of the Airport and makes forward business planning more difficult. Improving financial transparency should be a key benefit from a commercialised structure.
12. Our Base Case financial projections (i.e. assuming status quo) indicate that the Airport is expected to generate a small surplus in 2011 and could be achieving a surplus of £1.064 million (or £787,000 in real terms) by 2018. However, this will fall short of the sums likely to be needed to contribute to the capital costs of the runway works. The Airport is unlikely to generate sufficient surpluses to fund even its ongoing maintenance capex, let alone making a contribution to the cost of the runway and airfield rehabilitation works.
13. We benchmarked the Airport's financial performance against other similar sized regional airports, including Jersey. Even making allowance for the difficulty of establishing like-for-like comparators, our benchmarking exercise suggests that there is scope for improved commercial performance, principally through cost savings and increased commercial (non-aeronautical) revenues. Assuming this could be attained with the adoption of a more commercial approach to airport management, we estimate that the surplus could rise to £1.864 million in real terms by 2018. This highlights the potential benefits from commercialisation. However, our analysis indicates that this will still not be enough to generate sufficient funds to cover major capital expenditure, which has implications for the choice of potential commercialisation model.

## Commercialisation Options

14. In considering the options for commercialisation, there did not appear to be clarity amongst stakeholders as to the distinction between:
  - '*commercialisation*' which means the Airport acting as a more commercial entity seeking to optimise profit generation (or minimise loss-making) over the long-term, even if it is wholly publicly-owned;
  - '*corporatisation*' which is the act of incorporating the Airport to be a stand-alone entity (albeit potentially still under States ownership); and

## Commercialisation of Guernsey Airport Operations

---

- '*privatisation*' which would involve varying degrees or structures of private ownership or long-term control of the Airport (though it is often taken to mean a situation where private interests have a controlling stake in the equity of a business).
15. In practice, these are neither mutually inclusive nor mutually exclusive concepts and there are gradations of options available. We focused on considering four principal options:
- Status Quo;
  - Incorporate, States Funding;
  - Incorporate, Independent Funding;
  - Incorporate, then Franchise or Lease to the Private Sector.
16. We carried out a multi-attribute analysis to evaluate these options against the objectives distilled from our discussions with stakeholders. We tested our conclusions against different potential weightings of objectives, dependent on the extent to which the States wishes to maximise efficiency or to minimise risk.

## Analysis

17. Our analysis suggests that there would be clear benefits from incorporating the Airport using the provisions of the States Trading Companies Law and Ordinance. This would allow more efficient deployment of staff and easier exploitation of the commercial potential of the Airport. This appears to us an logical first step. Moving to a States Trading Company (STC) would require the establishment of a shadow board and it will be important to learn lessons from the commercialisation of the Post and Electricity operations. In particular, there needs to be clarity of objectives for the States Trading Company and a clear understanding of the roles of each of the stakeholders. In the case of the Airport, it needs to be clearly determined whether its performance will be monitored against:
- delivery of increased air services and passenger numbers, generating wider economic benefits for the island; or

**Commercialisation of Guernsey Airport Operations**

---

- more efficient airport operations, with a clear relationship between costs and charges; or
  - achieving self funding status without recourse to funding from the States.
18. It may not be possible to achieve all three strategic aspirations simultaneously, even though our financial analysis would suggest that there is clear potential to improve the financial performance of the Airport.
19. The extent to which there would be advantages in moving beyond this first step of incorporation depends on the precise balance and weighting of the objectives. At this stage, there is insufficient consensus to allow the most appropriate model to be precisely determined and this needs to be further explored between the component departments of the States to ensure that there is clarity of objectives and desired outcomes.
20. Our analysis suggests that there may be a realistic prospect of the Airport generating sufficient revenue to become operationally self-sufficient, including funding of routine maintenance and refurbishment capital expenditure. However, there will still be a need for the States' to fund or finance major capital development works. The 'save to spend' policy is unlikely to be sufficient to meet such longer requirements. Incorporation alone will not solve this dilemma and would still leave Airport capital expenditure requirements to compete with other States' investments for priority. It appears to us that independent finance-raising is unlikely to be relevant to a publicly-owned Airport company but there may be ways of achieving speedier access to States' funds under the STC model. This could be explored further as part of the process of incorporation.
21. We believe that an important issue will be ensuring that appropriate commercial airport management expertise is available to drive the Airport forwards, particularly to maximise its commercial potential and to improve the air service offer to Guernsey. To achieve this, there may be merit in bringing in a private sector partner either to operate the Airport on a management contract or through a franchise or lease arrangement. This would allow access to external expertise and help to drive efficiency and fuller exploitation of the commercial potential, but will require a clarity of objectives and targets which is not possible under the current governance arrangements.

## Commercialisation of Guernsey Airport Operations

---

22. We believe that there may be merit in the shareholder in the Airport Company not being Treasury & Resources, at least in its entirety, because of the conflict of interest inherent in common ownership of Aurigny, whether this is perceived or real. PSD as the shareholder or part-shareholder would at least offer some continuity of existing operational expertise. Whilst this would be a departure from convention for an STC, we understand that this would not be precluded under the law.

## Summary of Recommendations

### 1.1 We recommend that:

- the Airport be incorporated as an STC as a first step in a commercialisation process;
- this will require greater clarity of objectives than is evident amongst stakeholders today, including resolving potential conflicts in objectives as outlined in this report;
- it will be important to ensure policy consistency between the various departments and their actions in order to secure delivery of the optimum air service for Guernsey, for which the Airport is an essential component;
- in parallel with the incorporation process, consideration should be given to the extent to which it is desirable to bring in a private sector partner. This will depend on:
  - the extent to which necessary airport commercial management expertise can be recruited locally or on licence from the UK;
  - the extent to which the Airport can become financially self-supporting;
  - the funding regime for major capital developments;
  - the precise ranking of objectives.

- On the basis of our initial assessment, bringing in a private sector partner on a management contract basis appears to be the option most likely to deliver the best outcome in the circumstances where the States will remain as the funder of major capital development and having regard to the need to balance risk against achievement of optimum efficiency. This needs to be tested through further discussion amongst key stakeholders to confirm the objectives and their weightings on a consensus basis.

## 1 CONTEXT AND CURRENT POSITION

### Context

- 1.1 York Aviation LLP (YAL) was appointed by the Public Services Department (PSD) of the States of Guernsey to examine the options for the commercialisation of Guernsey Airport operations.
- 1.2 The context for this review is set out in a Green Paper on Commercialisation, which considered the potential for a new business environment for a number of trading entities administered by PSD and was considered by the States in January 2011. The Green Paper identified the potential benefits of commercialisation, or privatisation, as being:
  - *“Increased efficiency of operations that release funds to deliver greater value or reduce the liability of PSD.*
  - *Increased income generating capacity of the activities of the business units.”*
- 1.3 The Green Paper also set out three key factors relevant to the review of the trading entities:
  - *“Government needs to ensure essential services are provided, but not necessarily be the provider.*
  - *Government structures (not just in Guernsey) are usually stable but can be cumbersome. The culture focuses on public accountability where at States, Board and managerial levels business direction can occasionally be influenced by the wish to avoid adverse public opinion or political comment more than focussing on productivity.*
  - *Government-run businesses can often prove frustrating to commercial trading partners who struggle with the governance constraints placed on managers and political Boards which mean business decisions may not always be made in a timely manner.”*



## Commercialisation of Guernsey Airport Operations

---

1.4 The Green Paper was informed by an independent report from the Office of Utility Regulation (OUR), which suggested that there might be merit in separating the airport into essential state run assets, which would continue to be directly controlled within PSD, and commercialisation of the landside operations. The key factor underpinning its recommendations was that the Airport had not historically been capable of generating surpluses sufficient to fund its capital investment requirements and looked unlikely to do so for the foreseeable future in the light of the substantial costs of over £80 million to reconstruct the runway and airside infrastructure to meet current safety requirements and the operational capability of the Airport. However, the OUR did recommend that a business review be undertaken to inform consideration of the way forward and this forms the purpose of our current study. The specific recommendations in respect of the Airport were that:

- *“the Department is seeking to assess the extent to which the current Airport operational structure delivers value for money. This will provide an essential benchmark against which to measure whether any different business environment would be better. In terms of different structures the two main ones are:-*
  - *Outsource as many of the component parts of the Airport operations as practical, in the same way as security services and cleaning are currently, but continuing to report to management, albeit through contract terms; and*
  - *Commercialise with a wholly owned States company, as per Guernsey Post and Guernsey Electricity.”*

1.5 The specific requirements for this study were set out in a Brief issued on 17<sup>th</sup> June 2011, which set out the context that the Public Services Department (PSD) is now considering options for future restructuring of a number of its business units and is seeking to assess the extent to which the current operational and governance structure optimises business efficiency and/or value for money with a view to examining the scope for:

- increasing commercial focus at management level whilst ensuring States retain strategic control and oversight;
- transferring operational risks and financial losses to a private sector partner;
- taking advantage of private sector skills that might not otherwise be available;

- reducing the risk of conflict between States as a regulator, air licensing authority, airport owner, and owner of an airline.

1.6 We understand that an initial assessment of options suggests a preference for three potential business models:

- Franchise operation for a fixed term;
- Commercial company, owned by the States;
- Status quo.

However, our brief was not confined to such business models and we have given consideration to a wider range of business models, including privatisation, although we understand that this route is unlikely to be favoured given the critical role played by the Airport as the gateway to the islands. We also address the suggestion of the OUR that there might be merit in considering different approaches for airside and landside assets.

1.7 The required outputs from this study are:

- a summary of and viewpoint on the Airport's existing trading operation;
- a review of the business operating models available (including possibilities of the ultimate ownership of the asset remaining with the States of Guernsey);
- assessment of various models (to include franchise; States' owned company and status quo) having regard to the Airport's 'lifeline' role in the island context;
- recommendations on what is assessed to be the most suitable model for Guernsey in the medium to long term;
- an implementation programme for the recommended changes (taking into consideration Guernsey's position as a Crown Dependency).

1.8 We do not address in this report the specific issues associated with the operation of Alderney Airport, except to note an element of costs incurred at Guernsey Airport to provide management support and the fact that these are subject to reimbursement.

### **Safeguarding the economic role of the Airport**

- 1.9 A key issue underpinning the review is how to ensure that the Airport continues to provide the lifeline services linking Guernsey to the mainland and overseas. We articulated the economic importance of the Airport to the island in our June 2009 report on the Economic Assessment of the Options for Airport Development.
- 1.10 Whilst the objectives of improving commercial focus call for a significant degree of management freedom in a commercialised structure, in this situation there may be some essential services or service standards that are simply not economic – that is a purely commercially-focussed operator might choose not to do some things that the States would want done. Some of these non-economic objectives might still be manageable in a commercialised environment through financial incentives or minimum service standards applied to the operator, such as:
- ➔ hours of opening;
  - ➔ standards of service, by reference to IATA standards of service or otherwise;
  - ➔ compliance with CAA standards;
  - ➔ obligations to facilitate growth in demand, including provisions for future capital development requirements.
- 1.11 Balancing the critical role which the Airport plays in the life of the Bailiwick with the desire to commercialise the operation of the Airport has formed a key part of our study, which we return to in **Section 4**.

## **Experience of previous commercialisations in Guernsey**

- 1.12 In 1998, the decision was taken to commercialise the provision of postal services, electricity and telecoms on Guernsey. The commercialisation of post and telecoms was completed in 2001 and electricity in 2002. The provision of these services was first vested in States Trading Companies established under the States Trading Companies Law of 2001 and governed by specific Ordinances under the States Trading Companies Ordinance 2001<sup>1</sup>. We understand that the States Trading Companies Law provides for the establishment of additional States Trading Companies but that specific Ordinances would need to be passed related to each individual trading entity, i.e. the Airport.
- 1.13 In view of the market dominant or monopoly position held by each of the utility companies, they were required to have a licence to operate from the newly established Office of Utility Regulation, which was established to provide an economic regulatory function on the UK model.
- 1.14 In 2002, the States Telecom company was sold to Cable & Wireless but continued to operate under regulatory control.
- 1.15 Our stakeholder interviews revealed mixed views about the success of these commercialisations, for example:
- generally, service is considered to be better, although there were some initial difficulties with postal services;
  - management has greater freedom to manage and to negotiate the terms and conditions of staff;
  - prices to consumers are perceived to have risen, although this stems in part from elimination of cross subsidisation between different activities (i.e. may not be due to a rise in actual costs of delivery);
  - the sale of telecoms to Cable & Wireless is viewed as having undervalued the asset;
  - States Trading Companies continue to operate under a save to spend policy which limits the ability for capital investment as borrowing is not currently allowed for those remaining under 100% States ownership.

---

<sup>1</sup> Separate legal provisions were also made relating to the transfer of staff to the new trading entities and for pension arrangements, permitting staff employed by the trading companies to retain their existing States pensions.

## Commercialisation of Guernsey Airport Operations

---

- 1.16 As a result, there have been a number of reports on the commercialisation process and the effectiveness of the regulatory regime.

### National Audit Office Review

- 1.17 A review of Commercialisation and Regulation in the States of Guernsey was carried out in 2005 by the UK National Audit Office. The criteria which they adopted, and which also have relevance for our current review, were that:

- ➔ *Commercialisation* should lead to improved commercial performance through increased efficiency and enhanced profitability.
- ➔ *Regulation* should lead to improved consumer outcomes through lower prices, improved quality of service and longer term security of supply.

- 1.18 These criteria are also relevant to consideration of the best operating model for the Airport, particularly given the lifeline nature of air service operations but also given the constraints on the ability of the airport operator itself to control or influence the quality of air service provision to/from Guernsey. We will return to the issues which this poses in terms of identifying how best to commercialise the operation of the Airport in Section 5.

- 1.19 The conclusions of the NAO Report as reported to the States<sup>2</sup> were that:

- ➔ *“The States of Guernsey has adopted an appropriate model to meet the objectives of commercialisation in the three industries examined. The objectives of commercialisation can be achieved if the model is operated properly;*
- ➔ *However, in post and electricity improvements need to be made to the operation of the model. In particular, greater clarity is needed in the respective roles of shareholder, policy maker and operational management;*
- ➔ *Regulation has facilitated the benefits of commercialisation and is essential in all three industries, but it has come at a high cost. There are various ways in which the regulatory burden could be reduced.”*

---

<sup>2</sup> Billet X 2006

- 1.20 In particular, there were concerns about the relationships between the trading companies and the regulator and the costs which the regulatory system imposed on the trading companies and specific recommendations were made about improving the regulatory system.

### **Independent Review of Regulation**

- 1.21 In 2010, the Commerce and Employment Department (C&E) commissioned further research into the introduction of competition in the post and electricity sectors and how these sectors were regulated by the OUR. In effect this review considered the process of commercialisation, the effectiveness of governance and the interface with the regulator. All of these issues are relevant to the consideration of the potential commercialisation of Guernsey Airport.
- 1.22 In particular, the October 2010 Report from the Regulatory Policy Institute (RPI) raised a number of particular considerations which are highly relevant to our current review, namely:
- the small size of the market on Guernsey;
  - the structure of Government;
  - public ownership of the trading companies;
  - corporate governance in the commercialised public sector;
  - prospects for cooperation with Jersey;
  - the 'save to spend' policy;
  - the approach to regulation; and
  - the absence of competition legislation.
- 1.23 In particular, the RPI highlighted the particular features of publically owned commercial enterprises and the potential overlap between the role of the shareholder (the States) and the regulator in terms of reconciling the balance between maximising financial returns (minimising losses) to the States and meeting consumer needs for higher quality of service and lower prices. Lack of clarity in this area was seen as one of the reasons why regulation in the Guernsey context was not perceived to have been entirely effective to date.

## Commercialisation of Guernsey Airport Operations

---

- 1.24 Amongst the key recommendations emerging following the RPI report was a requirement for greater clarity in the role of the shareholder and that of the regulator. It is suggested that the role of the shareholder should focus on the commercial performance of the company and that the regulator's primary duty should be to safeguard the interests of consumers. The RPI report also contained detailed recommendations as to how regulation should be carried out, the potential for cooperation with Jersey in terms of the potential for a shared shareholder resource and detailed recommendations relevant to the current States Trading Companies.
- 1.25 Key lessons which we take from these reviews are the importance of being clear at the outset the objectives for commercialising Guernsey Airport and the need to reflect the issues of scale and mode of government in Guernsey. It is evident that there was a lack of clarity, to some degree, in respect of the commercialisation of both post and electricity which has given rise to tensions between the companies and the regulator<sup>3</sup>. Indeed, the RPI report does highlight that economic regulation was not really designed to deal with a state owned monopoly and is more usually applied where there is scope for introducing competition and/or monopolies are privately owned. We will consider later the appropriateness of economic regulation in the context of Guernsey Airport and in the context of the objectives for and constraints on the commercialisation process.

### Structure of the Report

- 1.26 The remainder of our report is structured as follows:
- in **Section 2**, we summarise the view of stakeholders and the objectives for commercialisation;
  - in **Section 3**, we examine the current governance and financial performance of the Airport;
  - in **Section 4**, we examine the potential financial benefits of commercialisation;
  - in **Section 5**, we examine the options for commercialisation;
  - in **Section 6**, we set out our recommendations and next steps.

---

<sup>3</sup> There are always tensions between the regulator and the regulated entity but the RPI and NAO reports both suggest that those seen on Guernsey have been greater than would have been expected, particularly given the small scale of the markets on Guernsey.

## 2 OBJECTIVES AND CONSTRAINTS

*“Once you specify in advance what a project's supposed to achieve and whose responsibility it is to see that it does, the entire system collapses. You're into the squalid world of professional management.” (Yes, Minister)*

### Stakeholder Views

- 2.1 In order to understand better how commercialisation might improve operation of the Airport and its ability to serve the needs of Guernsey, we interviewed a number of stakeholders regarding the operation, management and governance of the Airport. Being clear about the objectives is fundamental to assessing which of the alternative models is most likely to secure a beneficial outcome.
- 2.2 The list of stakeholders interviewed is set out in **Appendix A**. We interviewed representatives of all the key players as set out in Figure 3.1 in the next section.
- 2.3 We focussed our interviews on two key questions:
- ➔ What aspects of the Airport's operation need improvement?
  - ➔ What would a successful commercialisation look like?
- 2.4 Generally, we found support for the principle of commercialisation of the Airport operation, although some stakeholders found it harder to enunciate what exactly what would be better or different if the Airport was commercialised. Stakeholders found it easier to elaborate their overarching aspirations for the Airport, which included:
- ➔ to provide Guernsey with a reliable aviation gateway to the rest of the world;
  - ➔ to maximise the benefit the Airport provides to the Island economy (e.g. optimum hours of opening and charging regime that encourages travel, maximising employment, etc);
  - ➔ to be responsive to changing economic, business and infrastructure requirements in a timely manner;



## Commercialisation of Guernsey Airport Operations

---

- ➔ to be able to access essential capital funds where commercial business case exists and to do as promptly as necessary;
  - ➔ to introduce commercial management whilst ensuring States retain strategic control and oversight;
  - ➔ to transfer risks of operation and financial losses to a business/sector partner and access private sector skills;
  - ➔ to reduce the risk of conflict between States as a Airport owner, regulator, air licensing authority and airline owner;
  - ➔ to improve the customer experience;
  - ➔ to maximise efficiency;
  - ➔ to be able to act commercially whilst recognising the critical role the Airport performs for every aspect of Island life.
- 2.5 Many of these aspirations are general rather than specific and, to the extent that they imply an improved range of air services being offered, rely on the actions beyond the scope of the Airport, such as the air route licensing process and the future of the air route discount scheme which are both operated by Commerce and Employment.
- 2.6 At Ministerial level, there is a desire for greater cost transparency and a move towards a system where users pay directly for the costs of the Airport rather than it being supported through general taxation. However, it does need to be borne in mind that, subject to any trade-off between increased efficiency and exposure of cross-subsidy arising from commercialisation, this could result in prices borne by Airport users rising. Without any countering action by the States, this could impact the viability of more marginal services, as outlined in our previous report, with consequent impacts on the aim of ensuring that the Airport supports the delivery of air services necessary to support the wider economy and society.
- 2.7 Key stakeholders in the Airport did identify the following issues or shortcomings with the existing structure of operations:
- ➔ severe constraints on management autonomy, affecting the ability to manage the Airport with any commercial rigour or the ability to react to customer needs swiftly or effectively;

## Commercialisation of Guernsey Airport Operations

---

- that around 65% of operating costs are not within management control (i.e. staff costs and working conditions);
- the inefficiency and ineffectiveness of a one-size fits all approach to staff management across all of the States departments, for example in the case of the fire dispute;
- a challenging approach to managing investment in the Airport effectively, with the involvement of multiple stakeholders (sometimes with internally conflicting roles) and layers of approval stages which may inhibit rapid, financially-efficient action such as the runway rehabilitation programme. This is exacerbated by the consensus-style government of Guernsey which can result in delays or changes to projects which could adversely impact on the Airport's operation or the realisation of its commercial potential;
- the constant need to rank capital investment against other States' investment priorities, which may mean that efficient, smooth flows of investment (any amount above £25,000) are difficult to achieve and that investment in major maintenance or business development may happen when States' funding is deemed to be available rather than when it may be efficient to inject those funds for the business;
- a lack of commercial experience in the management structure;
- a lack of normal management information, especially opaque input costs (particularly where these inputs are supplied but not charged by the States) or a dynamic financial model projecting performance and investment needs under different scenarios;
- a lack of ability to manage quality or speed of technical input from other States departments (i.e. no SLAs or benchmarked inputs) even if these services are provided free to the Airport;
- a lack of any States stakeholder acting as an 'intelligent shareholder', holding management to account, or benchmarking performance against predetermined objectives.

### 2.8 Other issues identified include:

- the Airport's current Business Plan is not as developed in terms of integration with financial projections and detailed implementation plans as might be expected in a fully commercialised environment;

## Commercialisation of Guernsey Airport Operations

---

- the lack of a Master Plan for the development of the Airport;
- lack of a coherent market development plan resulting in airlines focussing route development on Jersey.

2.9 Based on our discussions with stakeholders, we believe that achieving clarity of objectives for any change in the governance and management of the Airport will be essential. We now go on to set out what we believe to be the principal objectives and constraints on the selection of the best model.

### Objectives or Aspirations?

2.10 We would draw a distinction between aspirations for commercialisation – that is, things that stakeholders hope or expect would be improved by commercialisation – and Airport Objectives, which are overarching targets that stakeholders might have for the Airport regardless of its mode of governance and therefore more relevant to benchmark options. Stakeholders we have spoken to have identified a number of possible aspirations which they sought to achieve in commercialising the Airport as set out above. We have tried to structure these to aid understanding of the extent to which commercialisation could secure improved performance.

2.11 These aspirations for commercialisation fall into three broad categories:

- System Strategic - aspirations relating to the overall provision of air services to Guernsey, of which the Airport is a critical part;
- Airport Strategic - aspirations which are specific to the Airport and are of a strategic nature in terms of how the Airport supports the System Strategic objectives.
- Operational - tactical, operational characteristics or features of management that help the Airport to meet its strategic objectives.

2.12 At a System Strategic level, the main requirement is to ensure that the Airport supports the overall aviation objective of providing reliable, relevant and good quality air services for the Island as efficiently as possible. Whilst ensuring reliability and resilience in air operations is a critical objective for the Airport, there are other actors, such as the airlines or Route Licensing function of C&E, which have a significant influence on the ability of the Airport to support or grow air services. The extent of States' intervention in the provision of air services to Guernsey is extremely unusual within Europe today and could serve to restrict at least some of the benefits by way of more commercial or efficient operations that could be delivered by commercialising the Airport.

2.13 At an Airport Strategic level, these aspirations appear to include:

- to be able to access essential capital funds where a commercial business case exists and to do as promptly as necessary to ensure that airport facilities remain fit for purpose;
- to introduce commercial management whilst ensuring States retain strategic control and oversight to safeguard the lifeline role;
- to transfer risks of operation and financial losses as far as possible to a business/sector partner and access private sector skills so as to minimise the drain on public sector resources;
- to maximise efficiency and operate consistently with the overarching States policy to move away from services being funded by general taxation to a 'user pays' principle based on transparent costs and charges.

2.14 Operational level aspirations include:

- greater transparency of operational and financial performance;
- reduce political involvement in Airport operations;
- liberate management to be able to operate more commercially or dynamically, with more commercial management skills available;
- simplify the points of contact and decision-making for third-party stakeholders (such as airlines);
- help management to manage staff directly in order to achieve cultural change and a more commercial and flexible approach to respond to user needs, e.g. opening hours;

## Commercialisation of Guernsey Airport Operations

---

- facilitate efficient financing of the Airport, accessing funds as determined by business needs and optimal investment cycles;
- reduce the risk of conflict between States as a Airport owner, regulator, air licensing authority and airline owner;
- increase overall efficiency of operations and ensure reliability of supply.

2.15 There are inherent conflicts in a number of these aspirations. For example,

- even operating with a higher degree of economic efficiency, commercialisation under the 'user pays' principle, once the true full costs of airport operations are taken into account, may result in charges to users rising, as happened in electricity and telecoms. This may result in airlines withdrawing services and might not be consistent with ensuring the Airport delivers the air services needed to support the economic and social needs of the island;
- commercialisation restricted to a 'save to spend' regime may neither be affordable (given projected capital costs and revenues), nor compliant with ICAO guidelines, nor consistent with efficient timing of investment (one reason why most private companies maintain credit facilities);
- bringing in a private sector partner may assist in developing a more commercial approach and improving efficiency but a private sector partner cannot be expected to take on existing States' financial losses, which was indicated as an aspiration in the terms of reference for this study.

2.16 Fundamentally, inherent conflicts of this sort should be identified and resolved as a pre-requisite to a successful commercialisation process. The NAO and RPI reports on previous commercialisations suggest that lack of clarity of objectives has hampered the effectiveness of commercialisation in the case of both of the States Trading Companies. This applies both to the role of the shareholder and the strategic direction given to the business and the regulatory framework.

2.17 To an extent, clarity of objectives is more important than the potential structural solution as a number of structural solutions could be designed to deliver against some or all of the aspiration outlined to us. However, it is essential to be clear at the outset how success will be measured. Will it be measured by:

- increased air services and passenger numbers, generating wider economic benefits for the island?
- more efficient airport operations, with a clear relationship between costs and charges?
- a self funding airport operation without recourse to funding from the States?

2.18 It is important to remember that the latter objectives may not necessarily deliver outcomes consistent with the overarching economic objective for the Bailiwick. This is why it is important that the impact of other initiatives, such as the potential for Open Skies, the future of the Air Discount scheme and the role of the regulator, both the DCA and the OUR, are clear and aligned at the outset if the benefits of commercialising the Airport are not, at the very least, to be diluted.

## **Constraints**

2.19 Clear indications were given to us by stakeholders that outright privatisation of the Airport asset was not likely to be politically acceptable given the critical lifeline role which it plays in securing access to the island. There is no realistic prospect of another airport facility being provided so the States need to retain a strategic level of control over the Airport to ensure that it continues to facilitate air service access to the level required to meet wider social and economic objectives.

2.20 It has been suggested by the OUR and others that this strategic control might be achieved by retaining the airside assets in public ownership, as this is the fundamental lifeline facility against which substantial capital expenditure is about to be incurred, whilst allowing full private sector control of the terminal and landside assets. In our view, there are inherent efficiencies and interface issues in separating the operation and management of the terminal airfield infrastructure, which we discuss further in the context of the options in the Section 5.

## Potential Objectives

2.21 Given the lack of clarity and potential conflicts in the various aspirations of stakeholders as put to us, we have attempted here to synthesize a more structured set of objectives in order to provide a framework to enable us to evaluate the potential governance options. We have grouped the objectives into three strategic outcomes supported by the tactical or operational measures:

### Security of Supply

- ➔ operational safety;
- ➔ ability to serve reasonable / appropriate levels of demand;
- ➔ robust operations / limited risk of interruption;
- ➔ ability to source funding when required / in support of effective development.

### Quality of Service, Support for Economic Development

- ➔ appropriate range of routes, quality destinations and frequencies, customer choice;
- ➔ good standard of facilities and services.

### Value for Money/Efficiency (of the aviation system as a whole)

- ➔ operational efficiency (opex, commercial revenues, etc), including efficient and effective decision-making;
- ➔ financial efficiency;
- ➔ support for investment by non-States actors: transparency, clarity, speedy, rational decision-making;
- ➔ operational innovation;
- ➔ limited / acceptable / appropriate (financial) risk exposure to States tax-payers;

→ limited / acceptable / appropriate environmental impact / externalities.

2.22 We go on to use this framework to assess the available commercialisation options in the Section 5.

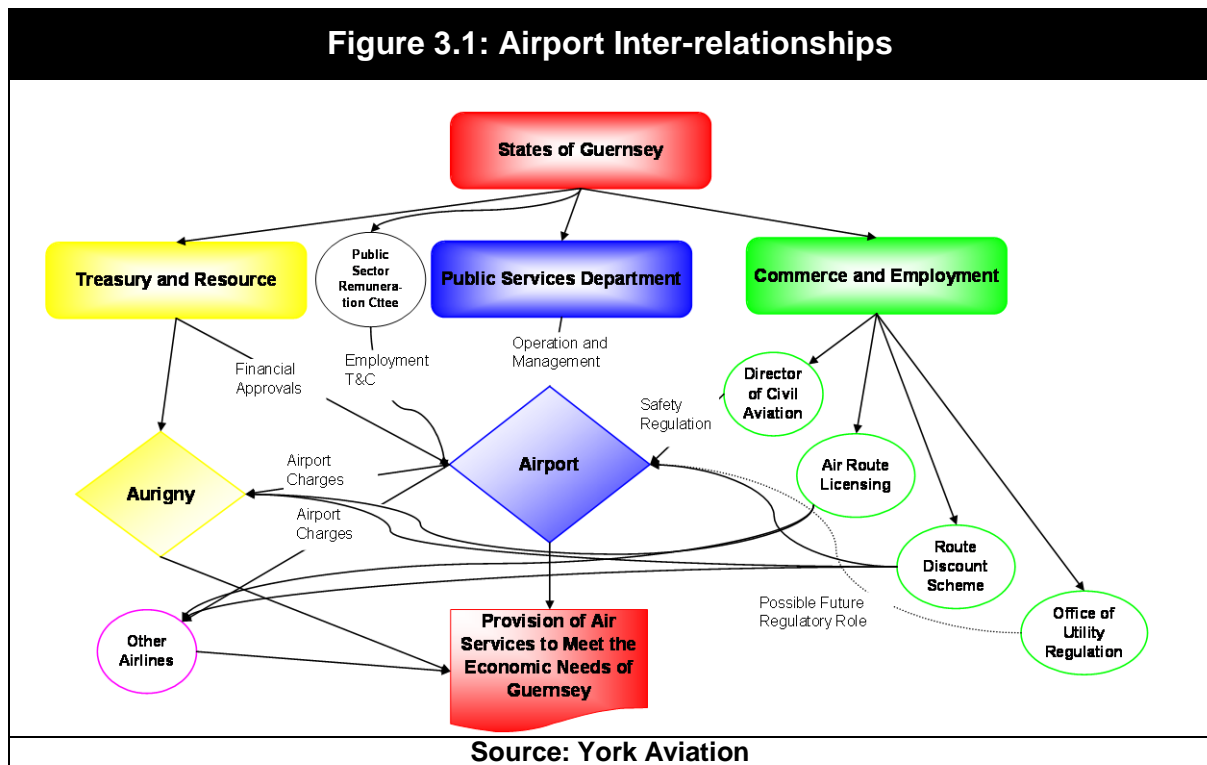


### 3 CURRENT POSITION OF GUERNSEY AIRPORT

#### Current Governance and Inter-relationships

- 3.1 Currently, Guernsey Airport operates as a department under the management of the Public Services Department. However, there are many other organisations which impact on the ability of the Airport to deliver its primary service to Guernsey, namely the provision of air services for passengers and freight. In this regard, an airport is different from other trading entities as it does not, in the main, sell its services directly to consumers but via a smaller set of customers or partners – the airlines and concessionaires. This is important in terms of considering the objectives for commercialising the Airport as, to the extent that safeguarding or improving the range of air services on offer to Guernsey is important, this cannot be achieved by the Airport alone and the actions of other organisations could potentially cut across some of the benefits which could arise from commercialisation.
- 3.2 Guernsey is unusual in a European context in continuing to operate a strict licensing regime where routes, frequencies and air fares are controlled (although we understand that the Commerce and Employment Department has indicated the intention to operate a more liberal approach, albeit short of full open skies, until such time as a formal competition regime is in force on Guernsey). It is also unusual for a regional airport owner also to own an airline, albeit at arm's length through another States' department.
- 3.3 We illustrate these inter-relationships in **Figure 3.1** and set out below their current and potential future roles in the delivery of air services at the Airport.

Figure 3.1: Airport Inter-relationships



### States of Guernsey [strategy]

- 3.4 The States of Guernsey sets the overall policy towards the Airport and has ultimate financial approval of both the budget and levels of capital investment.
- 3.5 The States also has ultimate control over staff terms and conditions of employment at the present time. This could change within a commercialised environment but influence could remain through considerations such as pension arrangements.
- 3.6 At present, the actions of the States can have a direct effect on the operation of the Airport, as for example during the firemen's dispute in 2009. However, we would expect that the principal interest of the States to be at the level of strategy and strategic investment rather than day to day operations.

## Commercialisation of Guernsey Airport Operations

---

### **Public Services Department *[operations]***

- 3.7 The Airport is treated as a trading entity run directly by the Public Services Department, although lacking effective autonomy. All staff are civil servants directly employed through PSD. Governance of the Airport is through the PSD Board. Effectively, the Airport is run as a department of PSD.

### **Treasury and Resources Department *[investment]***

- 3.8 T&R are responsible for setting budgets for the Airport. All capital expenditure is funded from central funds held and prioritised by T&R, under the policy direction of the States. Hence, T&R have been critical in securing funding for the forthcoming airfield rehabilitation project.
- 3.9 T&R currently act as the shareholder for all States Trading Companies. This includes Aurigny Airlines, which can give rise to perceived conflict of interest issues.

### **Commerce and Employment Department *[demand, safety]***

- 3.10 C&E are charged with the development of the economy on Guernsey. In connection with its primary remit, C&E has a number of key roles in relation to the Airport:
- The Director of Civil Aviation (DCA) (a joint position with Jersey) responsible for compliance of aviation activity on Guernsey, including the Airport, within international rules and regulations. *[safety]*
  - Air Route Licensing, which determines which airlines can operate which routes to/from Guernsey and at what frequencies. This function plays a critical role in determining the air services which are actually operated. Moving to an open skies regime, which would allow airlines to operate as they choose, remains under consideration, but this would require an effective competition regime to be in place on Guernsey. The current regime is perceived externally as a mechanism to protect Aurigny, highlighting the inherent conflicts arising from States' ownership of an airline and the Airport. *[demand]*

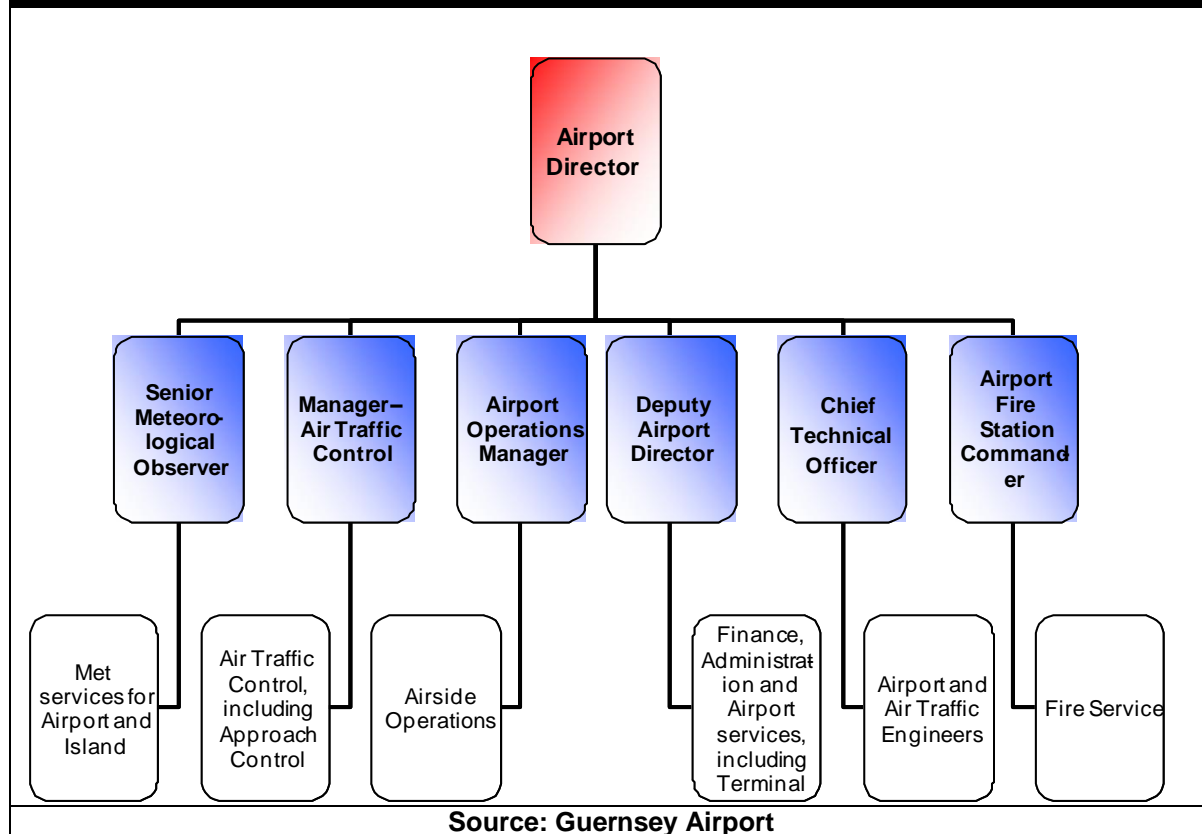
- Air Route Financial Concessions scheme, which provides funds to support airlines operating between Guernsey and UK destinations; at £1.05 per passenger this discount scheme is not targeted towards new route development but effectively nets off one element of the Airport Development Fee, instituted to fund the cost of the new terminal development. The future of this Discount Scheme is under review as part of the Financial Transformation Programme. *[demand]*
- The Office of Utility Regulation, which is the current economic regulator for the States Trading Companies, including the privatised telecoms sector. The OUR would become the economic regulator of the Airport if it is decided that economic regulation is required.

3.11 In considering the options for commercialising Guernsey Airport, it is important to bear in mind the roles of the different organisations as each as the potential to impact on the extent to which commercialisation would deliver benefit. Currently, there is very limited freedom for the Airport to act. Hence, in considering the options for commercialisation, it will be important to consider the interaction of all parts of the system to ensure that the outcome actually delivers a better service to Guernsey. We return to this in Section 5.

## Organisation Structure

3.12 The current management structure of the Airport is set out in **Figure 3.2**. What is striking is the focus on operations with complete absence of any commercial management. The main departments are operational, including the provision of meteorological services for the island as a whole. Although the Deputy Airport Manager manages the finance, administration and terminal services functions, there is no active commercial management to drive up commercial income, develop air services and to market the Airport more generally. It would appear that the route development function is effectively delegated to C&E under the responsibilities set out above.

Figure 3.2: Airport Organisation Structure



3.13 The absence of any commercial and marketing functions is almost unique for an airport of the scale of Guernsey. The existing management structure reflects that of an operating entity only rather than a commercial business. It mirrors to a large extent the budgetary process based on matching costs to revenues to attain a defined margin.

3.14 Airport staff are employed by the States as department employees, with terms and conditions set centrally. This limits the scope for airport management to vary terms and conditions to better meet the requirements of the Airport and its customers, including consideration of more flexible opening hours or the ability to improve efficiency through flexible rostering to maximise use of resources to match peaks of airline and passenger demand.

- 3.15 All budgeting and procurement is subject to multiple layers of States' approval involving other stakeholder departments. All expenditure above £25,000 is subject to strict States' procurement rules, with authorisation required at PSD, T&R and, on occasions, the States of Deliberation. This gives rise to complex bureaucratic procedures, even for expenditure which in an airport context would be considered relatively minor. The complexities are even greater in terms of major capital projects.
- 3.16 A number of activities are provided centrally by other States' departments and for which no charge is currently levied on the Airport. These services include IT, Human Resources, Estates, Legal and Treasury. Whilst the effect of this is to reduce the operating cost of the Airport, i.e. it is in receipt of an operational subsidy, it also means that the Airport has no control over standards of service, which can impact adversely on relationships with clients if, for example, there are delays in resolving lease or property issues.

## **Financial Performance**

- 3.17 Two of the principal drivers of commercialisation are typically:
- the scope for efficiency savings; and
  - the opportunities for increased revenue generation.
- 3.18 Generally, when airports are commercialised, one of the key objectives of operating at arm's length from the state is performance improvement in respect of operating costs. In terms of the ability to increase revenues, the potential for Guernsey Airport is limited by the potential scale of the market and the price sensitivity of airline demand. Hence, the principal real opportunity for increased revenues is likely to be in the field of commercial or non-aeronautical activities, including car parking, retail and catering, and offices.
- 3.19 In order to assess whether there is a realistic prospect of the Airport being viable as a free-standing entity, we constructed a relatively simple Profit & Loss model based on the Airport's published accounts and budgets for the period to 2018. We made adjustments to these figures to enable a judgement to be made as to viability going forward, assuming that the Airport was independent of States' funding and services, with the exception of the need to fund the runway pavement related works. We set out the result of this analysis below.

## Commercialisation of Guernsey Airport Operations

---

3.20 Part of this analysis required us to take a view of Guernsey's current and forecast financial performance compared with other UK airports of a similar size. We, therefore, began the exercise by benchmarking Guernsey with a range of small to medium sized UK regional airports and we set out the results of this analysis below.

### Benchmarks

- 3.21 We used data on UK airports for 2009/10 published by Leigh Fisher (formerly by the Centre for Regulated Industries) which provides financial data for a wide range of UK airports<sup>4</sup>. However, information for the Channel Islands Airports is not included in the Leigh Fisher analysis, so comparisons have been made with data provided directly by Guernsey Airport and with data for Jersey Airport obtained from the States of Jersey Financial Report & Accounts.
- 3.22 We considered a range of UK Regional Airports with passenger throughput of between 250,000 and 3 million passengers per annum. These included Aberdeen, Bournemouth, Cardiff, Doncaster Sheffield, Durham Tees Valley, Exeter, Leeds-Bradford, Humberside, and Southampton. At 902,000 passengers per annum in 2009, Guernsey was approximately in the mid range of passenger throughput of these airports, as is indicated in **Table 3.1**. All data in this and subsequent similar tables refers to either the 2009/10 financial year or the full 2009 calendar year.

| <b>Table 3.1: Passenger Throughput at Selected UK Regional Airports</b> |                          |
|---|--------------------------|
| <b>Airport</b>  | <b>Passengers (000s)</b> |
| Aberdeen  | 3,006                    |
| Leeds Bradford  | 2,526                    |
| Southampton   | 1,802                    |
| Cardiff   | 1,628                    |
| Jersey  | 1,461                    |
| <b>Guernsey</b>   | <b>902</b>               |
| Bournemouth   | 815                      |
| Doncaster   | 804                      |
| Exeter  | 790                      |
| Humberside  | 318                      |
| Durham Tees Valley  | 278                      |
| Source: UK Airports Performance Indicators 2009/2010                    |                          |

---

<sup>4</sup> UK Airports Performance Indicators 2009/10.

## Commercialisation of Guernsey Airport Operations

3.23 We began by looking at the proportions of aeronautical income and commercial income at the selected airports. As can be seen from **Table 3.2**, Guernsey is at the bottom of the table in terms of having the lowest percentage income from commercial sources of all the selected airports, including Jersey, by some considerable margin. Guernsey is consequently much more reliant on aeronautical income than other airports. This gives a prima facie indication of the scope for improved commercial performance, although it should be noted that each airport needs to be considered on its own merits as, for example, Bournemouth Airport has a substantial property portfolio compared with other airports. Nevertheless, Guernsey is not part of the EU and Duty Free allowances do apply for travel to the UK and EU countries, giving the Airport a potential comparative advantage in selling Duty Free items. This potential is not being realised.

| <b>Table 3.2: Aeronautical and Commercial Income Percentages</b> |                            |                            |                            |                            |
|--|----------------------------|----------------------------|----------------------------|----------------------------|
| <b>Airport</b>   | <b>Aero Income (£000s)</b> | <b>Comm Income (£000s)</b> | <b>Aero Income Percent</b> | <b>Comm Income Percent</b> |
| Bournemouth  | £4,843                     | £10,860                    | 30.8%                      | 69.2%                      |
| Doncaster  | £2,224                     | £4,832                     | 31.5%                      | 68.5%                      |
| Durham Tees  | £3,048                     | £5,626                     | 35.1%                      | 64.9%                      |
| Leeds Bradford   | £7,352                     | £12,600                    | 36.8%                      | 63.2%                      |
| Exeter   | £7,590                     | £9,375                     | 44.7%                      | 55.3%                      |
| Humberside   | £2,758                     | £2,481                     | 52.6%                      | 47.4%                      |
| Cardiff  | £8,837                     | £7,292                     | 54.8%                      | 45.2%                      |
| Aberdeen   | £27,124                    | £20,818                    | 56.6%                      | 43.4%                      |
| Southampton  | £15,916                    | £10,729                    | 59.7%                      | 40.3%                      |
| Jersey   | £8,697                     | £4,999                     | 63.5%                      | 36.5%                      |
| <b>Guernsey</b>  | <b>£7,633</b>              | <b>£2,680</b>              | <b>74.0%</b>               | <b>26.0%</b>               |
| Source: UK Airports Performance Indicators 2009/2010             |                            |                            |                            |                            |



## Commercialisation of Guernsey Airport Operations

3.24 We also examined aeronautical income per passenger which gives an indication of the yield that the Airport is getting from its charges. This is set out in **Table 3.3** and shows Guernsey in the middle of the range. The aeronautical income figure for these airports, including Guernsey, is shown after the various route discounts have been applied<sup>5</sup> and is therefore reflective of what the airlines actually pay<sup>6</sup>. We have also included income related to the charges for security (£1.072 million in 2010) which is not shown separately in Guernsey's published accounts, but netted off against expenditure to make the comparison with other airports consistent, where security charges are usually included in overall aeronautical income.

| <b>Table 3.3: Aeronautical Income per Passenger</b>  |                            |                            |                            |
|--|----------------------------|----------------------------|----------------------------|
| <b>Airport</b>                                       | <b>Terminal Pax (000s)</b> | <b>Aero Income (£000s)</b> | <b>Aero Income per pax</b> |
| Durham Tees  | 278                        | £3,048                     | £10.96                     |
| Exeter   | 790                        | £7,590                     | £9.61                      |
| Aberdeen   | 3,006                      | £27,124                    | £9.02                      |
| Southampton  | 1,802                      | £15,916                    | £8.83                      |
| Humberside   | 318                        | £2,758                     | £8.67                      |
| <b>Guernsey</b>                                      | <b>902</b>                 | <b>£6,524</b>              | <b>£7.23</b>               |
| Jersey   | 1,461                      | £8,697                     | £5.95                      |
| Bournemouth  | 815                        | £4,843                     | £5.94                      |
| Cardiff  | 1,628                      | £8,837                     | £5.43                      |
| Leeds Bradford                                       | 2,526                      | £7,352                     | £2.91                      |
| Doncaster  | 804                        | £2,224                     | £2.77                      |
| Source: UK Airports Performance Indicators 2009/2010 |                            |                            |                            |

<sup>5</sup> It should be noted that some airports report revenue from airport charges net of all discounts and marketing support payments. Others do not so comparisons in this area need to be treated with a degree of caution. In this analysis, we have shown the figures for Guernsey net of the C&E funded air route discount scheme as well as the Airport funded runway discounts.

<sup>6</sup> Aircraft Parking (or 'Picketing') is not included in aeronautical revenue as it is not identified separately from commercial income in the airport's accounts, but is a relatively small sum.

3.25 In terms of commercial income per passenger, **Table 3.4** shows that Guernsey lies at the bottom of the range of selected airports. It is interesting to note that commercial income per passenger at Bournemouth Airport, which had a similar level of passenger throughput as Guernsey in 2009/10, is more than four times the level at Guernsey, albeit this is derived from a substantial property portfolio. Nonetheless, the other figures in this table suggest, prima facie, that considerable scope exists for improving the level of commercial income at Guernsey.

| <b>Table 3.4: Commercial Income per Passenger</b>    |                            |                            |                            |
|--|----------------------------|----------------------------|----------------------------|
| <b>Airport</b>                                       | <b>Terminal Pax (000s)</b> | <b>Comm Income (£000s)</b> | <b>Comm Income per pax</b> |
| Humberside   | 318                        | £5,626                     | £17.69                     |
| Bournemouth  | 815                        | £10,860                    | £13.33                     |
| Exeter   | 790                        | £9,375                     | £11.87                     |
| Durham Tees  | 278                        | £2,481                     | £8.92                      |
| Aberdeen   | 3,006                      | £20,818                    | £6.93                      |
| Doncaster  | 804                        | £4,832                     | £6.01                      |
| Southampton  | 1,802                      | £10,729                    | £5.95                      |
| Leeds Bradford                                       | 2,526                      | £12,600                    | £4.99                      |
| Cardiff  | 1,628                      | £7,292                     | £4.48                      |
| Jersey   | 1,461                      | £4,999                     | £3.42                      |
| <b>Guernsey</b>                                      | <b>902</b>                 | <b>£2,680</b>              | <b>£2.97</b>               |
| Source: UK Airports Performance Indicators 2009/2010 |                            |                            |                            |

## Commercialisation of Guernsey Airport Operations

3.26 In terms of operational expenditure per passenger, **Table 3.5** shows that Guernsey appears to be at the lower end of the range. Most airports include expenditure on security in opex costs so in order to compare like with like we have added the expenditure on the security contract at Guernsey (which was £1.094 million in 2009) into the opex figure, although it is netted off against income in the published accounts. Even with this adjustment, Guernsey's operational expenditure per passenger is not as high as some airports, which indicates there may be few opportunities for significant efficiency gains. However, the ranking may be distorted by the fact that some services which would normally be included in operational expenditure (such as IT, HR, and Legal Services) are supplied to Guernsey Airport centrally by the States at no direct cost and are therefore not included in the Airport's operational expenditure. We estimate that the cost of procuring these services on a transparent basis of commercially, coupled with the addition of appropriate marketing and commercial development personnel would increase airport costs by of the order of £400,000 per annum<sup>7</sup>. Assuming our assessment of the cost of these services is correct, the effect on opex would only be £0.44 per passenger which would still leave opex per passenger at Guernsey Airport substantially below its peer airports. This may indicate some further upside risk to opex to reflect a fully stand alone operation.

| <b>Table 3.5: Operational Expenditure (Opex) per Passenger</b> |                            |                  |                     |
|--|----------------------------|------------------|---------------------|
| <b>Airport</b>   | <b>Terminal Pax (000s)</b> | <b>Opex (£m)</b> | <b>Opex per Pax</b> |
| Durham Tees  | 278                        | £13.9            | £50.00              |
| Humberside   | 318                        | £9.0             | £28.30              |
| Exeter   | 790                        | £16.6            | £21.01              |
| Doncaster  | 804                        | £13.8            | £17.16              |
| Bournemouth  | 815                        | £12.7            | £15.58              |
| Southampton  | 1,802                      | £25.4            | £14.10              |
| Aberdeen   | 3,006                      | £41.0            | £13.64              |
| Jersey   | 1,461                      | £19.1            | £13.07              |
| <b>Guernsey</b>  | <b>902</b>                 | <b>£9.2</b>      | <b>£10.20</b>       |
| Leeds Bradford   | 2,526                      | £24.0            | £9.50               |
| Cardiff  | 1,628                      | £14.9            | £9.15               |
| Source: UK Airports Performance Indicators 2009/2010           |                            |                  |                     |

<sup>7</sup> Based on similar analysis for the City of Derry Airport and discussions with airport management.

3.27 Separating out staff costs as a proportion of operational expenditure shows that Guernsey has a much higher proportion of expenditure on employees than any of the other airports (although Jersey's too is high) as is reflected in **Table 3.6**. This may to some degree result from some services being supplied to the Airport by the States, thus making the proportion of labour costs higher than it would otherwise be. Conversely, bringing some of these services in-house would increase employment costs. The high staff costs could also arise from the fact that the Airport supplies some operational services, such as the Met Office, as a community service for the benefit of the wider island as well as supporting a wider ATC function. Although the cost of this community Met Office service is recovered by Guernsey Airport, it would not normally be shown as a direct staff cost by the other airport comparators. It is, therefore, difficult to be sure of the degree to which such comparisons are fair.

**Table 3.6: Staff (Payroll) Costs as a Percentage of Operational Expenditure**

| Airport         | Opex (£m)   | Staff Costs (£000s) | Percent      |
|-----------------|-------------|---------------------|--------------|
| <b>Guernsey</b> | <b>£9.2</b> | <b>£6,032</b>       | <b>65.6%</b> |
| Jersey          | £19.1       | £10,742             | 56.2%        |
| Aberdeen        | £41.0       | £18,394             | 44.9%        |
| Southampton     | £25.4       | £11,364             | 44.7%        |
| Humberside      | £9.0        | £3,960              | 44.0%        |
| Durham Tees     | £13.9       | £5,976              | 43.0%        |
| Exeter          | £16.6       | £7,039              | 42.4%        |
| Bournemouth     | £12.7       | £4,656              | 36.7%        |
| Leeds Bradford  | £24.0       | £6,699              | 27.9%        |
| Doncaster       | £13.8       | £2,815              | 20.4%        |
| Cardiff         | £14.9       | £1,472              | 9.9%         |

Source: UK Airports Performance Indicators 2009/2010

## Commercialisation of Guernsey Airport Operations

---

3.28 An alternative measure is to consider staff costs per employee as an indication of the level of salaries and overheads for each employee at Guernsey compared with the other selected airports. **Table 3.7** shows that Guernsey is high up the list in this case, only exceeded by Jersey and two BAA airports. This may reflect both the inherent problems caused by terms and conditions being set centrally and the inability of management to negotiate flexible and efficient working practices. It is likely also to be a reflection of the higher cost of living on Guernsey. Over time, it might be expected that a commercialised airport operation could secure some reduction in employment costs but, more likely, the short to medium term savings would come through improving productivity, enabling more to be delivered with the same resources.

| <b>Table 3.7: Staff Costs per Employee</b>           |              |                            |                             |
|--|--------------|----------------------------|-----------------------------|
| <b>Airport</b>                                       | <b>E'ees</b> | <b>Staff Costs (£000s)</b> | <b>Staff Costs per e'ee</b> |
| Aberdeen   | 242          | £18,394                    | £76,008                     |
| Southampton  | 171          | £11,364                    | £66,456                     |
| Jersey   | 190          | £10,742                    | £56,537                     |
| <b>Guernsey</b>                                      | <b>116</b>   | <b>£6,032</b>              | <b>£52,000</b>              |
| Durham Tees  | 125          | £5,976                     | £47,808                     |
| Leeds Bradford                                       | 162          | £6,699                     | £41,352                     |
| Bournemouth  | 129          | £4,656                     | £36,093                     |
| Doncaster  | 88           | £2,815                     | £31,989                     |
| Cardiff  | 48           | £1,472                     | £30,667                     |
| Humberside   | 142          | £3,960                     | £27,887                     |
| Exeter   | 258          | £7,039                     | £27,283                     |
| Source: UK Airports Performance Indicators 2009/2010 |              |                            |                             |

3.29 However, it remains something of a paradox that staff costs per employee are high, whilst overall operational expenditure is low. This can only be explained by the extent to which services are carried out by other parts of the States civil service or not carried out at all, such as marketing functions.

### Base Case

- 3.30 Currently, the Airport is targeted with achieving a 5% operating margin, although it has struggled to do so in recent years. Until 2010, any surpluses were paid into the Ports Holding Account by way of repayment of past loans drawn from this holding account. From 2010, the Ports Holding Account has been consolidated into the States' budget.
- 3.31 We set out in **Table 3.8** (and graphically in **Figure 3.1**) a 'Base Case' analysis in current (nominal) prices of Guernsey Airport's income and expenditure from 2007 to 2018. The timeframe of 2018 has been chosen as it would mark the end of a five year period after any potential change of commercial status, which would be likely to take place in 2013 if at all. This data has been derived from the published accounts for the years 2007 to 2010, and combined with the Airport's own budgets which cover the period from 2011 to 2016 and which we have extrapolated to 2018. In most cases, costs and revenues have simply been inflated at 3% per annum from 2012 on the assumption that traffic remains constant at 900,000 passengers per year. Some budgets have been frozen where considered possible.

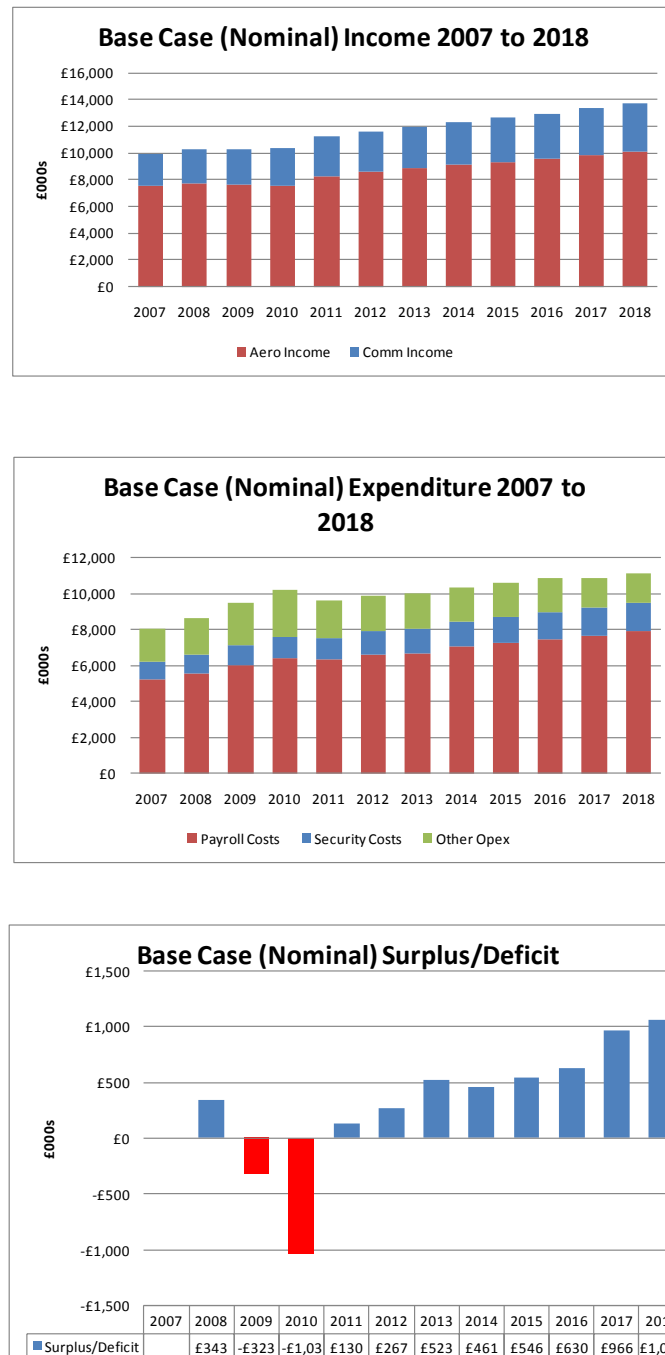
## Commercialisation of Guernsey Airport Operations

**Table 3.8: Guernsey Airport Actual and Projected  
(Base Case, Nominal Prices)**

| Guernsey Airport - Historical & Projected Base Case<br>(based on published accounts and GCI budgets)<br>(£000s) Current (Nominal) Prices  |   | 2007    | 2008    | 2009    | 2010    | 2011    | 2012    | 2013    | 2014    | 2015    | 2016    | 2017    | 2018    |
|---|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| <b>INCOME</b>   |   | Note    |         |         |         |         |         |         |         |         |         |         |         |
| <b>Aeronautical Income</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Aeronautical (Traffic Receipts)   | 1 | £5,759  | £5,842  | £5,803  | £5,746  | £6,150  | £6,300  | £6,500  | £6,700  | £6,900  | £7,100  | £7,313  | £7,532  |
| Security Charges  | 2 | £983    | £1,040  | £1,026  | £1,044  | £1,100  | £1,280  | £1,380  | £1,420  | £1,465  | £1,510  | £1,555  | £1,602  |
| Airport Development Charge  |   | £794    | £811    | £804    | £778    | £802    | £805    | £810    | £810    | £810    | £810    | £810    | £810    |
| Security & Aldemey Adjustment   | 3 |         |         |         |         | £231    | £180    | £160    | £165    | £170    | £175    | £180    | £186    |
| <b>Total Aeronautical Income</b>  |   | £7,536  | £7,693  | £7,633  | £7,568  | £8,283  | £8,565  | £8,850  | £9,095  | £9,345  | £9,595  | £9,859  | £10,130 |
| <b>Commercial Income</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Advertising/Picketing/Sundries  |   | £323    | £377    | £406    | £409    | £435    | £453    | £461    | £469    | £477    | £482    | £496    | £511    |
| Car Park Income   |   | £470    | £511    | £525    | £567    | £750    | £710    | £732    | £754    | £756    | £758    | £781    | £804    |
| Rents   |   | £1,573  | £1,663  | £1,749  | £1,813  | £1,750  | £1,900  | £1,960  | £2,015  | £2,075  | £2,135  | £2,199  | £2,265  |
| <b>Total Commercial Income</b>  |   | £2,366  | £2,551  | £2,680  | £2,789  | £2,935  | £3,063  | £3,153  | £3,238  | £3,308  | £3,375  | £3,476  | £3,581  |
| <b>Total Income</b>   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Total Operating Income  |   | £9,902  | £10,244 | £10,313 | £10,357 | £11,218 | £11,628 | £12,003 | £12,333 | £12,653 | £12,970 | £13,335 | £13,711 |
| <b>EXPENDITURE</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| <b>Staff Costs (Payroll)</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Payroll Costs   |   | £5,225  | £5,533  | £6,032  | £6,412  | £6,352  | £6,606  | £6,676  | £7,032  | £7,238  | £7,430  | £7,653  | £7,882  |
| Payroll Costs as % of total opex  |   | 66.0%   | 65.1%   | 65.5%   | 64.8%   | 66.2%   | 67.0%   | 66.9%   | 67.8%   | 68.2%   | 68.5%   | 70.4%   | 70.7%   |
| <b>Security Contract Costs</b>  | 4 | £988    | £1,043  | £1,094  | £1,191  | £1,176  | £1,300  | £1,375  | £1,415  | £1,460  | £1,505  | £1,550  | £1,597  |
| <b>Other Opex</b>   | 5 | £1,812  | £2,063  | £2,373  | £2,606  | £2,060  | £1,955  | £1,929  | £1,925  | £1,909  | £1,905  | £1,665  | £1,665  |
| (minus) Other Recoveries (Met & Fuel)   | 6 | £109    | £146    | £287    | £307    |         |         |         |         |         |         |         |         |
| <b>Total Expenditure</b>  |   | £7,916  | £8,493  | £9,212  | £9,902  | £9,588  | £9,861  | £9,980  | £10,372 | £10,607 | £10,840 | £10,868 | £11,144 |
| <b>EBITDA</b>   |   | £1,986  | £1,751  | £1,101  | £455    | £1,630  | £1,767  | £2,023  | £1,961  | £2,046  | £2,130  | £2,467  | £2,566  |
| <b>Depreciation</b>   |   |         | £1,408  | £1,424  | £1,492  | £1,500  | £1,500  | £1,500  | £1,500  | £1,500  | £1,500  | £1,501  | £1,502  |
| <b>Surplus/Deficit</b>  |   |         | £343    | £-323   | £-1,037 | £130    | £267    | £523    | £461    | £546    | £630    | £966    | £1,064  |
| <b>Airport Capex</b>  | 7 |         | £1,270  | £1,351  | £655    | £4,023  | £2,728  | £650    | £220    | £195    | £20     |         |         |
| <b>Cash Flow (assuming no debt)</b>   |   |         | £-927   | £-1,674 | £-1,692 | £-3,893 | £-2,461 | £-127   | £241    | £351    | £610    |         |         |
| <b>(Runway Project assumed separate)</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| <b>RATIOS &amp; ASSUMPTIONS</b>   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Terminal Pax  |   | 886,736 | 914,742 | 902,040 | 885,945 | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 |
| Aero Income per Pax   |   | £8.50   | £8.41   | £8.46   | £8.54   | £9.20   | £9.52   | £9.83   | £10.11  | £10.38  | £10.66  | £10.95  | £11.26  |
| Growth in Aero Income per Pax   |   |         | -1.0%   | 0.6%    | 0.9%    | 7.7%    | 3.4%    | 3.3%    | 2.8%    | 2.7%    | 2.7%    | 2.7%    | 2.8%    |
| Inflation   |   |         |         |         |         |         | 3.0%    | 3.0%    | 3.0%    | 3.0%    | 3.0%    | 3.0%    | 3.0%    |
| Commercial Income per Pax   |   | £2.67   | £2.79   | £2.97   | £3.15   | £3.26   | £3.40   | £3.50   | £3.60   | £3.68   | £3.75   | £3.86   | £3.98   |
| Growth in Commercial Income per Pax   |   |         | 4.5%    | 6.5%    | 6.0%    | 3.6%    | 4.4%    | 2.9%    | 2.7%    | 2.2%    | 2.0%    | 3.0%    | 3.0%    |
| Growth in Car Parks Income  |   |         | 8.7%    | 2.7%    | 8.0%    | 32.3%   | -5.3%   | 3.1%    | 3.0%    | 0.3%    | 0.3%    | 3.0%    | 3.0%    |
| Growth in Rents Income  |   |         | 5.7%    | 5.2%    | 3.7%    | -3.5%   | 8.6%    | 3.2%    | 2.8%    | 3.0%    | 2.9%    | 3.0%    | 3.0%    |
| Number of Employees   |   |         |         | 116     | 114     |         |         |         |         |         |         |         |         |
| Payroll Costs   |   | £5,225  | £5,533  | £6,032  | £6,412  | £6,352  | £6,606  | £6,676  | £7,032  | £7,238  | £7,430  | £7,653  | £7,882  |
| Staff Costs per employee  |   |         |         | £52.00  | £56.25  |         |         |         |         |         |         |         |         |
| Payroll costs as percentage of opex   |   | 66.0%   | 65.1%   | 65.5%   | 64.8%   | 66.2%   | 67.0%   | 66.9%   | 67.8%   | 68.2%   | 68.5%   | 70.4%   | 70.7%   |
| <b>Notes</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 1 Aeronautical Income is shown net of discounts.  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 2 Netted off against costs in published accounts but shown separately here  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 3 Adjustment to allow for surplus/deficit on security and Aldemey recovery, which are separated in budgets from 2011.   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 4 Netted off against income in published accounts but shown separately here   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 5 Other Opex' between 2007 and 2010 is shown net of security costs, but includes costs of Met Office & Fuel   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 6 Recoveries for Met Office & Fuel between 2007 and 2010 have been subtracted from expenditure to make the figures consistent with the budgets going forward, which are shown net of these recoveries |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 7 Projected capex taken from GCI Capital Programme  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| NB: Projections up to 2016 are taken from the Airport's budgets. Projections for 2017 and 2018 are extrapolated.  |   |         |         |         |         |         |         |         |         |         |         |         |         |

**Source: York Aviation Analysis of Guernsey Airport Published Accounts and Budgets**

**Figure 3.1: Guernsey Airport Actual and Projected  
(Base Case, Nominal Prices)**



Source: York Aviation Analysis of Guernsey Airport Published Accounts and Budgets



## Commercialisation of Guernsey Airport Operations

---

3.32 We believe that the data presented in Table 3.8 is consistent in terms of the historical perspective derived from the published accounts and the future perspective derived from the budgets. However, a number of adjustments have had to be made to achieve this. For example, the published accounts treat expenditure and recoveries separately, whereas in the budgets some recoveries, but not all, are netted off against the expenditure. In order to ensure a like-for-like comparison, we have shown security costs and income separately, subtracted the other relevant recoveries figure from the operating expenditure figure in the historical published accounts up to 2010, and adjusted the income to allow for the Alderney recharge.

3.33 The term 'Recoveries' refers to:

- Security Charges (£1,191,000 in 2010 and levied on the airlines), which are netted off against security costs in the budget projections;
- the MET Office (£105,000 in 2010), which is treated as a 'service to the community' because the Airport provides a meteorological information service to the wider island;
- the Airside Fuel Facility (£50,000 in 2010) through which the Airport sells vehicle diesel fuel to airside operators;
- the Alderney Airport Administration Charge (£152,000 in 2010) which is recovered from Alderney Airport for administration services provided by Guernsey Airport.

3.34 We have presented the security income and costs separately, as is usual practice at other airports. However, after adjusting for the other recoveries, the 'Surplus/Deficit' line as presented in Table 3.8 remains consistent with the surplus or deficit shown in both the published accounts and the budgets. Beyond 2016, the surplus potentially grows as extrapolating the assumptions forwards results in expenditure growing more slowly than revenue.

- 3.35 Aeronautical income is shown net of the PSD funded runway rebates for new routes but without taking account of any discounts funded by C&E under the Air Route Discounts scheme<sup>8</sup>. This is important to note because in any alternative scenario in which the Airport were to become completely free-standing and this support payment discontinued, the subsidy would become an additional cost to the Airport if the charges to the airlines were to remain at current levels. This has implications for projected revenues, which we consider further later in this section. The subsidy from C&E will amount to £796,000 in 2010/11 and has been projected forward at this level in real terms to 2018. This figure needs to be considered in the context of marketing budgets, which would be a common feature at commercialised airports.
- 3.36 We have shown the surplus/deficit after depreciation but before interest and tax and this indicates that in the Base Case the Airport was expected to be in surplus from 2011, subject to the budgets being achievable. The surplus is expected to rise in the Base Case to £1,064,000 in nominal terms by 2018.
- 3.37 The accounts show an operating deficit of £1.037 million in 2010, whereas the budgets for 2011 projected an operating surplus of approximately £130,000, although the outturn figure in the budgets is less than this at £6,600. This improved position has been achieved by a reduction in expenditure and an increase in income. In respect of expenditure, the Airport was affected by some exceptional expenditure in 2010 in the form of PFOS pollution control<sup>9</sup>, fire appliance engine/drive train failure, and increased security contract costs resulting from revised regulations. The costs associated with PFOS are predicted to reduce in 2011 and the work on the fire appliance was completed at the end of 2010.
- 3.38 In respect of income, the Airport is expecting passenger numbers to return to normal levels (900,000) in 2011, which will boost aeronautical income. Many airports, including Guernsey, were badly affected by ash restrictions and adverse weather (snow and ice) in 2010, all of which had a negative effect on income. However, the Airport has increased car parking rates from July 2011 and rents have increased due to a steady increase in duty free sales.

---

<sup>8</sup> i.e. the airlines actually pay less than the amounts shown with the balance funded by C&E.

<sup>9</sup> PFOS is a chemical used in foam for fire-fighting.

## Commercialisation of Guernsey Airport Operations

---

- 3.39 We have also added the historical and projected annual capital expenditure, reflecting the ongoing maintenance and replacement costs. It is important to note, however, that these figures exclude any runway-associated expenditure. Assuming that the ongoing maintenance and replacement costs are funded from internal resources without additional debt, this gives an estimated cash flow projection which is positive from 2014. We do not have any information about projected capital expenditure beyond 2016 but we would expect ongoing maintenance and replacement capex to be higher, for example, than the level indicated for 2016, with an ongoing liability more likely to be at least £500,000 per annum. This suggests that the Airport may not attain a cash flow positive position until beyond 2017.
- 3.40 **Table 3.9** and **Figure 3.2** show the same Base Case figures in real terms (i.e. constant 2011 prices) and this shows a surplus of £787,000 by 2018 and a positive cash flow from 2014. However, it is interesting to note that both the aeronautical income per passenger and the commercial income per passenger remains virtually static in real terms, implying very little planned improvement in real terms revenue potential or productivity in this Base Case scenario.

## Conclusion

- 3.41 Our examination of the current position of Guernsey Airport has highlighted the extent to which the Airport is subject to the influence of many different actors. The lack of autonomy is evident. For example, the surplus could be wiped out if the Airport was required to fund the route discount its scheme itself.
- 3.42 Benchmarking the Airport's performance against that of other similar UK airports is problematic because true like-for-like comparison is not always easy to achieve. However, even making allowance where possible for the particular circumstances at Guernsey, our benchmarking exercise suggests that there is scope for improved commercial performance.
- 3.43 Projecting the financial performance of the Airport forward and comparing it with past performance has proved to be a difficult exercise because of the different way in which the historical accounts and the future budgets are drawn up, and the way in which airline discounts are treated. This in itself draws attention to the problems with the current financial structure of the Airport and makes forward business planning more difficult.

## Commercialisation of Guernsey Airport Operations

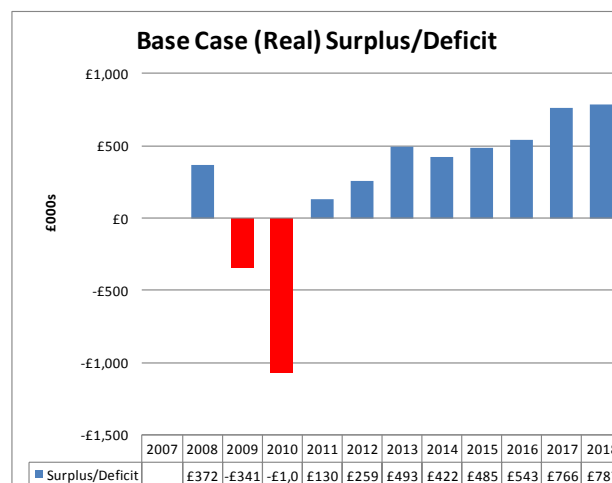
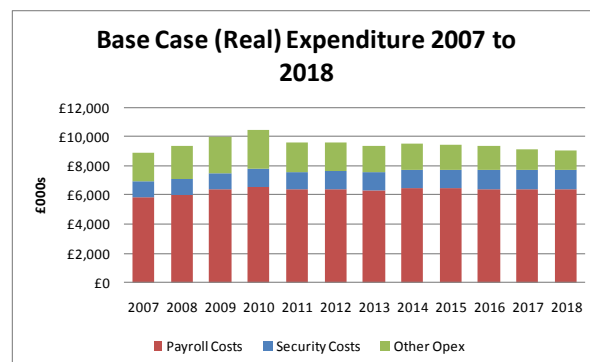
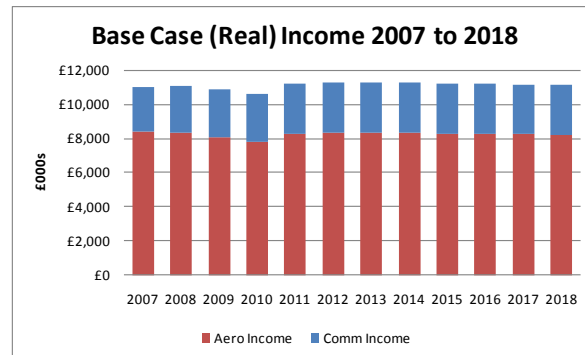
Table 3.9: Guernsey Airport Actual and Projected  
(Base Case, Real Prices)

| Guernsey Airport - Historical & Projected Base Case<br>(based on published accounts and GCI budgets)<br>(£000s) Constant 2011 (Real) Prices   |   | 2007    | 2008    | 2009    | 2010    | 2011    | 2012    | 2013    | 2014    | 2015    | 2016    | 2017    | 2018    |
|---|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| <b>INCOME</b>   |   | Note    |         |         |         |         |         |         |         |         |         |         |         |
| <b>Aeronautical Income</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Aeronautical (Traffic Receipts)   | 1 | £6,407  | £6,328  | £6,121  | £5,901  | £6,150  | £6,117  | £6,127  | £6,131  | £6,131  | £6,125  | £6,125  | £6,125  |
| Security Charges  | 2 | £1,094  | £1,127  | £1,082  | £1,072  | £1,100  | £1,243  | £1,301  | £1,300  | £1,302  | £1,303  | £1,303  | £1,303  |
| Airport Development Charge  |   | £883    | £878    | £848    | £799    | £802    | £782    | £764    | £741    | £720    | £699    | £678    | £659    |
| Security & Alderney Adjustment  | 3 |         |         |         |         | £231    | £175    | £151    | £151    | £151    | £151    | £151    | £151    |
| <b>Total Aeronautical Income</b>  |   | £8,383  | £8,333  | £8,051  | £7,772  | £8,283  | £8,316  | £8,342  | £8,323  | £8,303  | £8,277  | £8,256  | £8,237  |
| <b>Commercial Income</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Advertising/Picketing/Sundries  |   | £359    | £408    | £428    | £420    | £435    | £440    | £435    | £429    | £424    | £416    | £416    | £416    |
| Car Park Income   |   | £523    | £554    | £554    | £582    | £750    | £689    | £690    | £690    | £672    | £654    | £654    | £654    |
| Rents   |   | £1,750  | £1,801  | £1,845  | £1,862  | £1,750  | £1,845  | £1,847  | £1,844  | £1,844  | £1,842  | £1,842  | £1,842  |
| <b>Total Commercial Income</b>  |   | £2,632  | £2,763  | £2,827  | £2,864  | £2,935  | £2,974  | £2,972  | £2,963  | £2,939  | £2,911  | £2,911  | £2,911  |
| <b>Total Income</b>   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Total Operating Income  |   | £11,016 | £11,096 | £10,877 | £10,637 | £11,218 | £11,289 | £11,314 | £11,286 | £11,242 | £11,188 | £11,168 | £11,148 |
| <b>EXPENDITURE</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| <b>Staff Costs (Payroll)</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Payroll Costs   |   | £5,813  | £5,993  | £6,362  | £6,585  | £6,352  | £6,414  | £6,293  | £6,435  | £6,431  | £6,409  | £6,409  | £6,409  |
| Payroll costs as % of total opex  |   | 66.0%   | 65.1%   | 65.5%   | 64.8%   | 66.2%   | 67.0%   | 66.9%   | 67.8%   | 68.2%   | 68.5%   | 70.4%   | 70.7%   |
| <b>Security Contract Costs</b>  | 4 | £1,099  | £1,130  | £1,154  | £1,223  | £1,176  | £1,262  | £1,296  | £1,295  | £1,297  | £1,298  | £1,298  | £1,298  |
| <b>Other Opex</b>   | 5 | £2,016  | £2,235  | £2,503  | £2,676  | £2,060  | £1,898  | £1,818  | £1,762  | £1,696  | £1,643  | £1,394  | £1,354  |
| (minus) Other Recoveries (Met & Fuel)   | 6 | £121    | £158    | £303    | £315    |         |         |         |         |         |         |         |         |
| <b>Total Expenditure</b>  |   | £8,806  | £9,200  | £9,716  | £10,169 | £9,588  | £9,574  | £9,407  | £9,492  | £9,424  | £9,351  | £9,102  | £9,061  |
| <b>EBITDA</b>   |   | £2,209  | £1,897  | £1,161  | £467    | £1,630  | £1,716  | £1,907  | £1,795  | £1,818  | £1,837  | £2,066  | £2,087  |
| <b>Depreciation</b>   |   |         | £1,525  | £1,502  | £1,532  | £1,500  | £1,456  | £1,414  | £1,373  | £1,333  | £1,294  | £1,300  | £1,300  |
| <b>Surplus/Deficit</b>  |   |         | £372    | £341    | £1,065  | £130    | £259    | £493    | £422    | £485    | £543    | £766    | £787    |
| <b>Airport Capex</b>  | 7 |         | £1,376  | £1,425  | £673    | £0      | £2,810  | £690    | £240    | £173    | £17     |         |         |
| <b>Cash Flow (assuming no debt)</b>   |   |         | £1,004  | £1,766  | £1,738  | £130    | £2,551  | £197    | £181    | £312    | £526    |         |         |
| <b>(Runway Project assumed separate)</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| <b>RATIOS &amp; ASSUMPTIONS</b>   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Terminal Pax  |   | 886,736 | 914,742 | 902,040 | 885,945 | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 |
| Aero Income per Pax   |   | £9.45   | £9.11   | £8.93   | £8.77   | £9.20   | £9.24   | £9.27   | £9.25   | £9.23   | £9.20   | £9.17   | £9.15   |
| Growth in Aero Income per Pax   |   |         | -3.6%   | -2.0%   | -1.7%   | 4.9%    | 0.4%    | 0.3%    | -0.2%   | -0.2%   | -0.3%   | -0.2%   | -0.2%   |
| Inflation (historical Guernsey RPIX for June, and 3% future)  |   | 1.039   | 1.046   | 1.029   | 1.027   |         | 1.03    | 1.03    | 1.03    | 1.03    | 1.03    | 1.03    | 1.03    |
| Compounded Inflation  |   | 1.112   | 1.083   | 1.055   | 1.027   |         | 1.03    | 1.06    | 1.09    | 1.13    | 1.16    | 1.19    | 1.23    |
| Commercial Income per Pax   |   | £2.97   | £3.02   | £3.13   | £3.23   | £3.26   | £3.30   | £3.30   | £3.29   | £3.27   | £3.23   | £3.23   | £3.23   |
| Growth in Commercial Income per Pax   |   |         | 1.8%    | 3.7%    | 3.2%    | 0.9%    | 1.3%    | -0.1%   | -0.3%   | -0.8%   | -0.9%   | 0.0%    | 0.0%    |
| Growth in Car Parks Income  |   |         | 5.9%    | 0.0%    | 5.2%    | 28.8%   | -8.1%   | 0.1%    | 0.0%    | -2.7%   | -2.7%   | 0.0%    | 0.0%    |
| Growth in Rents Income  |   |         | 2.9%    | 2.4%    | 0.9%    | -6.0%   | 5.4%    | 0.2%    | -0.2%   | 0.0%    | -0.1%   | 0.0%    | 0.0%    |
| Number of Employees   |   |         |         | 116     | 114     |         |         |         |         |         |         |         |         |
| Payroll Costs   |   | £5,813  | £5,993  | £6,362  | £6,585  | £6,352  | £6,414  | £6,293  | £6,435  | £6,431  | £6,409  | £6,409  | £6,409  |
| Staff Costs per employee  |   |         |         | £54.85  | £57.76  |         |         |         |         |         |         |         |         |
| Payroll costs as percentage of opex   |   | 66.0%   | 65.1%   | 65.5%   | 64.8%   | 66.2%   | 67.0%   | 66.9%   | 67.8%   | 68.2%   | 68.5%   | 70.4%   | 70.7%   |
| <b>Notes</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 1 Aeronautical Income is shown net of discounts.  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 2 Netted off against costs in published accounts but shown separately here  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 3 Adjustment to allow for surplus/deficit on security and Alderney recovery, which are separated in budgets from 2011.  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 4 Netted off against income in published accounts but shown separately here   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 5 Other Opex between 2007 and 2010 is shown net of security costs, but includes costs of Met Office & Fuel  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 6 Recoveries for Met Office & Fuel between 2007 and 2010 have been subtracted from expenditure to make the figures consistent with the budgets going forward, which are shown net of these recoveries |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 7 Projected capex taken from GCI Capital Programme  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| NB: Projections up to 2016 are taken from the Airport's budgets. Projections for 2017 and 2018 are extrapolated.  |   |         |         |         |         |         |         |         |         |         |         |         |         |

Source: York Aviation Analysis of Guernsey Airport Published Accounts and Budgets

## Commercialisation of Guernsey Airport Operations

**Figure 3.2: Guernsey Airport Actual and Projected (Base Case, Real Prices)**



Source: York Aviation Analysis of Guernsey Airport Published Accounts and Budgets

- 3.44 However, our Base Case financial projections (i.e. assuming status quo) indicate that the Airport is expected to generate a small surplus in 2011 and could be achieving a surplus of £1.064 million (or £787,000 in real terms) by 2018. However, this will fall short of the sums likely to be needed to contribute to the capital costs of the runway works.
- 3.45 Although the current financial projections show the Airport reverting to making a surplus, compared to the current losses, the Airport is unlikely to generate sufficient surpluses to fund even its ongoing maintenance capex, let alone making a contribution to the cost of the runway and airfield rehabilitation works.
- 3.46 We consider in the next section, an alternative financial projection if a more commercial approach was adopted.

## 4 FINANCIAL EFFECTS OF COMMERCIALISATION

### Potential Commercialised Scenario

- 4.1 We have also considered in **Table 4.1** (shown graphically in **Figure 4.1**) a potential Alternative Scenario (shown in real, constant prices) in which the Airport is treated as a free-standing entity and therefore may have scope for greater efficiency and commercial revenue generation.
- 4.2 The opportunities for cost savings are likely to be greatest in the area of staff (payroll) costs and we have already noted in Table 3.6 that staff costs as a percentage of opex at 65.6% is much higher at Guernsey than at any of the other comparator airports, all of which are below 50%. However, it may prove difficult to significantly reduce these costs in practice, given that Security and Cleaning are already outsourced and the other area of significant staff cost (the Fire Service) may prove difficult to reduce. However, there may be some scope for outsourcing ATC or the Met Office services. For the purposes of illustration, therefore, we have made an assumption that equivalent payroll savings of around £0.5 million in real terms could be achieved by 2018, although such savings may effectively come from productivity improvements rather than from a reduction in actual staff numbers.
- 4.3 There may also be potential opportunity to increase commercial revenue generation, particularly in the area of car parking and rents. Again, we have not assessed the practicality of achieving such revenue increases but, for the purposes of illustration, have assumed that commercial revenue per passenger might rise to a level of around £5.00 in real terms by 2018, which would reflect the levels of income currently being achieved by airports such as Leeds-Bradford and Cardiff, as set out in Table 3.4.

## Commercialisation of Guernsey Airport Operations

Table 4.1: Guernsey Airport Actual and Projected  
(Alternative Case, Real Prices)

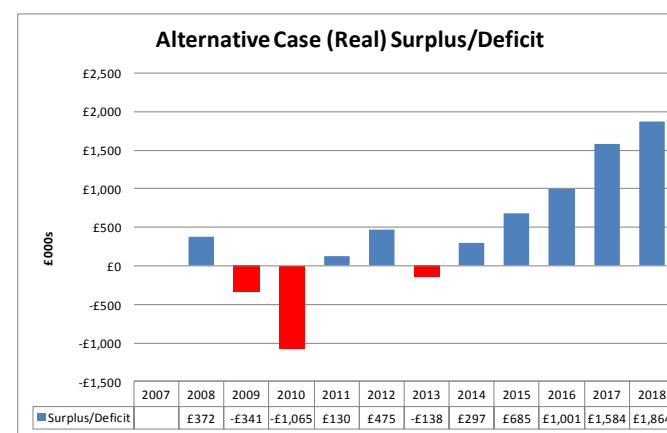
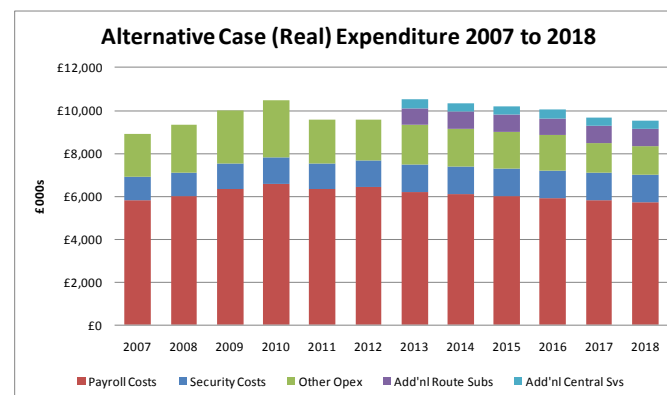
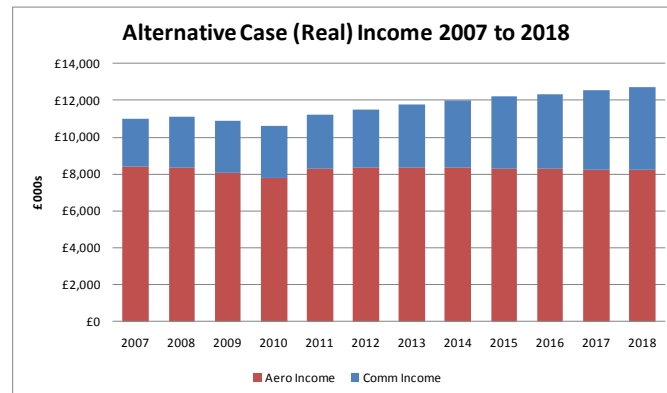
| Guernsey Airport - Historical & Projected Alternative Case   |   | 2007    | 2008    | 2009    | 2010    | 2011    | 2012    | 2013    | 2014    | 2015    | 2016    | 2017    | 2018    |
|--|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| (based on published accounts and GCI budgets)  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| (£000s) Constant 2011 (Real) Prices  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| <b>INCOME</b>  |   | Note    |         |         |         |         |         |         |         |         |         |         |         |
| <b>Aeronautical Income</b>   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Aeronautical (Traffic Receipts)  | 1 | £6,407  | £6,328  | £6,121  | £5,901  | £6,150  | £6,117  | £6,127  | £6,131  | £6,131  | £6,125  | £6,125  | £6,125  |
| Security Charges   | 2 | £1,094  | £1,127  | £1,082  | £1,072  | £1,100  | £1,243  | £1,301  | £1,300  | £1,302  | £1,303  | £1,303  | £1,303  |
| Airport Development Charge   |   | £883    | £878    | £848    | £799    | £802    | £782    | £764    | £741    | £720    | £699    | £678    | £659    |
| Security & Alderney Adjustment   | 3 |         |         |         |         | £231    | £175    | £151    | £151    | £151    | £151    | £151    | £151    |
| <b>Total Aeronautical Income</b>   |   | £8,383  | £8,333  | £8,051  | £7,772  | £8,283  | £8,316  | £8,342  | £8,323  | £8,303  | £8,277  | £8,256  | £8,237  |
| <b>Commercial Income</b>   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Advertising/Picketing/Sundries   |   | £359    | £408    | £428    | £420    | £435    | £440    | £435    | £429    | £424    | £416    | £416    | £416    |
| Car Park Income  |   | £523    | £554    | £554    | £582    | £750    | £750    | £760    | £770    | £780    | £790    | £800    | £810    |
| Rents  |   | £1,750  | £1,801  | £1,845  | £1,862  | £1,750  | £2,000  | £2,250  | £2,500  | £2,700  | £2,850  | £3,100  | £3,250  |
| <b>Total Commercial Income</b>   |   | £2,632  | £2,763  | £2,827  | £2,864  | £2,935  | £3,190  | £3,445  | £3,699  | £3,904  | £4,056  | £4,316  | £4,476  |
| <b>Total Income</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Total Operating Income   |   | £11,016 | £11,096 | £10,877 | £10,637 | £11,218 | £11,505 | £11,787 | £12,022 | £12,207 | £12,333 | £12,572 | £12,712 |
| <b>EXPENDITURE</b>   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| <b>Staff Costs (Payroll)</b>   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Payroll Costs  |   | £5,813  | £5,993  | £6,362  | £6,585  | £6,352  | £6,414  | £6,200  | £6,100  | £6,000  | £5,900  | £5,800  | £5,700  |
| Payroll Costs as % of total opex   |   | 66.0%   | 65.1%   | 65.5%   | 64.8%   | 66.2%   | 67.0%   | 59.0%   | 58.9%   | 58.9%   | 58.8%   | 59.9%   | 59.7%   |
| Security Contract Costs  | 4 | £1,099  | £1,130  | £1,154  | £1,223  | £1,176  | £1,262  | £1,296  | £1,295  | £1,297  | £1,298  | £1,298  | £1,298  |
| Other Opex   | 5 | £2,016  | £2,235  | £2,503  | £2,676  | £2,060  | £1,898  | £1,818  | £1,762  | £1,696  | £1,643  | £1,394  | £1,354  |
| (minus) Other Recoveries (Met & Fuel)  | 6 | £121    | £158    | £303    | £315    |         |         |         |         |         |         |         |         |
| Additional Cost of Route Subsidies   |   |         |         |         |         |         |         | £796    | £796    | £796    | £796    | £796    | £796    |
| Additional Cost of Centralised Services  |   |         |         |         |         |         |         | £400    | £400    | £400    | £400    | £400    | £400    |
| <b>Total Expenditure</b>   |   | £8,806  | £9,200  | £9,716  | £10,169 | £9,588  | £9,574  | £10,510 | £10,353 | £10,189 | £10,037 | £9,689  | £9,548  |
| <b>EBITDA</b>  |   | £2,209  | £1,897  | £1,161  | £467    | £1,630  | £1,932  | £1,276  | £1,670  | £2,017  | £2,295  | £2,884  | £3,164  |
| <b>Depreciation</b>  |   |         | £1,525  | £1,502  | £1,532  | £1,500  | £1,456  | £1,414  | £1,373  | £1,333  | £1,294  | £1,300  | £1,300  |
| <b>Surplus/Deficit</b>   |   | £372    | £341    | £1,065  | £130    | £475    | £138    | £297    | £685    | £1,001  | £1,584  | £1,864  | £1,864  |
| <b>Airport Capex</b>   | 7 | £1,376  | £1,425  | £673    | £0      | £2,810  | £690    | £240    | £173    | £17     |         |         |         |
| <b>Cash Flow (assuming no debt)</b>  |   | £1,004  | £1,766  | £1,738  | £130    | £2,335  | £827    | £57     | £511    | £984    |         |         |         |
| <b>(Runway Project assumed separate)</b>   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| <b>RATIOS &amp; ASSUMPTIONS</b>  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Terminal Pax   |   | 886,736 | 914,742 | 902,040 | 885,945 | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 | 900,000 |
| Aero Income per Pax  |   | £9.45   | £9.11   | £8.93   | £8.77   | £9.20   | £9.24   | £9.27   | £9.25   | £9.23   | £9.20   | £9.17   | £9.15   |
| Growth in Aero Income per Pax  |   |         | -3.6%   | -2.0%   | -1.7%   | 4.9%    | 0.4%    | 0.3%    | -0.2%   | -0.2%   | -0.3%   | -0.2%   | -0.2%   |
| Inflation (historical Guernsey RPIX for June, and 3% future)   |   | 1.039   | 1.046   | 1.029   | 1.027   |         | 1.03    | 1.03    | 1.03    | 1.03    | 1.03    | 1.03    | 1.03    |
| Compounded Inflation   |   | 1.112   | 1.083   | 1.055   | 1.027   |         | 1.03    | 1.06    | 1.09    | 1.13    | 1.16    | 1.19    | 1.23    |
| Commercial Income per Pax  |   | £2.97   | £3.02   | £3.13   | £3.23   | £3.26   | £3.54   | £3.83   | £4.11   | £4.34   | £4.51   | £4.80   | £4.97   |
| Growth in Commercial Income per Pax  |   |         | 1.8%    | 3.7%    | 3.2%    | 0.9%    | 8.7%    | 8.0%    | 7.4%    | 5.5%    | 3.9%    | 6.4%    | 3.7%    |
| Growth in Car Parks Income   |   |         | 5.9%    | 0.0%    | 5.2%    | 28.8%   | 0.0%    | 1.3%    | 1.3%    | 1.3%    | 1.3%    | 1.3%    | 1.3%    |
| Growth in Rents Income   |   |         | 2.9%    | 2.4%    | 0.9%    | -6.0%   | 14.3%   | 12.5%   | 11.1%   | 8.0%    | 5.6%    | 8.8%    | 4.8%    |
| Number of Employees  |   |         |         | 116     | 114     |         |         |         |         |         |         |         |         |
| Payroll Costs  |   | £5,813  | £5,993  | £6,362  | £6,585  | £6,352  | £6,414  | £6,200  | £6,100  | £6,000  | £5,900  | £5,800  | £5,700  |
| Staff Costs per employee   |   |         |         | £54.85  | £57.76  |         |         |         |         |         |         |         |         |
| Payroll costs as percentage of opex  |   | 66.0%   | 65.1%   | 65.5%   | 64.8%   | 66.2%   | 67.0%   | 59.0%   | 58.9%   | 58.9%   | 58.8%   | 59.9%   | 59.7%   |
| <b>Notes</b>   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 1 Aeronautical Income is shown net of discounts.   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 2 Netted off against costs in published accounts but shown separately here   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 3 Adjustment to allow for surplus/deficit on security and Alderney recovery, which are separated in budgets from 2011. |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 4 Netted off against income in published accounts but shown separately here  |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 5 Other Opex' between 2007 and 2010 is shown net of security costs, but includes costs of Met Office & Fuel            |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 6 Recoveries for Met Office & Fuel between 2007 and 2010 have been subtracted from expenditure                         |   |         |         |         |         |         |         |         |         |         |         |         |         |
| to make the figures consistent with the budgets going forward, which are shown net of these recoveries                 |   |         |         |         |         |         |         |         |         |         |         |         |         |
| 7 Projected capex taken from GCI Capital Programme   |   |         |         |         |         |         |         |         |         |         |         |         |         |
| NB: Projections up to 2016 are taken from the Airport's budgets. Projections for 2017 and 2018 are extrapolated.       |   |         |         |         |         |         |         |         |         |         |         |         |         |
| Figures highlighted in yellow indicate where changes from the Base Case assumptions have been made.                    |   |         |         |         |         |         |         |         |         |         |         |         |         |

Source: York Aviation Analysis of Guernsey Airport Published Accounts and Budgets



## Commercialisation of Guernsey Airport Operations

**Figure 4.1: Guernsey Airport Actual and Projected (Alternative Case, Real Prices)**



Source: York Aviation Analysis of Guernsey Airport Published Accounts and Budgets

- 4.4 However, under this scenario the Airport may also face areas of additional cost:
- the Air Route Discount subsidy that is currently funded by C&E would have to be funded directly by the Airport in order to maintain airport charges at the present level and thus avoid the prospect of airlines withdrawing services; this subsidy currently amounts to £796,000 and has been assumed to remain the same going forward;
  - we have already referred above to a number of centralised services that are currently provided by the States (such as IT, HR, and Legal Services) but as a free-standing entity the Airport would have to cover these costs directly; the current extent of these costs is not completely clear, but we have estimated these costs along with the costs of some additional staff to drive increase commercial income, to be in the region of £400,000 per annum.
- 4.5 The impact of these assumptions is set out in Table 4.1 where the changes made compared with the Base Case are highlighted in yellow.
- 4.6 Under this Alternative Scenario, the surplus could rise to £1,864,000 in real terms by 2018, with a positive cash flow from 2014, although, as indicated in paragraph 2.37, some allowance needs to be made for ongoing capex requirements, which will delay the attainment of a positive cash flow from Airport operations.

### **Airport Charges and the Effect on Demand**

- 4.7 We have not assumed any real increase in airport charges. However, it is important to recognise that the airlines are not currently paying the full amounts received by the Airport as the total is supported by the Air Route Discount payment from C&E. This used to be paid directly to the airlines but is not reimbursed directly to the Airport. We understand that the future of this discount scheme is under review as part of the Financial Transformation Programme and a decision as to whether to continue with the scheme will be made later this year.

## Commercialisation of Guernsey Airport Operations

---

- 4.8 Should the discounts be withdrawn and the airlines (and their passengers) be charged the full amounts (net of any runway discounts offered by PSD), then this would have similar detrimental effects on passenger volumes as stated in our Update Report on the Implications of Airport Pricing, i.e. the reduction in passengers could be in the range 1% to 4%, although this may not reflect fully decisions by the airlines to withdraw marginal routes or seasonal capacity. This would have wider detrimental impacts for Guernsey, particularly in terms of the tourism sector.
- 4.9 Our analysis in Table 4.1 shows that a commercialised Airport could absorb an equivalent level of marketing/route support costs as that currently funded by C&E. This is on the basis of a fully commercialised approach achieving increased non-aeronautical revenues and lower base operating costs. Should the Airport be required to absorb these costs before having achieved the commercial revenue uplift and cost savings the impact on the Airport finances would be negative through a combination of increased cost and/or lost revenue due to a reduction in flights and passengers.
- 4.10 Flybe has reiterated to us that airport charges on Guernsey remain amongst the highest in its network, even with the discount scheme in place. Blue Islands commented about the lack of a commercial approach to incentivising new route development compared to Jersey. For these reasons, we believe that a commercialised airport would wish to keep a discount scheme in place but may well seek to target it more effectively to maximise benefit. What this does highlight is the current interdependence between different actors which has the effect of influencing the extent to which the Airport can maximise its commercial returns and secure the best possible range of air services to meet the requirements of Guernsey. Commercialising on its own without giving the Airport the ability to control the levers of attracting additional demand would only deliver partial benefits.

### Capex

- 4.11 A major driver of the examination of the options for commercialising the Airport is the experience in gaining approval to proceed with the runway rehabilitation works.

- 4.12 Previously capital expenditure has been funded from the Ports Holding Account. Over the period 2000-2010, the Airport drew approximately £38.4 million from this account (out of total funded capital expenditure of approximately £63.8 million). This included approximately £27 million for the new terminal (being repaid by the Terminal Development Fee) and more general capital expenditure totalling approximately £1 million per annum. It is not clear the extent to which this represents high airfield maintenance costs due to the delays in going ahead with the full runway and airfield rehabilitation programme.
- 4.13 It is already clear that the £80.5 million cost of the runway and airfield rehabilitation programme is having to be largely 'gifted' by the States in recognition of the important role which the Airport plays in the economic and social wellbeing of the Bailiwick. We understand that the question of a more direct contribution from the Airport, by way of increased airport charges, remains in abeyance pending this review of the future of the Airport.
- 4.14 Our analysis would suggest that a commercialised Airport may, beyond 2017, be able to generate sufficient surplus to fund its ongoing maintenance capex requirements but there does not appear to be the headroom to pay back other than a small part of the cost of the runway and airfield rehabilitation programme. Nor would the Airport be able to generate surpluses to fund any future major capital requirements, such as a major refurbishment or extension of the terminal<sup>10</sup> or any future runway extension works, if required.
- 4.15 This suggests that, even under a commercialised regime, the Airport would still be dependent on either borrowing or States' funding of any major capital development requirements. We consider the implications of this for each of the potential commercialisation models in Section 5.

## Conclusions

- 4.16 The Alternative Case financial projections (i.e. assuming the Airport gains some degree of independence) assume that some staff cost savings can be made and commercial income in some areas can be increased. It also allows for increased costs of providing directly for items that are currently funded by other departments of the States. With these changed assumptions, the surplus could rise to £1.864 million in real terms by 2018. This highlights the potential benefits from commercialisation.

---

<sup>10</sup> A detailed evaluation would have to be done at the time to examine the income expected from the passenger growth which would trigger the requirement for additional capital expenditure.

**Commercialisation of Guernsey Airport Operations**

---

- 4.17 However, our analysis indicates that this will not be enough to generate sufficient funds to cover major capital expenditure, which has implications for the choice of potential commercialisation model.

## 5 OPTIONS FOR ANALYSIS

### Context

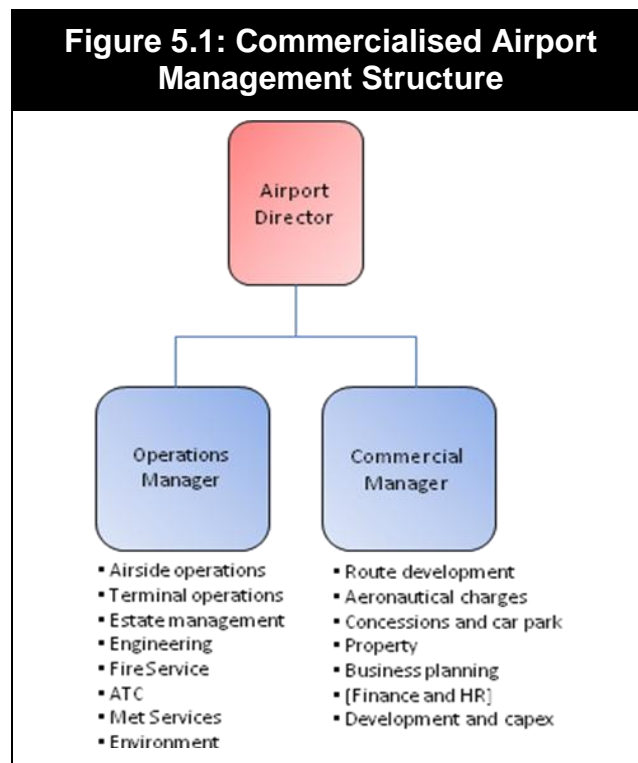
- 5.1 This section describes the options that are available to the States which could improve the commercial effectiveness of the Airport. The options are presented in sets of governance options with increasing levels of structural change. However, it is important to emphasise that structural change does not of itself confer improved commercial performance, rather some of these options might help to unfetter or incentivise a more commercially focussed management team from current constraints.
- 5.2 In this context, we consider:
- '*commercialisation*' to involve the Airport acting as a more commercial entity seeking to optimise profit generation (or minimise loss-making) over the long-term, even if it is wholly publicly-owned;
  - '*corporatisation*' to be the act of incorporating the Airport to be a stand-alone entity (albeit potentially still under States ownership); and
  - '*privatisation*' to involve varying degrees or structures of private ownership or long-term control of the Airport (though it is often taken to mean a situation where private interests have a controlling stake in the equity of a business).
- 5.3 There are multiple layers of governance options within these general terms. It is useful to draw some distinctions between terms. For example, corporatisation does not necessarily involve commercialisation as some countries feature airports that are incorporated as not for profit businesses. However, it is also possible to get bogged down in semantics, particularly where there are highly emotive attitudes in play. Some people might consider the States letting a management contract to a private company whilst retaining ownership of the Airport to be tantamount to privatisation, whereas others would argue that it is only once the business has been fully divested, without any Golden Share restrictions, that privatisation has taken place.
- 5.4 This mode of debate can be unhelpful, so instead we have focussed on graduated changes in corporate governance in order to examine which features might best help the Airport to operate in a 'commercialised' manner.

## Options

### Status Quo

- 5.5 Clearly, the easiest option to deliver would be to maintain the existing structure, as defined in section 3. In this model, one might assume that the strategic interrelationships and responsibilities between the sponsoring States departments would remain the same and that the Airport would continue to operate effectively as part of the Public Services Department, drawing on inputs from other States' functions as required (such as finance and accounting, HR and legal services). In this model, it is assumed that the Airport would continue to be funded through T&R budgeting and subject to the normal prioritisation process rather than reverting to hypothecated funding for ports and airports, as previously applied under the Ports Holding Account.
- 5.6 However, Status Quo could still offer scope to improve the commercial effectiveness of the Airport, either in terms of its own financial performance or in terms of how it interacts with airlines or other commercial partners. Firstly, the Airport could be given a much clearer set of objectives through a directive from the States on how it is expected to perform financially together with a mandate to management to execute this. There certainly seems to be room to clarify the States' objectives for the Airport and aviation system as a whole. Moreover, it may be useful to consider whether the 'belt and braces' approach to demand management of route licensing, route subsidy and airline ownership is as efficient and effective as it might be, given that it involves multiple stakeholders and obviates the normal airport function of route development and marketing.
- 5.7 Next, there may well be scope to improve how the Airport itself performs by injecting new commercial skills into the management team. Whilst stakeholders have generally been supportive of the operational competence of the existing management team, it is also clear that there is limited experience of commercial management either at another airport or other commercially focussed business. This might involve recruiting additional management skills and possibly providing additional training to support the operationally-focussed staff at the Airport.

- 5.8 Finally management could be restructured within the existing framework of States' governance so as to reflect structures more commonly seen at other European regional airports where there is significantly greater emphasis on commercial behaviour. One alternative management model is shown in **Figure 5.1** below.



- 5.9 In this alternative model of Status Quo, the current management system would be simplified into two new executive functions supporting the Airport Manager, with an Operations Manager continuing to deliver operational performance, whilst a new Commercial Manager role would focus on business issues. These could include route development, charging and exploiting commercial opportunities such as retail and property. The Commercial Manager might also take responsibility for some of the functions more normally associated with a Finance Director such as business planning and management of strategic investment. This is because the Status Quo model assumes that funding would continue to be driven through T&R, possibly eliminating the need for a Finance Director at the Airport.



## Commercialisation of Guernsey Airport Operations

---

- 5.10 There may be an option to examine whether all of the functions that are currently outsourced to other States' departments (such as legal or estates services) provide the most commercially effective service or whether they might best be provided by a third party or self-provided by the Airport. It is not within the scope of this report to consider this in more detail, although it seems unlikely that an Airport of the scale of Guernsey could provide all of these services efficiently itself. Moreover, some services may be provided by other States' departments because the States are also providing key inputs (such as employees or finance) to support the Airport operations.
- 5.11 In addition, there may be scope to examine whether all of the existing functions are currently delivered by the Airport in the most commercially effective manner. This might either challenge whether these functions are charging appropriately for their services or selling them as widely as they can (perhaps meteorological services), or it could question whether there is scope to provide them more efficiently (perhaps through increased cost-sharing with Jersey).

### *Advantages and Disadvantages*

- 5.12 This section has suggested that there may be scope to improve the commercial performance of the Airport by making changes within the existing governance structure simply by giving management a clearer mandate to operate on a commercial basis, providing management with additional commercial skills and potentially restructuring the management team. The benefits of this approach would be:
- simple, and quick to effect;
  - relatively low-risk and low cost;
  - does not rule out subsequent changes, perhaps to a corporate structure.
- 5.13 However, there are several obvious drawbacks to this approach:
- the existing system of governance does not provide adequate information or incentives to really improve commercial performance: the real lack of commercially relevant financial data or projections that currently exists is testament to this. This is partly because there is no shareholder (or non-executive equivalent) demanding and analysing performance metrics or challenging management's business plans;

- without adequate data and motivation, it would be hard to measure or incentivise performance;
- the existing system of governance hampers management from operating commercially, partly through byzantine reporting and decision-making structures, partly through fairly high levels of political involvement in decision-making. Improving the effectiveness of Airport management would not, of itself, improve these governance arrangements and bring the necessary clarity to allow management to deliver;
- the Airport would continue to rely on States' funding, investing when public funds are available (taking into account other spending priorities) rather than according to the investment requirements of the business. It might be useful to consider whether the amount of time taken to secure the rehabilitation of the runway would have occurred if the Airport had access to independent funding and whether there may be additional cost consequences of delay to investment, either on this or other capital projects;
- treating Airport employees as interchangeable with any other public sector staff grades disables management from devising management systems and pay-grades bespoke to the Airport, which has different needs to more public-service orientated arms of government;
- the existing structure features several States actors' trying to resolve ill-defined States objectives for air services simultaneously (i.e. PSD, C&E, Director of Civil Aviation, T&R, Aurigny).

### **Incorporate, States' funding**

- 5.14 Corporatisation of the Airport would involve separating and incorporating the Airport functions from the Public Services Department. The easiest and quickest way of doing this would be to follow the example of the Utilities (Post, Electricity, Telecoms) corporatisations on Guernsey, transforming the Airport into a States Trading Company ('STC') within the ambit of the States Trading Company (Bailiwick of Guernsey) Law 2001 and associated States Trading Company (Bailiwick of Guernsey) Ordinance 2001. This would require the States to agree that the new corporate entity should be added to Schedule 1 of the STC Ordinance and that a description of the undertaking be added to Schedule 2.

## Commercialisation of Guernsey Airport Operations

---

- 5.15 In this hypothetical model, a new legal entity would be vested in the form of a limited liability company, wholly-owned by the States. The Ordinance currently provides for the Minister and Deputy Minister of Treasury and Resources to hold the issued shares of an STC in trust for the States (any further transfer of shares to require States approval). As with other limited liability companies, the Airport (say Guernsey Airport Limited, or 'GAL') would have a Memorandum of Association, setting out the general objectives and activities of the company and Articles of Association, providing for the corporate governance of the entity.
- 5.16 If incorporation was under the STC Ordinance, it would also be the case that:
- non-executive directors of the company would be appointed by the States on the recommendation of T&R, no member of the States may be a director;
  - remuneration of non-executive directors would be determined by T&R, Airport Board to determine remuneration of executive directors;
  - directors would submit strategic plans to T&R, setting out financial targets, extent of activities, and major investments and divestments;
  - States may give guidance of a general nature on preferred policies to T&R through the States Strategic Plan.
- 5.17 We believe that, although the Ordinance currently specifies T&R as the shareholder in respect of the existing STCs, which are treated as States' investments, there would not be an impediment to this role being held in whole or in part by PSD in respect of the Airport as the Law is not specific in this respect. We believe there are some advantages if this could be achieved as PSD holds some technical expertise in respect of Airport operations but the main advantage is that this would reduce the perceived conflict inherent in a common shareholding of the Airport and the airline, Aurigny.
- 5.18 Following the STC Law and Ordinance, GAL would be vested with appropriate assets, defined in an asset register lodged at the Greffe. Similarly, all Airport contracts would be novated to GAL, including those of existing employees who would transfer to GAL under the Transfer of Undertakings Law which would result in them retaining current terms and conditions of employment. Airport employees would also retain their entitlement to membership of the Public Service Pension Scheme, underwritten by the States.

- 5.19 The STC structure provides that utilities *may* be economically regulated bodies (though those that are will be subject to a different tax regime to those that are not). Although an incorporated Airport would act as a monopoly with profit-seeking objectives (under the terms of the Ordinance), it is not clear that price regulation would necessarily be required in this case. Firstly, the cost of regulation might be disproportionate to the scale of the business (and probably any efficiencies arising from commercialisation) and, secondly, this model of incorporation is assumed to occur under full public ownership, with T&R effectively approving aeronautical charges through approvals of business plans. This would provide government control of price setting, as occurs now.
- 5.20 One further crucial issue that may differentiate the Airport operating as an STC compared to the STC utilities is that of financing. The utility STCs operate as self-funding businesses, generating sufficient income from consumers to fund investment on the 'save to spend' principle (including cash funds that they were vested with on incorporation). Whilst the Airport also generates income from consumers, there is a real question of how financially sustainable it can be over the whole investment lifecycle. That is, the Airport may be able to generate sufficient revenue to cover operating costs, and maybe even maintenance costs, but it is doubtful that it could fund major investment (such as further runway/airfield rehabilitation or extension if required) directly through retained user charges and non-aeronautical income without a material impact on demand. Indeed, the 'save to spend' approach may be incompatible with ICAO rules on airport financing which discourages pre-funding of airport investment (today's users paying for facilities to be used at some future date).
- 5.21 There are various funding models that might address this issue. These include:
- The States could fund major new investment on the current system of prioritised business cases across spending departments, providing grant funding with minor investment (to be defined) possibly funded through retained earnings. This model involves all States' funding to GAL effectively being equity finance (though there could be different layers of finance calling for different levels of return);

## Commercialisation of Guernsey Airport Operations

---

- T&R could act as a government bank, providing credit lines on pre-agreed terms to GAL perhaps on quasi-commercial corporate banking terms, softened to be financeable by Airport cash flows. This potential model further suggests that there is merit in a distinction being maintained between the States' shareholder and the potential role for T&R acting as a bank with separate returns and amortisation required on debt and equity. From the Airport's perspective, this model could provide greater flexibility and an ability to operate more commercially – funding as required by the business rather than when available compared to other departments' investment requirements. However, the cost of this commitment would be borne by the States' budget, potentially with GAL cash calls clashing with other spending requirements and raising the level of external debt that might be required by the States.
- The States could fund the major investment required in the near term (mainly runway rehabilitation) on a grant basis, then endow the Airport with these assets on incorporation and GAL would be required to operate subsequently on a self-funding basis;
- the Ports Holding Account (hypothecated funds) could be resurrected such that the ports and Airport cross-subsidise each other as required. This obviously presupposes that the funds the entities could jointly raise would be sufficient for requirements and that users would tolerate such a cross-subsidy, which may not be the case.

### *Advantages and Disadvantages*

- 5.22 Incorporation of the Airport through the States Trading Company route would follow a well-trodden path for restructuring States entities that operate in more commercial sectors. One of the main drivers for incorporating the other utility companies was that these businesses were increasingly facing competition from other private sector entities that were not restricted by States governance structures (particularly Post and Telecoms). This is less of an issue for the Airport, but nevertheless there may be some relevant advantages.

5.23 It is also important to recognise that one key consequence of corporatisation is that costs and revenues of trading activities by public entities become much more transparent. Whilst there can be real advantages in terms of improved management information, it may also *appear* that corporatised entities cost more to operate simply because real operating costs are more transparent, such as the costs currently borne by the States of accounting or legal services which are likely to be explicitly transferred to the Airport's accounts and ultimately to consumers. This does not mean that corporatisation is more expensive than traditional operations, simply that it is likely that the full cost of operating the Airport will become apparent.

5.24 In contrast to the Status Quo model, the advantages of incorporation may therefore be expected to include:

- more transparent information on costs of operations, permitting more effective and efficient operational planning;
- a new shareholder function demanding greater access to management information and holding management to account for financial performance more effectively (combined with the explicit provision for expert apolitical non executive directors);
- this might be associated with the establishment of a more professional independent Board structure, bringing additional skills to support Airport governance;
- better defined role for politicians and departments, focussed on specifying strategic objectives, whilst freeing GAL management to make tactical decisions;
- an opportunity for the States to define the roles and responsibilities of all States' actors in the civil aviation market more clearly, possibly reducing the need for so many (often conflicting) functions;
- transfer of staff to new corporate structure provides for employment on existing terms but also enables management to deploy staff in a more relevant manner without being restrained by general provisions of States' employment (staff costs alone represent some 65% of Airport operating costs and are currently outwith management control).

## Commercialisation of Guernsey Airport Operations

---

5.25 There may be some illusory advantages of incorporation; for example, one being the apparent ability of the States to put risks of operations at greater distance to the States' finances behind a corporate veil. This would be misleading because whilst GAL might be a limited liability company, in reality the States could not afford for the Airport to cease business and operations. In reality, the States would always have to stand behind the Airport in the event of financial failure. However, real disadvantages of corporatisation are probably relatively limited:

- ➔ corporatisation does not of itself confer commercialisation, it simply facilitates this. So steps would have to be taken to improve the commercial operations of the Airport (as described in Status Quo). There could be a question of how able the Airport would be to attract strong commercial management given its small scale (and how limited this is within the European airport sector anyway);
- ➔ corporatisation does not inherently solve the issue of how to fund Airport development;
- ➔ the States would continue to be exposed to the full financial risks of airport ownership and operations;
- ➔ the current STC structure provides for the shareholder function to be serviced by T&R, but it would be important to consider whether this department has the capacity or expertise to provide expert shareholder functions to the Airport given its role with multiple other STCs (and the risk of apparent conflicts of interest with its role as shareholder of Aurigny). This issue could be resolved by delegation of shareholder functions to PSD;
- ➔ there may be a risk of contract failure or error whilst novating commercial or employment contracts to GAL. However, this risk is probably small given the experience of successful transfers with other STCs.

**Incorporate, independent funding**

- 5.26 An alternative model of corporatisation to the standard STC model might be to create a new corporate entity in identical manner to the GAL STC described above, but to confer it with powers to raise investment funding through independent sources of debt capital instead of relying on States' funding exclusively. This would mean that in the event that States' funding were not available, GAL could raise debt funding against its own balance sheet. This model has been used for publicly-owned airports in the UK and continental Europe.
- 5.27 Whilst this might seem to offer GAL greater funding flexibility and the ability to deliver capital projects in periods that States' investment priorities lie elsewhere, it is not a very attractive or realistic prospect from a States' budgeting perspective:
- it would probably be highly inefficient to finance airport development using the Airport rather than States' balance sheet, given the credit strength of the States;
  - the Airport would be likely to pay commercial interest rates reflecting the risk of the airport as a corporate entity whereas, in reality, the States would almost certainly step-in to make good any financial failure in order to secure continued operations of the Airport, obviating any possible risk benefits of off-balance sheet (to the States) financing;
  - given these issues it would be likely that any borrowing by the Airport would be subject to some form of letter of credit from the States (T&R) and it would be highly unlikely that T&R would sanction any other body with independent liability-incurring powers that could affect the budget or the States' credit rating.
- 5.28 For these reasons, it is assumed that independent finance-raising is unlikely to be relevant to a publicly-owned Airport company.

**Other models of incorporation**

- 5.29 The models of incorporation considered so far are essentially based on the States Trading Company model, partly because this is a known, existing structure which could be readily implemented in Guernsey, and partly because it represents a broad for-profit corporate structure. There are alternative models of incorporation that have been used to establish public-interest businesses in the European infrastructure sector. These include:



## Commercialisation of Guernsey Airport Operations

---

- companies limited by guarantee (rather than shares);
- Industrial and Provident Societies; and
- various not-for-profit trust structures.

5.30 Many of these are orientated towards public interest activities where there is an explicit rejection of a profit extraction agenda, with net revenues being retained for further investment and the commonwealth of stakeholders. Whilst Guernsey Airport does represent a public interest activity, it is hard to see how a corporate structure focussed on not-for profit behaviour would be consistent with commercialisation.

### **Incorporate, private management contract**

5.31 The next class of governance options to consider involve corporatisation followed by varying degrees of third party (private sector) management contracting. The motivation for doing this would be:

- the Airport may be able to source (commercial) management skills from larger (typically private) airport operators that it might otherwise struggle to attract by itself;
- there may be a perception that States-owned entities should focus on service-provision but could benefit from private sector profit generation to subsidise this service provision; and
- associated with this there may be a desire for transfer of commercial risk to the private sector.

5.32 To some extent, there is already experience of private management contracting at the Airport with some specific functions (such as security or catering) already provided by private companies. There may be scope to increase the number of functions contracted out whilst retaining overall management of the Airport under States' control. In this case, Airport management would ultimately become more contract management rather than direct control.

5.33 However, an alternative structure could involve outsourcing management of the Airport completely to a private sector operator. In this model, the States would retain ownership of all Airport infrastructure and property whilst a private sector airport operator / Private Sector Partner ('PSP') is contracted to operate and develop the Airport for a defined period. It is likely that Airport staff would transfer to the PSP for the duration of the management contract in order for the efficiencies of PSP management to be generated. It would be difficult to see a PSP trying to manage the Airport using public sector employees. The scope and scale of management provided by the PSP could range from:

- a) the PSP provides airport operations and commercial skills covering aeronautical and non-aeronautical revenue generation, whilst the States retain responsibility for setting aeronautical charges, route development and airfield infrastructure maintenance and development. The States would probably receive all revenues generated from airport operations and property and disburse management charges to the PSP, though it could be structured so the PSP receive all non-aeronautical (commercial) revenues, whilst the States take all aeronautical revenues;
- b) as above but the PSP also takes responsibility for route development; and
- c) the PSP takes full responsibility for Airport management, including route development and airfield infrastructure development and maintenance, but possibly not setting charges (to reduce the need for economic regulation). Infrastructure development and maintenance costs would be funded by the States as under the corporatised models with budgetary cost controls and possibly some form of incentivised management payment to the PSP for delivering capital projects to time and budget.

5.34 The basis for remunerating the PSP and transferring risk obviously depends upon the level of control that is transferred to the PSP. If the PSP is simply providing services but has no ability to influence demand or revenues, then it is likely that it would be paid on some form of fixed fee, adjusted for performance standards, with payment possibly generated from overall airport income.

## Commercialisation of Guernsey Airport Operations

---

5.35 In all of these models, the States retain ownership of the Airport infrastructure together with responsibility for investing in its development. This means that the investment required by a PSP is relatively limited (essentially establishing management structures) and, therefore, it should be possible to establish a relatively short contracting period (a few years) which could result in the management contract being rolled over on a tendered, competitive basis fairly frequently. This might increase competitive pressure on PSP candidates and over time help to improve operational efficiency of the business, although it would be important to consider the disruptive effect of changing PSPs on customers, airlines, and staff.

### *Advantages and Disadvantages*

5.36 Contracting out management to a PSP could help to attract commercial skills that are currently missing at the Airport and might not necessarily be attracted by simply corporatising the business. There are a myriad of different forms of contracting out which offer different levels of risk transfer to the private sector. However, in general, the advantages include:

- ➔ management of the Airport further distanced from political interference;
- ➔ attracting additional commercial skills (the net benefits of which could be benchmarked against a business plan from existing management);
- ➔ possible efficiencies of Guernsey Airport being managed as part of a group of other airports (for example sharing route development or staff training costs);
- ➔ it may be possible to inject an element of risk transfer to the PSP depending upon the scale of involvement. This could take the form of fees against meeting a pre-agreed budget, or some form of performance fee for delivering new infrastructure to time and budget.

5.37 Disadvantages of contracting out could include:

- ➔ possible confusion, complexity and political strife arising from staff transfers to the PSP, particularly if this happens regularly;
- ➔ contractual complexity resulting in a loss of a single point of responsibility for Airport performance (though unlikely if overall management is contracted out); and

- contractual complexity or risk of litigation if interdependent activities are not carefully managed (for example, if the States had responsibility for maintaining infrastructure or route development and failed to manage these properly, impacting PSP fees).

### **Incorporate, then franchise or lease to the private sector**

- 5.38 The ultimate extension of contracting out would be to lease or franchise the Airport post-corporatisation to a PSP. This model would look similar to wholesale contracting-out of the Airport, except that the States would step even further away from management. Again, there are various models that could apply (covering the scale and scope of PSP operations) but, in general, they involve the PSP being granted a period to operate the Airport within guidelines determined by a Lease or Franchise (or Concession) Agreement. The Airport would be handed back to the States in a pre-determined condition upon termination, either because the franchise period had expired or because there had been some material breach.
- 5.39 As with contracting-out, it would be necessary to decide whether to provide a wholesale franchise of all airport assets and businesses to be exploited by the PSP or whether to separate some activities. For example, it might be possible to separate the operation of the terminal and associated Airport property from the airside airfield infrastructure (which could remain under States control). In this model, the States would continue to be responsible for setting tariffs and generating aeronautical revenue from the runway and apron, whilst the PSP would manage non-aeronautical/commercial revenue generation. The PSP would also need to raise aeronautical fees in relation to security and general terminal infrastructure and this could give rise to complications in respect of the Terminal Development Fee which is collected to repay the States for past investment in the new terminal. Whilst such a structure might seem attractive in some respects, it would be likely to raise significant interface issues, both in terms of how the Airport is managed as a whole (for example scheduling airfield and terminal works) and also in terms of interdependent revenue generation (for example terminal usage and income dependent on airport operations, route development and tariff setting).
- 5.40 Another variant of this approach would be some form of joint venture, where part of the equity of the Airport company is sold to the private sector. This could be a minority stake, as for example was the case at Newcastle Airport. This secures the benefit of private sector involvement but with the public sector still retaining a substantial degree of influence.

## Commercialisation of Guernsey Airport Operations

---

### *Advantages and Disadvantages*

5.41 The advantages and disadvantages of franchising or lease are largely the same as those for contracting out. However, the longer term nature of the arrangements and the need for more control by the franchisee or lessee means that the level of States' control will be diluted.

5.42 The advantages lie in:

- a fully commercial approach to management;
- the potential for the Airport to become financially self-sufficient, subject to confirmation of the potential to generate profits sufficient to fund longer term capital requirements with appropriate borrowing.

5.43 The disadvantages lie in:

- Greater risk of political disruption through the transfer to a private sector partner;
- the risk that the contractual arrangements may not prove robust over the longer term due to external events affecting the balance of risk and reward beyond the scope envisaged in the original agreement..

### **Analysis**

5.44 We set out in **Table 5.1** overleaf an analysis of the potential commercialisation options against the objectives summarised at the end of Section 2.

| Table 5.1: Analysis of Commercialisation Options            |  |  |   |  |
|---|--|--|---|--|
| Status Quo  |  | Incorporate States' Funding  | Incorporate, Independent Funding  | Incorporate, Private Management Contract<br>Franchise or Lease |
| Security of Supply  |  |  |   |  |
| operational safety;   | In principle, all the options are capable of delivering a high level of operational safety, under the regulatory supervision of the DCA. However, those options with a higher risk of delays to capital funding could potentially lead to essential safety works being subject to delay. |  |   |  |
| ability to serve reasonable / appropriate levels of demand; | In principle, all options should be capable of delivering sufficient capacity to meet demand but this will depend on the ability to source funding for future major capex.   |  |   |  |
| robust operations / limited risk of interruption;           | Relatively high risk of disruption due to inflexible labour contracts and risk of political interference.  | Some risk of disruption during incorporation process and lower risk of political interference. | Higher risk of disruption during period of transfer to private sector management but lower risk thereafter. |  |

### Commercialisation of Guernsey Airport Operations

|   |   |   |  |   |  |
|---|---|---|--|---|--|
| ability to source funding when required / in support of effective development.      | Difficult due to complex States' prioritisation and approval process.   | Would enable maintenance capex over £25k to proceed as required although would still be subject to States' prioritisation and approval processes for major capex. | Subject to Airport generating sufficient revenues to repay debt, would enable funds to be available as required. | Would enable maintenance capex over £25k to proceed as required although would still be subject to States' prioritisation and approval processes for major capex. | Subject to Airport generating sufficient revenues to repay debt, would enable funds to be available as required. |
| Quality of Service, Support for Economic Development                                |   |   |  |   |  |
| appropriate range of routes, quality destinations and frequencies, customer choice; | Airport currently has no control, with responsibility for route development held by C&E.  | A corporatised Airport would be expected to take control of its own marketing, albeit the States may still chose to provide funding support.                      |  | A private sector partner would expect to take responsibility for route development, with their performance subject to appropriate targets and incentives.         |  |
| good standard of facilities and services.   | In principle, all options should be capable of ensuring a good standard of facilities and services. No particular criticisms have been received of current operational standards. |   |  |   |  |

## Commercialisation of Guernsey Airport Operations

| Value for Money/Efficiency (of the aviation system as a whole)  |   |   |   |   |
|---|---|---|---|---|
| operational efficiency (opex, commercial revenues, etc), including efficient and effective decision-making; | Difficult to achieve with current States' employment contracts and lack of commercial management approach | Corporatised Airport would be empowered to improve efficiency and adopt a more commercial approach but may be handicapped by lack of airport commercial management expertise locally. | Private sector partner would bring access to airport management expertise to drive efficiency and exploitation of commercial potential. |   |
| financial efficiency;   | Likely to remain poor – no transparency of costs or ability to adopt economically efficient pricing.      | States Trading Company would be empowered to attain greater financial efficiency but this would be constrained by the 'save to spend' policy.   | States Trading Company would be empowered to attain greater financial efficiency.   | Greater financial efficiency possible but strict controls will be required to ensure that the franchisee or lessee is still motivated to maximise the benefits of the Airport for the Bailiwick as a whole. |
| support for investment by non-States actors: transparency, clarity, speedy, rational decision-making;       | Likely to remain poor.  | Potential for some improvement but could be hampered by ongoing constraints on major capital development.   | Potential for some improvement but could be hampered by ongoing constraints on major capital development.                               | Likely to be greatest but objectives and targets would need to be clearly defined in lease or concession agreement.   |



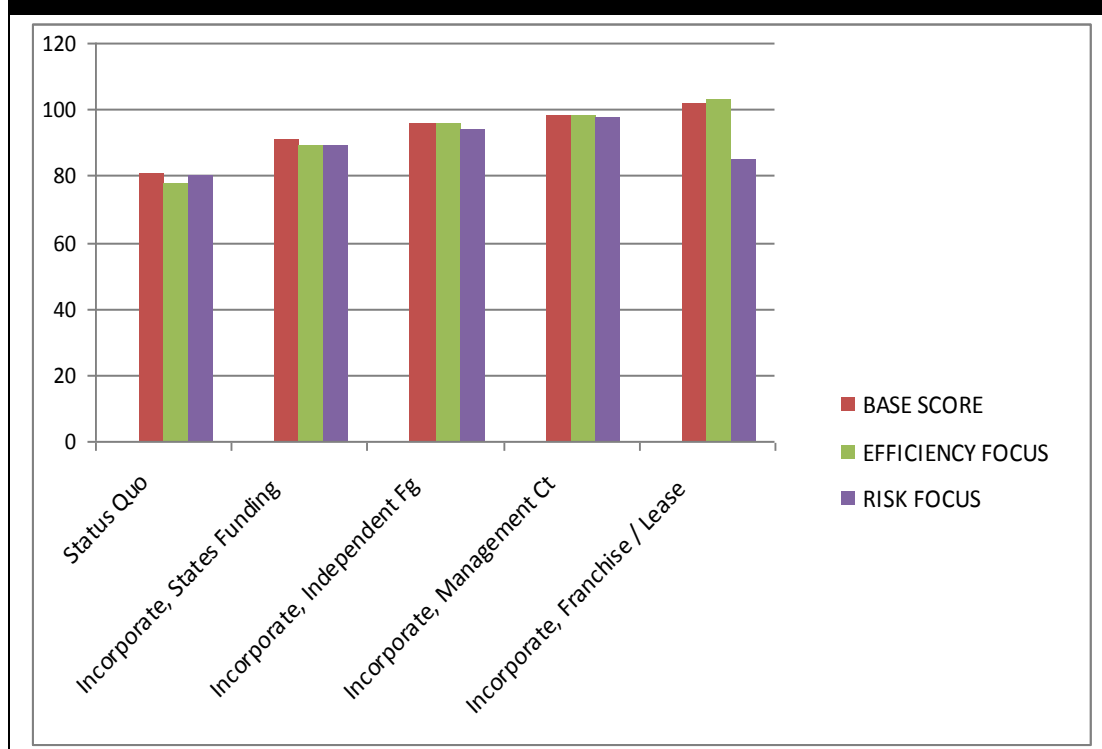
### Commercialisation of Guernsey Airport Operations

| operational innovation;  | Handicapped by States' procedures and controls. | Greater scope for innovation under trading company regime. | Maximum scope for private sector innovation.   |
|--|---|--|--|
| limited / acceptable / appropriate (financial) risk exposure to States tax-payers; | States effectively retains all financial risk.  |  | Contractual, lease or concession terms could transfer some performance risk to the private sector but this would need to be balanced by the potential for greater rewards. |
| limited / acceptable / appropriate environmental impact / externalities.           | Unlikely to vary between options.               |  |  |

- 5.45 We have drawn this analysis together into a Multi-Attribute Analysis ('MAA') framework, giving indicative values to each of objectives and each of the principal corporatisation models based on our assessment in Table 5.1.
- 5.46 MAA is commonly used to rank options when there are competing objectives (or attributes) for the options under review. It simply applies a base score (usually unavoidably on a subjective basis) to each option for each of the objectives being considered. Typically, this involves forced ranking where scores are subjectively applied and these are reviewed for internal consistency across the options. The results are aggregated to rank each option. MAA then, generally, tests the robustness of the ranking by applying different weights to the attributes (or objectives) and re-calculating the aggregate scores in order to see whether there are material changes in rankings. It is important to understand that MAA does not purport to provide some sort of scientific basis for option appraisal, even if the output looks definitive. It cannot be because scoring is inherently subjective. However, it does provide a logical framework for considering multiple options against multiple objectives and for understanding why one option may be preferred against another.
- 5.47 In this case, we have used MAA to review the Objectives defined in Section 2 against the Options defined in Section 5 and then tested the Base Scores generated for hypothetical extremes of risk averse decision-makers and those very focussed on financial efficiency. The results of this analysis are illustrated in **Figure 5.2** and set out in more detail in **Appendix B**. The indicative results for some options may exceed 100 because they are not percentage scores – there are twelve Objectives and each is scored out of ten.

## Commercialisation of Guernsey Airport Operations

**Figure 5.2: Assessment of Commercialisation Options**



5.48 We have illustrated two alternative potential weightings of the importance of each of the objectives:

- *Efficiency Focus* – to reflect the potential outcome if the most important objective for commercialisation is to minimise cost to the States and deliver maximum efficiency in operations; and
- *Risk Focus* – to reflect the potential outcome if the most important objective was to minimise financial and political risk to the States.

5.49 In both cases, it is clear that Status Quo is the lowest ranking option and that, generally, options with higher private sector involvement perform better. However, the extent to which variations on the incorporated models perform better or worse depends on the different weightings of objectives.

5.50 There would, of course, be other potential weightings of objectives as is evident from our discussions with the various stakeholders. Agreeing these weightings will be part of an essential next step in the process.

## 6 RECOMMENDATIONS AND NEXT STEPS

- 6.1 Our discussions with stakeholders have revealed widespread support for the principle of commercialising the Airport but far less clarity as to exactly what commercialisation is intended to achieve. Given the vital importance of the Airport, and the air service connections which it facilitates, to the economic and social well-being of Guernsey, stakeholders were able to articulate their aspirations for the Airport but these were not without contradictions, such as between the aspiration to achieve an improved range of air services and that to see users pay more directly the costs of airport services, without subsidy from the States.
- 6.2 The current governance arrangements are complex, with multiple levels of approval needed through various States' departments, particular for capital expenditure. Other departments, such as C&E, hold both regulatory responsibility and, effectively, control route development through the Air Route Licensing system and the Air Route Discount scheme. Coupled with lack of control over staff terms and conditions, airport management has no autonomy to manage the Airport to deliver the most efficient and effective service for Guernsey.
- 6.3 Our analysis suggests that there would be clear benefits from incorporating the Airport using the provisions of the States Trading Companies Law and Ordinance. This would allow more efficient deployment of staff and easier exploitation of commercial potential of the Airport. This appears to us an essential first step. The extent to which there would be advantages in moving beyond this first step depends on the precise balance and weighting of the objectives. At this stage, there is insufficient consensus to allow the most appropriate model to be precisely determined.
- 6.4 Moving to a States Trading Company would require the establishment of a shadow board (with appropriate airport expertise) and follow the process envisaged in Act and Ordinance. It will be important, however, to learn lessons from the commercialisation of the post and electricity operations. In particular, there needs to be clarity of objectives for the States Trading Company and a clear understanding of the roles of each of the stakeholders. In the case of the Airport, it needs to be clearly determined whether its performance will be monitored against:

## Commercialisation of Guernsey Airport Operations

---

- ➔ delivery of increased air services and passenger numbers, generating wider economic benefits for the island; or
  - ➔ more efficient airport operations, with a clear relationship between costs and charges; or
  - ➔ achieving self funding status without recourse to funding from the States.
- 6.5 It may not be possible to achieve all three strategic aspirations simultaneously, even though our financial analysis would suggest that there is clear potential to improve the financial performance of the Airport.
- 6.6 Our analysis suggests that there may be a realistic prospect of the Airport generating sufficient revenue to become operationally self-sufficient, including funding of routine maintenance and refurbishment capex. However, it is unlikely to generate sufficient operating profits to repay the cost of the runway rehabilitation works or for future major capital requirements, such as further major repairs, runway or terminal extension works. Hence, there will still be a need for the States' to fund or finance major capital development works. The 'save to spend' policy is unlikely to be sufficient to meet such longer requirements and may not be compatible with international conventions on airport charges, which recommend strongly against pre-funding of airport development.
- 6.7 Incorporation alone will not solve this dilemma and would still leave Airport capital expenditure requirements to compete with other States' investments for priority. It appears to us that independent finance-raising is unlikely to be relevant to a publicly-owned Airport company but there may be ways of achieving speedier access to States' funds under the STC model. This could be explored further as part of the process of incorporation.

- 6.8 We believe that an important issue will be ensuring that appropriate commercial airport management expertise is available to drive the Airport forwards, particularly to maximise its commercial potential and to improve the air service offer to Guernsey. This may be difficult to achieve for an Airport the scale of Guernsey and within the limitations of available expertise on Guernsey. For this reason, we believe that there is likely to be merit in bringing in a private sector partner either to operate the Airport on a management contract or through a franchise or lease arrangement. This would allow access to external expertise and help to drive efficiency and fuller exploitation of the commercial potential. The decision between the management contract or franchise/lease route is largely dependent on the extent to which the Airport can attain long run financial autonomy. This does not need to be determined at this stage as incorporation is an essential first step. It will be essential that clear targets and performance measures are set for a private sector partner. This will require a clarity which is not possible under the current governance arrangements.
- 6.9 Provided that clear direction, including objectives and measurable targets, is given to the Airport STC, we believe that separate economic regulation is unlikely to be needed, although the position might change under a full franchise or lease option with the Airport run by the private sector. Economic regulation is less well suited to state run monopolies, where broader consumer interests can be enshrined through the States' shareholder role. This would avoid the tensions which have been evident with the commercialisations of post and of electricity. However, it will be important that the balance of objectives is resolved at the shareholder level and clearly articulated in targets for the company.
- 6.10 We believe that there may merit in the shareholder in the Airport Company not being T&R, at least in its entirety, because of the conflict of interest inherent in common ownership of Aurigny, whether this is perceived or real. PSD as the shareholder or part shareholder would at least offer some continuity of existing operational expertise. Whilst this would be a departure from convention for an STC, we understand that this would not be precluded under the law.

## Summary of Recommendations

6.11 We recommend that:

- the Airport be incorporated as an STC as a first step in a commercialisation process;
- this will require greater clarity of objectives than is evident amongst stakeholders today, including resolving potential conflicts in objectives as outlined in this report;
- it will be important to ensure policy consistency between the various departments and their actions in order to secure delivery of the optimum air service for Guernsey, for which the Airport is an essential component;
- in parallel with the incorporation process, consideration should be given the extent to which it is desirable to bring in a private sector partner. This will depend on:
  - the extent to which necessary airport commercial management expertise can be recruited locally or on licence from the UK;
  - the extent to which the Airport can become financially self-supporting;
  - the funding regime for major capital developments;
  - the precise ranking of objectives.
- on the basis of our initial assessment, bringing in a private sector partner on a management contract basis appears to be most likely to deliver the best outcome in the circumstances where the States will remain as the funder of major capital development and having regard to the need to balance risk against achievement of optimum efficiency. This needs to be tested through further discussion amongst key stakeholders to confirm the objectives and their weightings on a consensus basis.

**APPENDIX A:**  
**LIST OF STAKEHOLDERS CONSULTED**



**Public Services Department**

Bernard Floucquet (Minister) and Colette Brown – 13.7.11

Adrian Lewis and Colin Le Ray – 12.7.11

James Menhenitt – 26.7.11

**Commerce and Employment Department**

Jon Buckland and George Sauvage – 13.7.11

Fergus Woods (Director of Civil Aviation) – 12.7.11

**Treasury and Resources Department**

Dale Holmes – 29.7.11

**Law Officers of the Crown**

Martin Thornton – 18.7.11

**Office of Utility Regulation**

John Curran and Michael Byrne – 18.7.11

**Chamber of Commerce**

Barry Cash, Carl Symes - 12.7.11

**Consultative Committee**

Dudley Jehan – 13.7.11

**Aurigny**

Malcolm Hart – 13.7.11

**Aiglle**

Richard Battersby – 18.7.11

**Flybe**

Ian Taylor – 26.7.11

**Blue Islands**

Rob Veron – 12.8.11

**APPENDIX B:**  
**MULTI-ATTRIBUTE ANALYSIS**

## BASE SCORE

### OBJECTIVES WEIGHT

#### 1. SECURITY OF SUPPLY

|                                       |           |           |           |           |           |  |  |
|---------------------------------------|-----------|-----------|-----------|-----------|-----------|--|--|
| Operational safety                    | 9         | 9         | 9         | 9         | 9         |  |  |
| Ability to serve reasonable demand    | 9         | 9         | 10        | 9         | 9         |  | Under status quo, some risk that delayed access to funding could delay capacity enhancement                                    |
| Robust operations                     | 7         | 8         | 8         | 9         | 9         |  | Ability to manage staff improved through incorporation, with further improvement if third party autonomous management in place |
| Ability to source funding effectively | 7         | 8         | 10        | 8         | 8         |  | Although States' funding will be cheapest, improved airport performance will enhance ability to access other funding sources   |
|                                       | <b>32</b> | <b>34</b> | <b>37</b> | <b>35</b> | <b>35</b> |  |  |

#### 2. QUALITY OF SERVICE

|   |           |           |           |           |           |  |  |
|---|-----------|-----------|-----------|-----------|-----------|--|--|
| Routes, destinations, frequencies, choice | 5         | 7         | 7         | 8         | 9         |  | Currently there is little commercial focus, which would be improved with incorporation. PSP will have greater incentive to promote route development |
| Standard of facilities and service        | 8         | 8         | 8         | 8         | 8         |  |  |
|   | <b>13</b> | <b>15</b> | <b>15</b> | <b>16</b> | <b>17</b> |  |  |

#### 3. VALUE FOR MONEY, SYSTEM EFFICIENCY

|   |           |           |           |           |            |  |   |
|---|-----------|-----------|-----------|-----------|------------|--|---|
| Operational efficiency                      | 7         | 8         | 8         | 9         | 9          |  | Efficiency difficult to achieve with current structure. Improvements will be possible with incorporation but greatest with private sector involvement                         |
| Financial efficiency                        | 6         | 7         | 8         | 8         | 8          |  | Current financial efficiency poor. Would be improved under STC and better with private sector involvement   |
| Support for investment by non-States actors | 5         | 7         | 8         | 8         | 9          |  | Currently poor due to complex governance. Would improve with incorporation but greater and longer term private sector involvement likely to increase prospects for investment |
| Operational innovation                      | 5         | 7         | 7         | 8         | 8          |  | Innovation currently handicapped under States' control. Would be improved with STC and further improved with private sector involvement                                       |
| Financial risk exposure for tax-payers      | 5         | 5         | 5         | 7         | 9          |  | Risk transfer only takes place with private sector involvement  |
| Environmental risk / externalities          | 8         | 8         | 8         | 7         | 7          |  | Some greater risk with transfer to private sector involvement   |
|   | <b>36</b> | <b>42</b> | <b>44</b> | <b>47</b> | <b>50</b>  |  |   |
| <b>TOTAL</b>                                | <b>81</b> | <b>91</b> | <b>96</b> | <b>98</b> | <b>102</b> |  |   |

**EFFICIENCY FOCUS****OBJECTIVES****1. SECURITY OF SUPPLY**

|                                       |          |           |             |           |           |           |
|---------------------------------------|----------|-----------|-------------|-----------|-----------|-----------|
| Operational safety                    | 1        | 9         | 9           | 9         | 9         |           |
| Ability to serve reasonable demand    | 0.5      | 4.5       | 4.5         | 4.5       | 4.5       | 9         |
| Robust operations                     | 0.5      | 3.5       | 4           | 4.5       | 4.5       | 4.5       |
| Ability to source funding effectively | 1        | 7         | 8           | 10        | 8         | 8         |
|                                       | <b>3</b> | <b>24</b> | <b>25.5</b> | <b>28</b> | <b>26</b> | <b>26</b> |

**2. QUALITY OF SERVICE**

|   |          |            |            |          |            |     |
|---|----------|------------|------------|----------|------------|-----|
| Routes, destinations, frequencies, choice | 0.5      | 2.5        | 3.5        | 4        | 4.5        | 4.5 |
| Standard of facilities and service        | 0.5      | 4          | 4          | 4        | 4          | 4   |
|   | <b>1</b> | <b>6.5</b> | <b>7.5</b> | <b>8</b> | <b>8.5</b> |     |

**3. VALUE FOR MONEY, SYSTEM EFFICIENCY**

|   |          |             |             |             |             |             |
|---|----------|-------------|-------------|-------------|-------------|-------------|
| Operational efficiency                      | 2        | 14          | 16          | 16          | 18          | 18          |
| Financial efficiency                        | 2        | 12          | 14          | 16          | 16          | 16          |
| Support for investment by non-States actors | 2        | 10          | 14          | 16          | 16          | 18          |
| Operational innovation                      | 0.5      | 2.5         | 3.5         | 3.5         | 4           | 4           |
| Financial risk exposure for tax-payers      | 1        | 5           | 5           | 5           | 7           | 9           |
| Environmental risk / externalities          | 0.5      | 4           | 4           | 4           | 3.5         | 3.5         |
|   | <b>8</b> | <b>47.5</b> | <b>56.5</b> | <b>60.5</b> | <b>64.5</b> | <b>68.5</b> |

**TOTAL**

|  |           |           |             |           |             |            |
|--|-----------|-----------|-------------|-----------|-------------|------------|
|  | <b>12</b> | <b>78</b> | <b>89.5</b> | <b>96</b> | <b>98.5</b> | <b>103</b> |
|--|-----------|-----------|-------------|-----------|-------------|------------|

**RISK FOCUS****OBJECTIVES****1. SECURITY OF SUPPLY**

|                                       |            |             |             |           |             |
|---------------------------------------|------------|-------------|-------------|-----------|-------------|
| Operational safety                    | 1          | 9           | 9           | 9         | 9           |
| Ability to serve reasonable demand    | 0.5        | 4.5         | 4.5         | 4.5       | 2.25        |
| Robust operations                     | 2.5        | 17.5        | 20          | 22.5      | 11.25       |
| Ability to source funding effectively | 1.5        | 10.5        | 12          | 12        | 12          |
|                                       | <b>5.5</b> | <b>41.5</b> | <b>45.5</b> | <b>48</b> | <b>34.5</b> |

**2. QUALITY OF SERVICE**

|   |          |            |            |          |             |
|---|----------|------------|------------|----------|-------------|
| Routes, destinations, frequencies, choice | 0.5      | 2.5        | 3.5        | 4        | 2.25        |
| Standard of facilities and service        | 0.5      | 4          | 4          | 4        | 2           |
|   | <b>1</b> | <b>6.5</b> | <b>7.5</b> | <b>8</b> | <b>4.25</b> |

**3. VALUE FOR MONEY, SYSTEM EFFICIENCY**

|   |            |           |           |             |             |
|---|------------|-----------|-----------|-------------|-------------|
| Operational efficiency                      | 0.5        | 3.5       | 4         | 4.5         | 4.5         |
| Financial efficiency                        | 0.5        | 3         | 3.5       | 4           | 4           |
| Support for investment by non-States actors | 1          | 5         | 7         | 8           | 9           |
| Operational innovation                      | 0.5        | 2.5       | 3.5       | 4           | 4           |
| Financial risk exposure for tax-payers      | 2          | 10        | 10        | 14          | 18          |
| Environmental risk / externalities          | 1          | 8         | 8         | 7           | 7           |
|   | <b>5.5</b> | <b>32</b> | <b>36</b> | <b>41.5</b> | <b>46.5</b> |

**TOTAL**

|  |           |           |           |             |              |
|--|-----------|-----------|-----------|-------------|--------------|
|  | <b>12</b> | <b>80</b> | <b>89</b> | <b>97.5</b> | <b>85.25</b> |
|--|-----------|-----------|-----------|-------------|--------------|

**(NB While there are no significant immediate resource implications associated with this Report's recommendations, the Treasury and Resources Department is of the view that there will certainly be major financial and resource issues to be addressed as part of any move to put the Airport into a 'States Trading Company' format. Based upon the evidence presented to date, the Treasury and Resources Department is far from convinced that such a move would be in the island's best interests and should the States decide to permit the Public Services Department to carry out further work on the feasibility of establishing a States Trading Company, that Department should not necessarily interpret such a decision as providing it with any form of 'agreement in principle' for the concept.)**

**(NB The Policy Council notes the Report.)**

The States are asked to decide:-

XI.- Whether, after consideration of the Report dated 21<sup>st</sup> December 2011, of the Public Services Department, they are of the opinion:-

1. To note the report prepared by York Aviation in Appendix 2 to that report.
2. To agree that the Public Services Department should undertake appropriate consultation prior to returning to the States with a report proposing clear objectives for the Airport, and at the same time proposing any appropriate and practical improvements that might be made to the current Airport governance and policy arrangements.
3. To note the Public Services Department's current view that establishment of a States Trading Company might present the most effective way forward for Guernsey Airport.
4. To agree that the Public Services Department should conduct further detailed investigation into, and consultation concerning, the option to establish a Guernsey Airport States Trading Company, before reporting back to the States, such investigation and consultation to include (but not be limited to):
  - (a) financial issues (costs, savings etc);
  - (b) consultation with employees likely to be affected by any proposals to create a States Trading Company;
  - (c) consultation with service users;
  - (d) potential for the shareholder role;
  - (e) potential regulation mechanism;

- (f) legislative implications.
5. To note that the funds that will be required to progress additional investigation and consultation, (provisionally estimated not to exceed £50,000) will be funded by Guernsey Airport.
  6. To note that the Public Services Department, working in conjunction with the Treasury and Resources Department, will be reviewing the current accounting and reporting arrangements for the Ports, including the mechanism of the Ports Holding Account.
  7. To note the intention of the Treasury and Resources Department to report, as part of the 2013 Budget Report, with an interim proposal for funding the Ports routine capital expenditure.

**TREASURY AND RESOURCES DEPARTMENT**  
**RESOURCE ACCOUNTING AND BUDGETING**

The Chief Minister  
Policy Council  
Sir Charles Frossard House  
La Charroterie  
St Peter Port

20<sup>th</sup> December 2011

Dear Sir

**1. Executive Summary**

- 1.1. This Report seeks authority to embark on a project under the banner of the Financial Transformation Programme (FTP) to improve and modernise the States' financial framework.
- 1.2. The current accounting model has a number of deficiencies, the most significant of which is the failure to account for our fixed assets that is, our land, buildings and equipment which together are thought to be valued at in excess of £2 billion. Without this ability, neither the ongoing value of those assets nor the true cost of their use by Departments can be properly represented in our accounts. This leads to an opaque picture regarding the true cost of the services we deliver, a lack of focus on driving the best value from these assets and an inability to compare costs and financial performance year on year.
- 1.3. The Report recommends the introduction of Resource Accounting and Budgeting over a four year period along with the adoption of International Public Sector Accounting Standards (IPSAS). IPSAS is an internationally recognised set of principles laying down best practice and guiding the preparation of accounts in the public sector.
- 1.4. There are numerous benefits to be gained from the introduction of such a system which are for the whole of the public sector and not merely for the accounting community. It is important that the framework is not seen as an end in itself but rather as a significant contribution towards good and effective governance. The benefits fall within four broad categories:



### 1.5. *Accountability*

The States are accountable for the resources under their control and have an obligation to deliver value for money. The extent to which this duty of accountability is discharged is difficult to assess without knowing the full cost of delivering services and subsequent outcomes achieved. A resource accounting framework provides information about how resources have been applied and, coupled with a performance framework, enables stakeholders to assess the correlation between inputs (resources spent) and outcomes (services delivered). In other words resource accounting provides financial information which more fully supports rational decision-making in difficult political situations.

### 1.6. *Decision Making*

The availability of more accurate and complete information which is directly related to outcomes supports better decision making which, in turn, leads to enhanced efficiency and effectiveness. It should also mean that debate on the wisdom of various decisions can focus on political factors rather than on disputed financial analysis and data.

### 1.7. *Comparability*

Resource accounting records the full costs of providing goods and services, and also recognises fixed assets. This means that the cost of service delivery will be comparable year on year. It also means that comparisons can be more easily made with decisions made by other jurisdictions or even in the private sector.

### 1.8. *Better Use of Assets*

The States does not currently account for its multi million pound portfolio of assets at all and there are no costs to Departments for their use. Resource accounting will deliver a full asset register which will encourage better stewardship of assets by those responsible for them or occupying them.

1.9. The delivery of this project represents a challenge to the public sector at a time of change and therefore must be appropriately resourced in order to ensure success. A suitably qualified and experienced team of two dedicated people will be required over the four year life at a total cost of £600k. Further, professional fees have been estimated at £700k giving a total estimated project cost of £1,300k.

1.10. This Report recommends that approval of various phases of the project on production of detailed business cases be delegated to the Policy Council to ensure that a robust control structure is put in place ensuring best value for money and successful delivery of this important project. The Treasury and

Resources Department will report back to the States in the annual Budget Report and Accounts on progress and changes.

- 1.11. The Public Accounts Committee has indicated its support for this project as a means of strengthening financial transparency, accounting for the full range of States entities and understanding the total assets and liabilities. The Committee also believes that the adoption of internationally accepted accounting standards is important in delivering the Core Principles of Good Governance. The Committee's letter of support is attached at Appendix A.

## **2. Introduction and Background**

- 2.1. The current financial framework in use by the States can be described as a modified accruals basis of accounting. This means that revenues such as income tax receipts are largely recognised in the period that they become available and measurable, and expenditure is recognised in the period in which the associated liability is incurred. Further, capital expenditure is charged in the year of charge and no assets are created and held on the balance sheet. The main deficiencies in the current framework are
  - Fixed assets are not recorded;
  - A focus on inputs i.e. the amount of money spent;
  - Lack of comparability year on year since capital expenditure is recorded in the year of acquisition and no charge for consumption in subsequent years (i.e. depreciation) is recorded;
  - Lack of clarity as to the full cost of projects and services in any given accounting period; and
  - Lack of comparability with other jurisdictions which are using a resource accounting framework.
- 2.2. Most of all the system carries a risk that Departments have to make decisions based on limited financial information because the full cost of service delivery including all capital costs is not known.
- 2.3. The modified accruals model used to be the preferred choice for the majority of governments. However, over recent years other jurisdictions have moved towards full accruals accounting, also known as resource accounting. Examples of other countries which have made the change are the United Kingdom, New Zealand, Canada and, more recently, the States of Jersey.
- 2.4. Moving to resource accounting means that income is accounted for when it is earned and expenditure when it is incurred. Therefore:

- Expenditure will be charged when the goods have been received or the services performed;
  - Income is, as far as possible, recognised when it is earned, rather than when received;
  - Items held in stock are charged to expenditure when they are issued; and
  - Capital assets are charged to expenditure over their lifetime through depreciation.
- 2.5. Experience from other jurisdictions indicates that these benefits are maximised and systems operate more efficiently where resource budgeting is implemented alongside resource accounting in order to ensure that budgets and actuals are aligned and facilitate effective budgetary control. Together, the project becomes the implementation of Resource Accounting and Budgeting (RAB) in the States of Guernsey.

### 3. The Case for Change

- 3.1. The Fundamental Spending Review Phase 2 report stated that *“effective financial governance and management are the principal enablers of sustainable progress for the States. They set and maintain the operational constraints and apply the rigour required for continued improvement”* With regard to the way the States monitor and report on finances, the report goes on to say *“There is an absence of robust and systematic monitoring of financial performance. There is a lack of effective challenge and thus a lack of transparency of the true financial position of the States. This is true both of management and financial accounting. The move to internationally recognised accounting practices is an essential and unavoidable step that must be taken to achieve the improvements required in the standards of financial management across the States.”*
- 3.2. Although this project was not one of the 107 identified as forming the Financial Transformation Programme (FTP), it has since been incorporated into the FTP given its fundamental importance as an enabler to sustain the benefits being delivered elsewhere and the assumption made in the Tribal report that this change was already underway.
- 3.3. This project also fits with the States objectives as laid out in the States Strategic Plan. The proposed project specifically contributes to the achievement of:
- The management of island resources wisely for the long term; and
  - The delivery of cost effective public services

3.4. The project would deliver on these objectives by providing an effective means to manage resources, people and assets as well as cash and by securing major improvements to information, accountability and the basis on which decisions are made.

3.5. The project would deliver:

- i. a major change in the way the States budget, manage and account for resources, to align with what is currently seen as best practice;
- ii. a process by which all of the costs associated with service provision are recognised and managed;
- iii. a system which enables medium and long term financial planning, under which all resource and asset costs will be recognised;
- iv. the recognition that the management and stewardship of the States' assets has significant implications for cost and service efficiency and effectiveness;
- v. the adoption of policies and standards which will be consistent, not just across the States, but with other public and private sector organisations providing similar services; and
- vi. financial statements which will be widely recognised and accepted by stakeholders, on island and internationally.

3.6. The project's critical success factors will therefore become:

- i. All assets and liabilities are recognised on the balance sheet giving a true picture of the financial position of the States of Guernsey;
- ii. The financial statements receive an audit opinion which certifies that they provide a 'true and fair view' of the financial affairs of the States of Guernsey;
- iii. Robust medium and long term financial planning is delivered; and
- iv. Decision making is supported by accurate and complete financial information.

#### 4. The Benefits

- 4.1. There are several key benefits to the introduction of a resource accounting and budgeting framework but it must be considered in context; it is important that it is not seen as an end in itself but as a significant contribution towards good and effective governance. The benefits fall broadly within four categories:

4.2. *Accountability*

The States are accountable for the resources under their control and have an obligation to deliver value for money. The extent to which this duty of accountability is discharged is difficult to assess without knowing the full costs of delivering the services and subsequent outcomes achieved. A resource accounting framework provides information about how these resources have been applied and, coupled with a performance framework, enables stakeholders to assess the correlation between inputs (resources spent) and outcomes (services delivered).

4.3. *Decision Making*

The availability of more accurate and complete information which is related directly to outcomes supports better decision making which, in turn, leads to enhanced efficiency and effectiveness. When information such as depreciation and the cost of capital is available, more informed and complete decisions can be taken.

4.4. *Comparability*

The current accounting framework largely records the amount of cash spent. Resource accounting records the full costs of providing goods and services and also recognises fixed assets. This means that the cost of service delivery will be comparable year on year.

4.5. *Better Use of Assets*

The States does not currently account for its multi million pound portfolio of assets at all and there are no costs to Departments for their use. Resource accounting will deliver a full asset register which will encourage better stewardship of assets by those responsible for them or occupying them.

- 4.6. In the short term, the benefits are largely around better financial control and reporting which should influence behaviours and decision making leading to better value for money. In the medium term, these changes could yield cashable savings. Although it is not possible to quantify or even estimate these at this stage, some examples are given in paragraphs 4.9 – 4.12 of savings realised elsewhere.

- 4.7. The tangible benefits to be derived from this project are

- Improvement in the systems of planning, managing and monitoring the use of scarce resources leading to improved value for money;
  - Improved transparency and better control over the costs of delivering services;
  - Application of methods and practices that increase the focus on stewardship of the States' assets through better information on how well managers use the resources entrusted to them;
  - Accountability for the use of resources by supporting key indicators of performance with accurate and relevant underlying data, reflecting the true economic impacts of resource allocation;
  - Development of a new set of financial statements to enhance the international reputation of the States as a progressive and transparent place in which to do business; and
  - Compliance with generally accepted accounting principles<sup>1</sup>, which will mean that the States' financial status and performance will be easier for key stakeholders to understand and relate to.
- 4.8. A number of examples of real world benefits which have been achieved following the transition to RAB are summarised in the paragraphs below.
- 4.9. **Stewardship of assets** – valuation of Ministry of Defence air stocks identified £1billion of inactive stock and a further £1billion of stock having a turnover of more than 60 years. The RAB control framework provided an incentive to cut these uneconomic holdings and question their retention. This led to substantial reductions in holdings. The cost was not only in the value of stock. RAB also revealed that these inactive stock items cost £870 million to maintain.
- 4.10. **Fixed asset savings** - the move to accruals RAB accounting and controls stimulated the Department for Health and Social Services in Northern Ireland to rethink its estates strategy. It moved from maintaining an expensive High Street presence to cheaper locations and concentrated transaction processing in fewer centres.

---

<sup>1</sup> Accounting principles vary across the world and are set by different governments and accounting bodies. There are therefore a number of fundamental variations across the world in both private and public sectors. For the purposes of this report, generally accepted accounting principles are defined as the basic underlying principles that are viewed internationally as representing good practice.

- 4.11. **Recognition of liabilities** – The UK Department of Health determined the full scale of clinical negligence costs and set aside provision in the balance sheet to meet this liability. Better exposure and understanding of these liabilities has led to action to prevent them arising in the first place.
- 4.12. **Better management of working capital** - The Serious Fraud Office, following introduction of RAB, identified the full value of its debtors as £4 million from uncollected cost awards. This highlighted issues with the collection of fines and costs in the courts service which have been improved.

## 5. The Way Forward

- 5.1. A full options appraisal has been carried out in preparation for this report which looked at three dimensions of options namely:

- 5.2. *The extent of change*

Various options were considered including do nothing and implementing resource accounting only to produce annual accounts on a resource basis. The preferred option is a full implementation of resource accounting and budgeting under which the States' finances would be managed by one single set of rules, securing the benefits of resource accounting in the budget setting and management process. This is the most complete option and the one which will deliver the fundamental changes required to yield the benefits described above. It will most significantly improve the management of the States' finances in the medium to long term, and the efficiency and effectiveness of the services it delivers.

- 5.3. *The set of rules under which the financial statements will be prepared – the accounting convention*

The accounting convention deals with the way the statutory accounts are constructed, the "rules" used and the way in which supporting information is disclosed to aid the reader's understanding. Having considered several options it is recommended to seek to adopt International Public Sector Accounting Standards (IPSAS) which are based on International Financial Reporting Standards (IFRS) but adapted to meet the specific requirements of the public sector.

- 5.4. *The speed at which the changes should be made*

A four year period for implementation has been selected in order to mitigate the substantial risks that would arise in attempting to deliver to a shorter timeframe. This timeframe will allow incremental changes to be made,

periods of shadow running to be adopted and fully compliant IPSAS/IFRS accounts to be produced for the year ending 31 December 2015.

- 5.5. In summary, the recommended option is full implementation of resource accounting and budgeting to be introduced over a four year timescale under the IPSAS accounting requirements. The Treasury and Resources Department will report back to the States through the Annual Budget Report and the States Accounts on progress and changes throughout the life of the project.

## **6. Impact Assessment**

- 6.1. The Treasury and Resources Department commissioned Deloitte LLP to undertake an impact assessment of the proposed transition to resource accounting and IPSAS in the summer of 2011. A detailed report has been produced and considered by the Treasury and Resources Department which examines the likely impact on the States of delivering the project as outlined in section 5.
- 6.2. The Executive Summary of the report states that *“adoption of IPSAS would clearly have a substantial impact on the format and content of the financial statements of the States. This would include the presentation of additional primary statements, recognition of additional assets and liabilities and considerably more extensive disclosure in the financial statements. Such changes, whilst challenging to implement, should provide more meaningful and comparable financial information than the current States accounts”*
- 6.3. The report covers issues of consolidation, key areas of technical challenge, out of scope entities, project planning and resource and looking ahead at any proposed changes to the IPSAS regime that might impact in the future. The report concludes that the critical areas requiring the most effort in terms of implementation of the project will be fixed assets and revenue recognition (eg accounting for income tax receipts in the year in which they are due rather than when they are paid). The findings of the report are consistent with the early work undertaken by the Treasury team.



## 7. Resourcing the Project

- 7.1. The plan envisages that the project will fall into two distinct phases.
- 7.2. The scoping phase will take up the first six months of the project and will include tasks such as a detailed confirmation of the “as is” situation (which is important given the disparate systems and approaches currently in use), an “as is” versus “to be” gap analysis, the definition of accounting policies, the agreement of scope with respect to the definition of assets and, importantly, the design of a new chart of accounts to coincide with the planned development of the general ledger, SAP.
- 7.3. The detailed scope and design phase will initially build on the gap analysis undertaken in the impact assessment and agree accounting policies. It will then involve the preparation and population of asset registers and values, detailed specifications for systems and processes, preparation of the reporting framework, the development of training strategies and production of the first set of shadow accounts.
- 7.4. The implementation phase will include continued preparation of shadow accounts, implementation of new budgeting procedures, staff training and will ultimately result in the publication of the first full set of accounts and budgets prepared under this new framework.
- 7.5. In defining the resource requirement to undertake this project, experience of RAB implementations in other public sector organisations have been taken into account before recommending the size and scope of the in house project team which needs to be created. In addition, advice has been taken from Deloitte as part of the impact assessment. This team will be resourced either through internal appointment or by direct external recruitment specifically for the project.
- 7.6. The project will require 2 Full Time Equivalent (FTE) staff to undertake the detailed work required. In addition, each Department will be required to nominate a ‘RAB Champion’ to work on Department specific elements of the project on a part time basis
- 7.7. By far the majority of the costs come from the people required to implement the project. It is estimated that a Finance and Accounting Lead will be required who will act as the project manager and be supported by a Project Support role. Part of the roles of these staff will be training, particularly in years three and four to ensure that a full training programme is delivered. This training will not only be for finance professionals but also for all managers and budget holders.
- 7.8. There will also be additional professional fees payable for the valuation of assets, additional audit fees and additional specialist training. There will be

a continued requirement for some of these professional fees once RAB is implemented although the scale of those costs cannot be estimated until further detailed work has been done especially around the extent of assets to be included and the valuation methodology.

- 7.9. The table below summarises the likely project costs by year in rounded figures:

| <b>Type of Cost</b> | <b>Year 1<br/>£'000</b> | <b>Year 2<br/>£'000</b> | <b>Year 3<br/>£'000</b> | <b>Year 4<br/>£'000</b> | <b>Total<br/>£'000</b> |
|---------------------|-------------------------|-------------------------|-------------------------|-------------------------|------------------------|
| Staff               | 150                     | 150                     | 150                     | 150                     | 600                    |
| Professional Fees   | -                       | 200                     | 250                     | 250                     | 700                    |
| <i>Total</i>        | <i>150</i>              | <i>350</i>              | <i>400</i>              | <i>400</i>              | <i>1,300</i>           |

- 7.10. There will also potentially be different resource requirements to support this upgraded approach to accounting and reporting requirements for example a Capital Accountant to maintain the asset register and also additional resources to ensure that the standards adopted are kept up to date in line with international changes. The detailed scoping and design phase will also be used to define these requirements in more detail but it is envisaged that these can be contained within the current overall finance staff establishment across the States given other structural changes which are being delivered as part of the FTP.
- 7.11. In summary, the maximum costs for the project are estimated at £1.3m over the four year life of the project to be funded from the Fundamental Spending Review Fund as part of the FTP. These project costs will be repaid from savings accruing to the fund from other projects. However, it should be noted that the introduction of RAB may itself generate cashable savings once embedded. It is recommended that the Policy Council be given delegated authority to approve detailed project costs and authorise any ongoing revenue implications. The Treasury and Resources Department should then be instructed to take account of any ongoing revenue implications in recommending budgets for future years.

## **8. Principles of Good Governance**

- 8.1. In preparing this Report, the Department has been mindful of the States Resolution to adopt the six core principles of good governance defined by the UK Independent Commission on Good Governance in the Public Services (Billet IV of 2011). The Department believes that all of the proposals in this Report comply with those principles.

## 9. Conclusions

- 9.1. In order to effectively budget, report and plan in a sophisticated environment like the States of Guernsey, it is essential to have a robust and tested accounting framework in place. Such a framework not only facilitates these activities, but enables stakeholders, both internal and external, to evaluate how effectively and efficiently the States has performed. It facilitates year on year comparison and, because the recommended framework is recognised internationally, it facilitates comparisons across jurisdictions. It also, importantly, allows the true cost of services delivered to be determined through the recognition of the existence and continued use of our valuable assets.
- 9.2. With the recognised requirement to deliver ever more efficient and cost effective services in a sustainable way, it is crucial that a more sophisticated approach be applied to financial management, reporting and planning. The changes proposed in this report will ensure that the States is able to deliver the quality of financial information required to meet these objectives.

## 10. Recommendations

- 10.1. To approve the introduction of Resource Accounting and Budgeting as outlined in this report.
- 10.2. To approve the adoption of International Public Sector Accounting Standards.
- 10.3. To approve a budget of £1,300,000 to be funded from the Fundamental Spending Review Fund and delegate responsibility to the Policy Council to approve detailed budgets for different phases of the project on production of detailed business cases.
- 10.4. To direct the Treasury and Resources Department to take any future revenue requirements into account in recommending budgets for future years.

Yours faithfully

C N K Parkinson  
Minister

Deputy J Honeybill, Deputy Minister  
Deputy R Domaille  
Deputy A Langlois  
Deputy S Langlois

## APPENDIX A



### PUBLIC ACCOUNTS COMMITTEE THE STATES OF GUERNSEY

Public Accounts Committee  
Sir Charles Frossard House  
PO Box 43, La Charroterie  
St Peter Port, Guernsey  
GY1 1FH  
Telephone +44 (0) 1481 717000  
Facsimile +44 (0) 1481 713787  
Email [pac@gov.gg](mailto:pac@gov.gg)

Minister  
Treasury and Resources Department  
Sir Charles Frossard House  
La Charroterie  
St Peter Port  
GY1 1FH

3 January 2012

Dear Deputy Parkinson

#### **Resource Accounting and Budgeting**

The Public Accounts Committee is mandated to ensure that the highest standards are applied in the management of their financial affairs and also to recommend to the States the appointment of the States External Auditors and their remuneration.

Over the past eight years, the Committee has met with the External Auditors on a regular basis to review the external audit of the accounts and discussed the fact that the States were not compliant to the United Kingdom or internationally recognised accounting standards and instead had applied its own standards. The Committee has also been monitoring the situation in Jersey and the States of Jersey conversion to UK GAAP compliant accounts in recent years.

In order to increase its focus on the States of Guernsey Accounts, the Committee set up a Working Party in 2011 specifically to review the Accounts, starting with those for 2010. Following a recommendation from the Working Party to the full Committee, in August 2011 a hearing was held where questions were asked of the Chief Accountant regarding the format and content of the Accounts.

The Committee is fully supportive of the changes being proposed to bring in resource accounting and budgeting. The current accounts are not consolidated and do not include all funds held by the States of Guernsey such as the funds held by Social Security Department and fully owned trading bodies. The accounts exclude the cost and details of assets held by the States of Guernsey as well as its contingent liabilities. Disclosure of internal controls is also limited and adherence to the international standards would bring out more information on the accountability of staff and Board members.

In a letter dated October 2011 from the International Federation of Accountants (IFAC) to the Group of Twenty (G-20), accrual based accounting for the public sector for governments and public sector institutions were recommended. The IFAC indicates that *“adoption of IPSASs would represent a significant step forward in achieving the financial transparency of national governments worldwide”* and that *“full disclosure of all assets, liabilities, and contingent liabilities is vital for assessing the true economic implications of public sector financial management”*.

The Committee believe that in order to adhere to the six Core Principles of Good Governance that it is important that the Accounts of the States of Guernsey follow internationally accepted accounting standards such as IPSAS (International Public Sector Accounting Standards). Not only will this be beneficial to the States of Guernsey and the people of Guernsey in being more open and transparent and indicating those accountable, it will allow for easier comparison on the performance of other jurisdictions.

Promoting a ‘spend to save’ project such as this, can only benefit Guernsey in the long term. The Committee fully supports the proposals put forward by the Treasury and Resources Department.

Yours sincerely



Deputy L Gallienne  
Chairman

Deputy B Paint, Vice-Chairman  
Deputy M Garrett  
Deputy Mrs J Stephens  
Deputy M Storey  
Mr M Best  
Mr C Bradshaw  
Mr E Thomas  
Advocate M Helyar

**(NB The Policy Council supports the proposals contained in this Report.)**

**The States are asked to decide:-**

XII.- Whether, after consideration of the Report dated 20<sup>th</sup> December 2011, of the Treasury and Resources Department, they are of the opinion:-

1. To approve the introduction of Resource Accounting and Budgeting as outlined in that report.
2. To approve the adoption of International Public Sector Accounting Standards.
3. To approve a budget of £1,300,000 to be funded from the Fundamental Spending Review Fund and delegate responsibility to the Policy Council to approve detailed budgets for different phases of the project on production of detailed business cases.
4. To direct the Treasury and Resources Department to take any future revenue requirements into account in recommending budgets for future years.

## COMMERCE AND EMPLOYMENT DEPARTMENT

### CONSTRUCTION OF A REPLACEMENT SLAUGHTERHOUSE

The Chief Minister  
Policy Council  
Sir Charles Frossard House  
La Charroterie  
St Peter Port

13<sup>th</sup> December 2011

Dear Sir

#### **1. Executive Summary**

- 1.1 The Department operates the Island's slaughterhouse (via a contracted out operator) from a prominent Victorian building in St Peter Port. The building does not meet modern standards for such facilities and is not capable of conversion or refurbishment to the necessary standards.
- 1.2 The Environmental Health Section of the Health and Social Services Department is responsible for the regulation of food hygiene and has advised that the facility should not be licensed to operate beyond April 2012. However, with a clear States' decision to proceed with a replacement within 12 months made prior to that date, the existing facility will be able to operate until the new unit is commissioned.
- 1.3 The project is not part of the States capital prioritisation process and the £2 million cost will be funded by use of the Department's existing capital allocation and the capital account within the Farm Loans Fund. There will be a saving of approximately £120,000 per annum accruing mainly as a result of the discontinuation of compensation payments put in place in response to the BSE crisis in the mid 1990s. This contribution alone will be sufficient to fund the rebuild costs over a 14 - 16 year period.
- 1.4 Once commissioned the replacement slaughterhouse (abattoir) will provide an opportunity for the greatly increased availability of locally produced beef and the potential for an expanded meat (beef, sheep and pig) production sector.
- 1.5 A site for the replacement slaughterhouse has been identified in the Longue Hogue reclamation area adjacent to the cattle carcase incinerator.
- 1.6 Further to a tender process that closed at the end of November 2011, for the design and build of a suitable replacement facility, the Department

recommends that approval is given to accept the preferred tender submitted by Harbour View Construction Limited.

## **2 Existing Facilities and the Need to Improve**

- 2.1 The Island has been served for some 150 years by the existing Slaughterhouse located on the Castle Emplacement in St Peter Port. The building is not suitable either as a structure, or in terms of location, to be the Island's Slaughterhouse and expert surveys have shown that it is not cost effective or practical to consider its conversion to comply with modern standards for the slaughter of livestock.
- 2.2 In 2009 the Environmental Health Section of the HSSD (EHS) reviewed the slaughterhouse operation and commissioned an independent study by the UK's Meat Hygiene Service. The conclusion of the study was that the existing facility, whilst well and carefully operated, fell sufficiently far below accepted standards to represent a public health risk.
- 2.3 The recommendation from the Director of Environmental Health and Pollution Regulation was that the St Peter Port Slaughterhouse should be closed and be replaced by a new facility. Furthermore it was specified that it be operated to modern, EU equivalent, standards, which would enable the Island to export meat once again.
- 2.4 It is believed that good animal welfare practice would no longer condone the export of livestock to another jurisdiction for slaughter and many of the older culled dairy animals would not be considered 'fit' to travel. The operation of a new fully compliant slaughterhouse will mean that the meat from most dairy cows can once again be used for human consumption, on the island or abroad, thus significantly reducing the need to incinerate the bodies of culled cattle.
- 2.5 It was agreed that the existing facility in St Peter Port could remain open for a further two years until April 2012, with some expenditure on a number of essential improvements, to ensure this part of the Island's farming infrastructure remained available for use while a replacement was planned and built. The EHS has been kept fully informed throughout the development of this project.
- 2.6 It became clear during 2010 that delays, arising from considerations of a suitable site for the development which were outside the control of the Department, would mean that the initial timescale for the construction and commissioning of a new facility by April 2012 could not be met. Despite this, the project has been progressed with the aim of being in a position to seek a firm decision on this project from the States of Deliberation prior to April 2012.
- 2.7 On the current timescale and with States approval, the new slaughterhouse would be under construction during 2012 and in full operation in early 2013.



### **3 Benefits For the Island arising for this Project**

3.1 A replacement slaughterhouse built to modern meat industry standards and designed with local needs in mind will benefit Guernsey in the following ways:-

- The continued and indeed potentially increased availability of locally produced meat after 2012.
- Exports of meat from all types of locally raised livestock will be possible.
- Built, operated to EU standards and licensed by the Health and Social Services Department, the facility will allow the removal all age restrictions on the slaughter of local cattle for human consumption both on and off the Island.
- Forming the basis of a meat (beef) production industry, the slaughterhouse could facilitate the diversification of local farming and improve its long term viability.
- Better designed facilities with a larger throughput will allow for commercially viable opportunities to increase the income from carcasses arising from such commercial activities as the sale of hides and offal.
- A substantial percentage of the approximately 400 cattle each year that do not currently enter the human food chain could be available for human consumption.
- There would be less waste of locally reared animals and consequently less fuel would be burnt to dispose of carcasses in the Island's carcase incinerator. This will reduce costs and carbon emissions.
- Co-location with the Island's carcase incinerator, most easily achieved at Longue Hougue, removes the need to transport offal and specified risk material by road for disposal.
- The existing slaughterhouse building will be available for re-allocation to other uses.
- Immediate and continuing revenue savings of some £120,000 or more per annum with the cessation of BSE related support schemes for dairy farmers.

### **4 Location**

4.1 After the Island's cattle carcase incinerator was built in 1996, outline plans were made for a new slaughterhouse to be built alongside it at the Longue Hougue site. However, this project was overtaken by planning for the Island's management of waste and, until that was concluded, a policy was adopted of maintaining and operating the existing slaughterhouse facility in St Peter Port at lowest cost until such time as a clear determination of land needs at Longue Hougue was made.

4.2 Following the mid 1996-7 consideration of a location for a new slaughterhouse, the process was repeated in 2003. That too concluded that a new facility would best be accommodated at the Longue Hougue site (alongside the cattle carcase incinerator).

- 4.3 In 2010, and whilst the situation was likely to have changed very little in the intervening period, but acknowledging that the most recent of these reviews was some 7 years old, the Department worked with the Treasury and Resources Department's States Property Service and the Planning Section of the Environment Department to determine what options existed for locations with appropriate use classes for a new slaughterhouse and, in the light of the value of co-location, the cattle carcase incinerator also.
- 4.4 The results of this site search suggested two possible sites: Longue Hougue, St Sampson and St Andrew's Quarry / "Best's Brickfield". The site options were appraised further:-

| <b>Site Selection Criteria</b>   | <b>Longue Hougue</b>  | <b>St Andrew's Quarry</b>   |
|--|---|---|
| Land in States ownership   | Yes   | Yes   |
| Planning Policy compliant  | Yes   | Yes   |
| Available for completion of the development in the required timescale (April 2012)           | Yes   | No  |
| Is the cost of co-location with a carcase incinerator low?                                   | Yes   | No  |
| Away from general public access areas  | Yes   | Yes   |
| Sufficient land for the needed plant to be built/relocated and for bio-security              | Yes   | Yes   |
| Close proximity to the existing cattle carcase incinerator for waste disposal                | Yes   | No  |
| Proximity to the Island's dairy farmed areas to allow short journey times.                   | No  | Yes   |
| Sufficient land for extension to provide for a possible meat cutting facility in the future. | Yes   | Not known, but assumed to be the case -> Yes                                  |
| <b>Score</b>   | <b>8/9</b>  | <b>6/9</b>  |
| <b>Assessment</b>  | <b>Preferred option</b><br>Lowest cost to provide full functionality. | <b>Second option</b><br>Co-location with incinerator would require extra cost |

- 4.5 Relevant to the appraisal of the St Andrew's Quarry site, it is estimated that the cost of moving the existing carcase incinerator to another location could be in the region of £500,000. Whilst the building that would house the Slaughterhouse is of a standard, agricultural, type and could be dismantled and relocated, it would be most cost effective to leave it in situ for any alternative uses and to construct a new building on a new site (that is, St Andrew's Quarry) and move the incinerator and ancillary equipment only.

- 4.6 Both services are operated for the Department by a slaughter man retained on contract. This arrangement has proved effective for more than 15 years and is expected to continue. The incinerator and slaughterhouse could operate from separate sites, but this would be more costly in operator time and running expenses.
- 4.7 Co-location will give greater opportunities for good value for money to be obtained on this outsourced contract. Co-location also gives more secure movement of specified risk and other waste materials from the Slaughterhouse for approved disposal by incineration. Co-location is favoured by both Environmental Health and the Island's Health and Safety Executive.

The Department has concluded that the Longue Hougue site, adjacent to the cattle carcase incinerator, is the most appropriate location for the replacement slaughterhouse.

This assessment is fully supported by the States Property Service and the Treasury and Resources Department.

The development of the project has continued on that basis.

## **5 Project Funding**

- 5.1 The project is not part of the States capital prioritisation process. This arises because of the urgency, to act by 2012, dates to communications from the Director of Environmental Health & Pollution Regulation sent in March 2010 and it would, therefore, not have been possible to have submitted a capital bid that could have received funding before 2015.
- 5.2 The capital funding for the construction of the replacement slaughter facility will be offset by annual revenue savings from the cessation of support expenditure that will no longer be paid to farms. It will also arise from increased returns from slaughterhouse, incineration, and euthanasia charges. Annual net budget savings in the region of £120,000 have been conservatively calculated as arising from this change.
- 5.3 Current support payments and revenue expenditure of immediate relevance to the opening of the new slaughterhouse are as follows:-

|  |              |
|--|--------------|
| Carcases not entering the food chain at present        | 450 per year |
| Of which, carcasses not suitable for human consumption | 50 per year  |
| Thus, carcasses eligible for Cull Cattle Compensation  | 400 per year |

|   |            |                       |
|---|------------|-----------------------|
| Value of compensation per carcase                           | (£)        | 150                   |
| Euthanasia cost currently supported for all carcases        | (£)        | 30                    |
| <b>(i) Cull Cattle Compensation annually (£150x400)</b>     | <b>(£)</b> | <b>60,000</b>         |
| <b>(ii) Euthanasia support annually (£30x450)</b>           | <b>(£)</b> | <b>13,500</b>         |
| <b><u>Total Annual Cull Cattle Scheme cost (i + ii)</u></b> | <b>(£)</b> | <b><u>73,500</u></b>  |
| Incinerator fuel cost per carcase (450 supported)           | (£)        | 175                   |
| <b><u>Total Carcase Incineration costs supported</u></b>    | <b>(£)</b> | <b><u>78,750*</u></b> |

\*Note: With the opening of the new slaughterhouse there will be many fewer whole cattle carcases needing to be disposed of by incineration. At the same time, the greater number of animals going through the new slaughterhouse will result in an increase in the amount of slaughterhouse waste to be incinerated.

However, a charge for waste disposal is included in the slaughterhouse fee structure and overall, it is estimated that the net cost of fuel paid by the Department will reduce by some £47,000 per year. This gives a conservative estimate of annual cash savings of £120,000 at existing rates.

- 5.4 The estimate of the period of time for all capital costs to be covered by these savings and increased fees, is between 14 to 16 years depending on the final capital cost (see also Section 10 of this Report).
- 5.5 In 2009, the Department transferred £1.07 million of unspent balances to its capital allocation in anticipation of this project. The Department's capital allocation will stand at £1.4million at the start of 2012. The Department cannot ignore routine capital requirements, but accepts that it will have to re-prioritise and re-schedule projects to release £1.3million of this total to part-fund the slaughterhouse project.
- 5.6 The Farm Loans Fund has a capital account of some £701,000 that, subject to the approval of the States, could be transferred to the capital allocation for the slaughterhouse project to complete the funding. There is approximately £230,000 outstanding on loans for farm infrastructure investment projects.
- 5.7 The Treasury and Resources Department has confirmed that if the capital account of the Farm Loans Scheme was transferred in its entirety to the Department's capital allocation, for the purposes of part funding the Replacement Slaughterhouse project, the Commerce and Employment Department would be able to draw loans from States Treasury, as an alternative funding mechanism for existing and future Farm Loans.

- 5.8 The cost of any subsidised rates on loans issued to farm businesses would be recorded in the Department's revenue accounts in the future, increasing transparency as well as releasing a significant and vital capital sum. The net result of this would be the continuation of the Farm Loans Scheme using an alternative funding mechanism. The Department will ensure that the terms of all existing farm loans remain unchanged by the proposal.
- 5.9 The Department would in any event have been reviewing the operation of the Farm Loans Scheme during 2012 as part of its wide review of the dairy industry, as approved by the States at its November 2011 meeting.
- 5.10 Therefore the Department can confirm that it will report back to the States on this subject in 2012, either as part of the wider dairy industry review or separately, as seems most appropriate and expedient. This development which alters the Farm Loans Scheme funding will simply be another factor to take into account in the wider industry review.

## **6 Transitional arrangements for the Cull Cattle Compensation Scheme.**

- 6.1 The States last received a report on the Cull Cattle Compensation Scheme in April 2002 (Billet VI 2002) from the, then, Agriculture and Countryside Board. At that time the States approved, inter alia, that the Board (and thus now the Department) would report back "*... to the States on the operation of the cull cattle compensation scheme without delay if developments in respect of BSE mean that it should be substantially altered or discontinued.*" The development of a replacement slaughterhouse which will, for the first time in 15 years, enable older animals to enter the food chain is such a development.
- 6.2 In consultations with the Guernsey Farmers' Association – which represents Island dairy farmers and whose cull cattle will contribute significantly to the increased use of the proposed modern standard slaughterhouse – the Department has been made aware of concerns regarding the impact of an abrupt closure of the BSE support scheme when the new slaughter facility opens.
- 6.3 The meat market has changed over the past 15 years. There has been increasing media comment regarding the taste and high quality of premium Guernsey beef, but it is also acknowledged that the market for meat from the older, "cull" animals is untested. As a result it cannot be known until the new facility is built, licensed, and in operation, how easy it will be to obtain a sustainable price for all of the meat likely to become available.
- 6.4 Whilst there is good reason to suppose that the best cuts of beef will find a ready local market, it is anticipated that a considerable quantity of non-premium meat will be exported to the processing market for which prices may be uncertain and for which contacts will need to be built in an initial market development period, which may take some months to settle down. However, we are assured that a reliable export market for Guernsey beef is likely to exist both in England and in France.

- 6.5 Against that background (and to give an orderly transition to the new arrangements), the Department believes that the Cull Cattle Compensation Scheme should cease once the new slaughterhouse is in operation, but for a limited period of between 6 and 12 months, a portion of its funding should be retained for a Transitional Carcase Underwriting Scheme.
- 6.6 Such an underwriting scheme would assure farmers that those cattle, which are sent for slaughter and confirmed by veterinary examination to be fit for human consumption, will return to the farmer no less than £150 per carcase (the current flat rate Cull Cattle Compensation payment) after all slaughter costs are taken into account.
- 6.7 At least 50% of cattle that will pass through the slaughterhouse are likely to be culled animals from the dairy herd, not necessarily of the best quality and for which a new market must be developed. Early contacts have suggested that the average price that could be realised for these should be no less than £200 to £250 per carcase with the average somewhat higher. With the slaughter fee of £64.50 per animal and as yet unknown export costs, these should still be expected to return at least £150 to the livestock farmer. If that were to be the case, the underwriting cost would be minimal or non-existent.
- 6.8 The Department considers that the most appropriate approach to this will be to report to the States in detail once the slaughterhouse replacement project is approved and underway, and when farmers have been consulted further<sup>1</sup>.
- 6.9 The Department considers it will be possible to return to the States with a fully detailed proposal at least 4 months before the opening of a new slaughterhouse.

## **7 Project Management**

- 7.1 The project is being managed in full compliance with States' approved capital project procedures. A Project Board was formed with membership and staff and political level from the Commerce and Employment Department and the Treasury and Resources Department.
- 7.2 The Project Board first met on 3<sup>rd</sup> May 2011 and has approved all substantive documents and procedures adopted by the Project Team. By December 2011 the Project Board had met on 8 occasions to discharge its responsibilities for project oversight.
- 7.3 The Project has been examined through the States' approved Gateway Review process and the Department would like to record its thanks to the members of

---

<sup>1</sup> It should be noted that compensation for diseased animals that are compulsorily slaughtered under animal health legislation is unaffected by these proposals. The compulsory slaughter compensation for cattle is £600 per animal.

staff who have made time to support this internal auditing process and for the constructive feedback given to the Project Team at all times.

- 7.4 The Gateway Review team recognised the robustness of the business case and the urgency of the project, and that it had strong support from the Treasury and Resources Department such that a funding mechanism was agreed without the need for funding from the capital reserve.
- 7.5 The most significant risks identified in this project were, in addition to the appropriate discharge of proper procurement processes (which have been followed using the standard approved methodology for States capital projects) were:
- specialist/technical and design support
  - funding
  - site selection
  - acceptability of the design solution for local industry needs
  - communication with users
  - the exit strategy for existing support schemes
- 7.6 These issues were all addressed and evidence provided to the Gateway Review Team which gave the project an AMBER status at Gateway 3, indicating that the project and procurement process had been completed in a satisfactory manner, such that the risks have been managed such that the project can be anticipated to be successful.
- 7.7 The matters outstanding of the Gateway Review, and which necessitated the AMBER status rather than a GREEN status, were:
- planning permission which was outstanding at the time (but see Section 9) and
  - confirmation of funding, which is dealt with in Section 5 above.

## **8 Procurement**

- 8.1 Due to the specialist nature of the proposed facility, the project team appointed technical consultants through an open tender process. Advertisements were placed in the Meat Trades Journal and on the States Tender Portal. Following an objective assessment process, the Project Board appointed Meat and Livestock Commission Services Limited (MLCSL) to provide vital technical and design support to the procurement process.
- 8.2 MLCSL drew up an Outline Specification and Facility Layout and Design for the project and took part in consultation meetings with facility users. As a result of these very positive meetings the designs were modified and subsequently given approval by the facility's users as being suitable for their commercial requirements. The plans were also supported by the Director of Environmental Health.

- 8.3 Following that process, a detailed Performance Specification was finalised, including a recommendation for a “Design and Build” procurement process to be adopted for the project.
- 8.4 A Pre-tender qualification process was completed in October 2011 and the Project Board approved the selection of five contractors to be invited to tender for the project.
- 8.5 A tender evaluation scheme was drawn up and approved by the Project Board. In the light of the technical nature of the project, the evaluation scoring was agreed as 60% “Quality” and 40% “Price”.
- 8.6 An assessment of “quality” in this context does not refer to the quality of the finished slaughterhouse, which is defined in the specification, but rather to the quality of the contractor’s tender proposals. For this project the quality assessment includes consideration of the construction programme, the contractor’s design, construction method statements, quality control and supervision, and health and safety proposals.
- 8.7 The tender period commenced on 18<sup>th</sup> October 2011 and, following two agreed extensions, closed at 10 AM on Monday 28<sup>th</sup> November 2011. Of the 5 selected contractors, 3 returned compliant tenders by the end of the tender period. Following assessment of the submitted and compliant tenders that of Harbour View Construction Limited scored highest under the evaluation scheme and the Project Board recommends that its tender for this project should be accepted by the States. The Department endorses that recommendation.
- 8.8 The Department can confirm that the States’ Rules for Financial & Resource Management have been followed.

## **9 Planning Considerations**

- 9.1 Previous site searches completed in collaboration with the Environment Department confirmed that the area at Longue Hougue is appropriately zoned for the establishment of a slaughterhouse. (See section 4 above).
- 9.2 The proposals for this development were formally submitted to the Environment Department on 18<sup>th</sup> October 2011 seeking planning consent.
- 9.3 Subsequently, work was done in communication with the Environment Department to slightly alter the position of the unit so that it could be sited clear of the Development Proximity Zone which extends from the fuel depot in Bulwer Avenue, and in relation to landscaping considerations.
- 9.4 Planning approval for the project was granted by the Environment Department on 19<sup>th</sup> December 2011.



## **10 Slaughterhouse Location and Layout**

- 10.1 The approved plans showing the location and the internal and external designs for the proposed replacement slaughterhouse are appended to this Report.

## **11 Financial and Resource Management**

- 11.1 The final project costings are as follows:

### Pre tender Costs

|                           |            |
|---------------------------|------------|
| Consultant's fees (MLCSL) | £26,058.38 |
|---------------------------|------------|

### Post tender Costs

|  |               |
|--|---------------|
| Contract - Harbour View Construction Ltd | £1,698,488.69 |
|--|---------------|

|                               |             |
|-------------------------------|-------------|
| Contingencies (Risk Register) | £125,452.93 |
|-------------------------------|-------------|

|                                       |             |
|---------------------------------------|-------------|
| Supervision and commissioning (MLCSL) | £150,000.00 |
|---------------------------------------|-------------|

|                             |                      |
|-----------------------------|----------------------|
| <u>Total Project Budget</u> | <u>£2,000,000.00</u> |
|-----------------------------|----------------------|

- 11.2 The project will be commissioned by the end of 2012 so all post tender expenditure is intended to take place in the 2012 financial year.
- 11.3 As this facility replaces an existing slaughterhouse that is operated by a contracted out operator, there are no additional resource implications associated with this project once it has been completed.

## **12 Consultation**

- 12.1 The Department has worked closely with the Treasury and Resources Department, the States Property Service, and the Environmental Health Section of the Health and Social Services Department on this project.
- 12.2 The Law Officers of the Crown have been consulted on this Report.
- 12.3 The operator of the Island's current slaughterhouse and carcase incinerator, and slaughterhouse users (farmers, livestock owners, and butchers) have been consulted at evening meetings attended by the project team and the retained technical consultants. This has provided valuable guidance on their commercial requirements and has influenced the design of the facility, in the context of the regulatory requirements for a modern food production facility.
- 12.4 The Department believes that it has complied fully with the six principles of corporate governance in the preparation of this States Report.

## 13 Recommendations

13.1 The Department recommends the States as follows:

- a) To approve the construction of a replacement slaughterhouse at the Longue Hougue Land Reclamation Site as set out in this Report;
- b) To approve acceptance of the tender of £1,698,488.69 from Harbour View Construction Limited for this work;
- c) To approve the closure of the capital account of the Farm Loans Fund and the transfer of the balance to the capital allocation of the Commerce and Employment Department;
- d) To approve a capital vote of £2,000,000 for the construction and commissioning of the replacement slaughterhouse, charged to the capital allocation of the Commerce and Employment Department;
- e) To note the Department's intention to report back to the States in 2012 with detailed proposals for the future of the Cull Cattle Compensation Scheme and the Farm Loans Scheme as set out in this report.

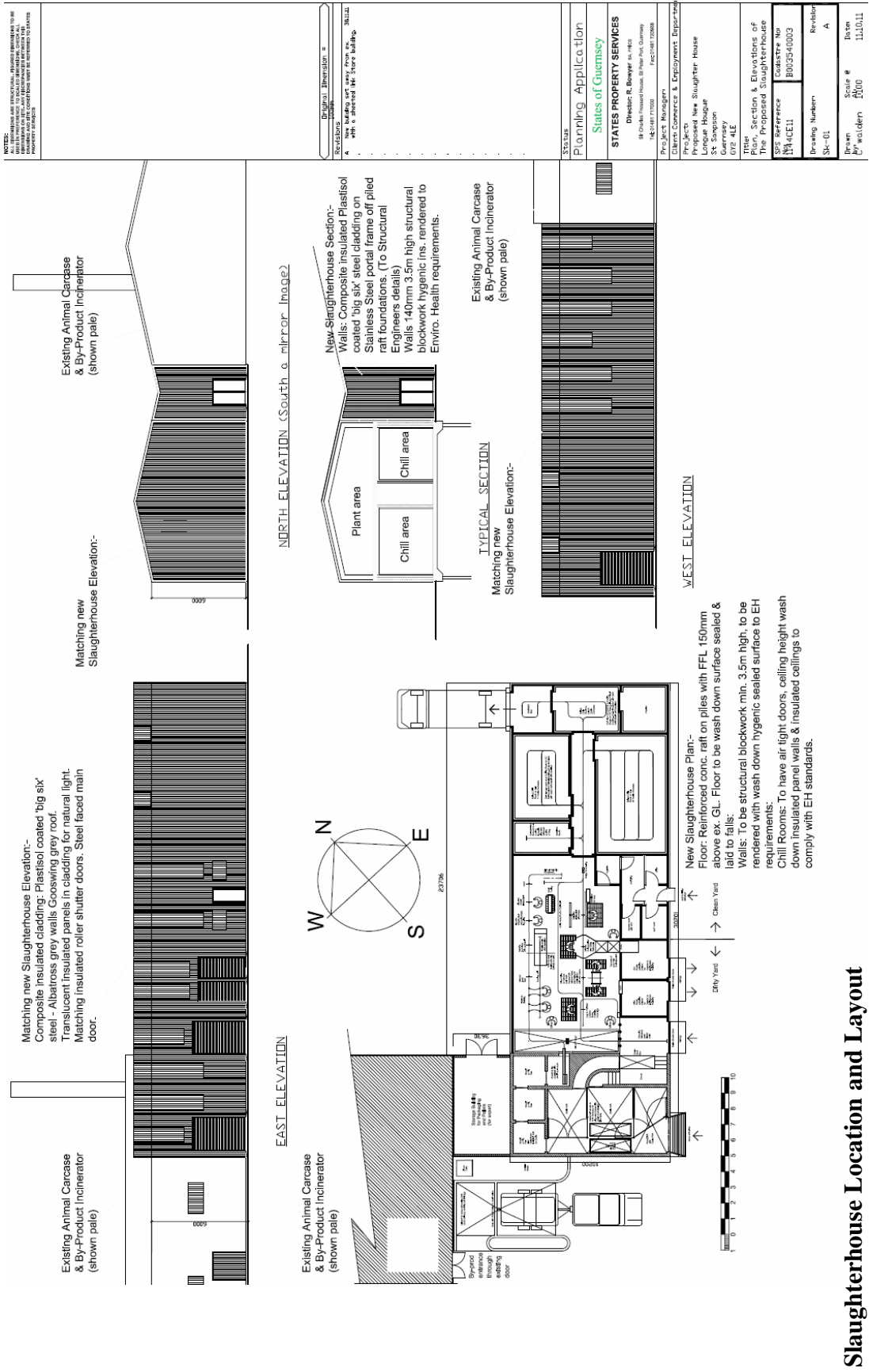
Yours faithfully

C S McNulty Bauer  
Minister

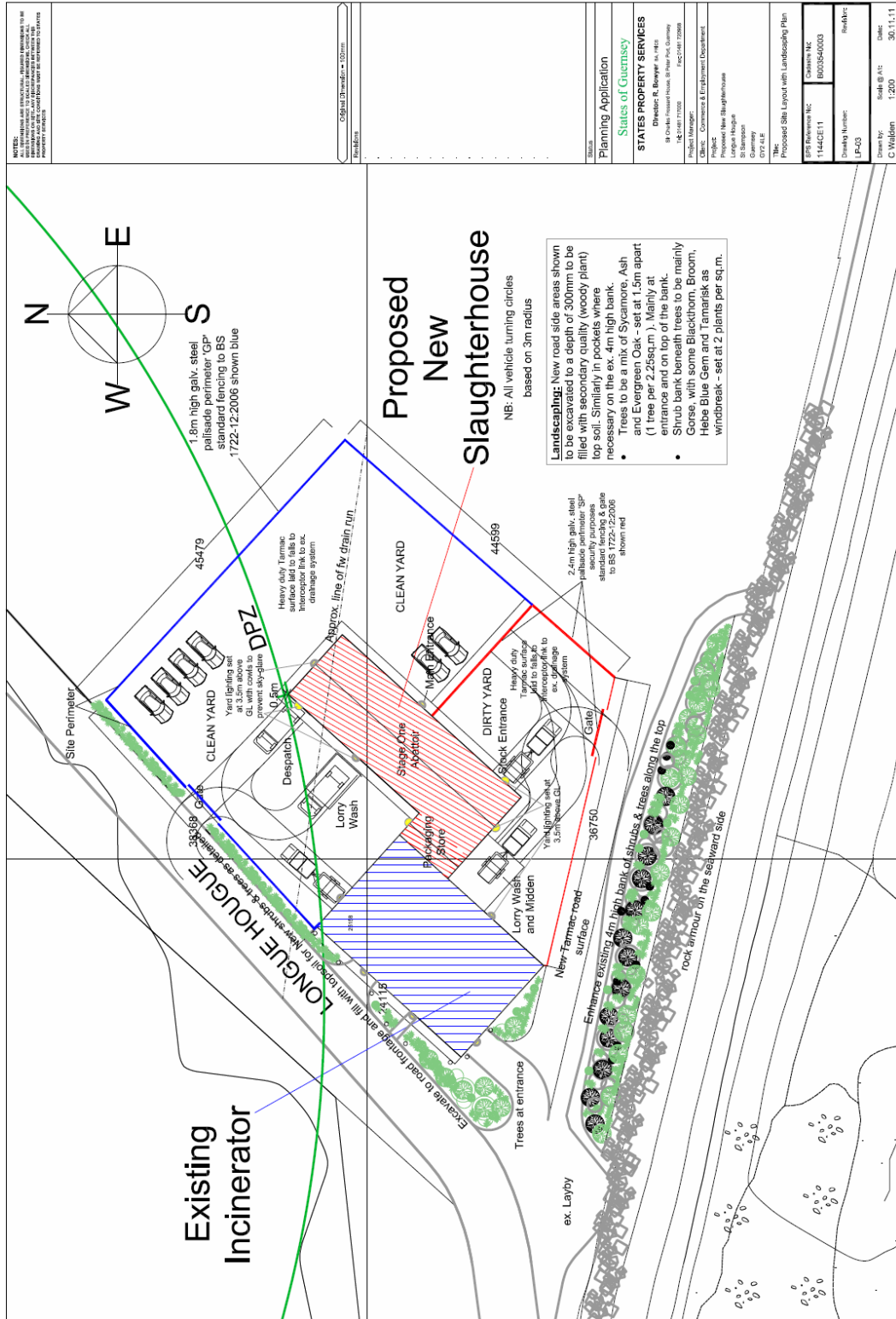
M Laine  
Deputy Minister

R Matthews  
M Storey  
A Brouard  
States Members

P Mills  
Non States Member



Slaughterhouse Location and Layout



## Slaughterhouse Location and Layout

(N B The Treasury and Resources Department has commented as follows:



Policy Council  
Sir Charles Frossard House  
La Charroterie  
St Peter Port

13 January 2012

Dear Chief Minister

**COMMERCE AND EMPLOYMENT DEPARTMENT – CONSTRUCTION OF A REPLACEMENT SLAUGHTERHOUSE**

The Treasury and Resources Department recognises the urgent need for the replacement of the existing slaughterhouse and that the constructing of new, modern facilities will allow the sale of meat from all types of locally reared livestock. This will result in a reduction in States annual revenue expenditure due to the discontinuation of the cull cattle compensation scheme.

Although this project is not part of the current Capital Programme it has been subject to the Gateway Review process which provides assurance to all stakeholders that the project has merit and that it can be justified on a 'business needs' basis with an assessment of the likely costs, risks and potential for success.

The final Gateway Review was 'amber' as planning permission had not been received and the panel was also concerned about the funding mechanism for the project. However, both issues have now been resolved satisfactorily.

The Treasury and Resources Department notes the funding for this project is proposed to be a combination of routine capital allocation (which largely comprises a transfer from Unspent Balances in 2010) and use of the capital account of the Farm Loans Fund. This is not the usual funding mechanism for projects of this size; however, given its exceptional nature and specifically the time constraints, the Treasury and Resources Department supports this proposed arrangement and the States Report.

However, when considering this Report and the recent Report concerning the 'Independent review of the Dairy Industry', Members noted that the farming industry receives a number of different subsidies from the States. The Treasury and Resources Department, therefore, considers it essential that the Commerce and Employment Department undertakes a value for money review of the total subsidies currently being provided when developing its comprehensive and coherent vision for the long-term future of the dairy industry in Guernsey.

Yours sincerely

C N K Parkinson ,  
Minister )

**(NB The Policy Council supports the proposals contained in this Report.)**

**The States are asked to decide:-**

XIII.- Whether, after consideration of the Report dated 13<sup>th</sup> December 2011, of the Commerce and Employment Department, they are of the opinion:-

1. To approve the construction of a replacement slaughterhouse at the Longue Hougue Land Reclamation Site as set out in that Report.
2. To approve acceptance of the tender of £1,698,488.69 from Harbour View Construction Limited for this work.
3. To approve the closure of the capital account of the Farm Loans Fund and the transfer of the balance to the capital allocation of the Commerce and Employment Department.
4. To approve a capital vote of £2,000,000 for the construction and commissioning of the replacement slaughterhouse, charged to the capital allocation of the Commerce and Employment Department.
5. To note the Department's intention to report back to the States in 2012 with detailed proposals for the future of the Cull Cattle Compensation Scheme and the Farm Loans Scheme as set out in this report.

**PUBLIC SERVICES DEPARTMENT****FUTURE BUSINESS ENVIRONMENT FOR GUERNSEY HARBOURS**

The Chief Minister  
Policy Council  
Sir Charles Frossard House  
La Charroterie  
St Peter Port

21<sup>st</sup> December 2011

Dear Sir

**1.0 Executive Summary**

- 1.1 Government has a key role in ensuring that public services are delivered. However, it has been suggested in the past by the Advisory and Finance Committee, and more recently by the Office of Utility Regulation and in the context of the Fundamental Spending Review, that government does not necessarily have to be the provider, and indeed may not be the most capable body to run all of the activities which may be necessary to deliver those public services.
- 1.2 Guernsey Harbours currently operates as a Business Unit of the Public Services Department. The current structure and the mechanisms by which Harbour operations are delivered are complex, with multiple strands of control being exercised by different sections of the States, whilst over-arching objectives that should apply to the operation of the Harbours, are not clear. As a result, the business struggles to act in a commercial manner and cannot realise the full potential that should be available in its operations. This report assesses the situation and examines what can be done to change it, to improve the efficiency and effectiveness of the business and benefit the community as a whole.
- 1.3 Based on the information available to date, the Department considers that simplifying arrangements by transforming Guernsey Harbours into a States-owned Trading Company, which is wholly owned by, but operates at arm's-length from, the States, is the best way forward. With this report, the Department seeks permission from the States to conduct further detailed investigation into this option, with a view to reporting back to the States at a later date.

## 2.0 Introduction and Background

- 2.1 Prior to the Machinery of Government changes in May 2004, the then Advisory and Finance Committee identified a number of States trading entities (including the Harbours) which “*might in future be areas that the States determine should be delivered differently*”. The Fundamental Spending Review, commenced in 2009, identified possible benefits for changing the current structures of Public Services Department Business Units (Summary Opportunity Report PSD\_009):

***“Benefit***

- *Increased efficiency of operations that release funds to deliver greater value or reduce the liability of PSD.*
  - *Increased income generating capacity of the activities of the business units.”*
- 2.2 The Department’s Business Units operate in a commercial environment serving customers who are paying for a service. These customers expect standards of quality, timeliness, response etc which are often difficult to deliver in the context of a political structure. By its very nature, government embraces a wide range of procedures, protocols, corporate governance, consultation processes, scrutiny etc to a degree which is rarely experienced by modest-sized business. The resulting risk is that the business becomes focused on satisfying all of the processes and protocols and not on delivering the key objectives for which it was established in the first place.
- 2.3 In Billet I of 2011, the Public Services Department reported that it had, with the assistance of the Office of Utility Regulation (OUR), been reviewing the options for changes to the ownership and corporate oversight of the various businesses currently within its mandate. This review had concluded that benefits could accrue from changes to the businesses. The States noted the Department’s ongoing evaluation of the options for several of its Business Units and its intention to report to the States of Deliberation with its recommendations in due course.
- 2.4 The Department reported back to the States with its recommendations for Guernsey Water and Guernsey Wastewater in January 2012. This report examines the case for changing the business environment of Guernsey Harbours.
- 2.5 It should be noted that, given that some aspects of changing the business environment are the same, parts of this report largely replicate sections that have previously been seen in the ‘Future Business Environment for Guernsey Water and Guernsey Wastewater’ report (Billet III of 2012).
- 2.6 Throughout this report, a number of abbreviations are used. Although these are defined in the text at appropriate points, a glossary is also included for ease of reference (Appendix 1).



### 3.0 Guernsey Harbours – Business Environment Review

#### What falls under ‘Guernsey Harbours’?

- 3.1 Guernsey Harbours, as presently structured, is a Business Unit of the Public Services Department and delivers a wide range of functions – governmental; legislative; administrative; commercial; operational; maintenance and enforcement, which are generally grouped as follows:
- Port Operations (commercial and leisure at St Peter Port and St Sampson)
  - Pilotage and licensing
  - Local lighthouse authority
  - Coast Guard and Search and Rescue
  - Maritime Safety Administration and vessel surveys,
  - Registrar of Shipping
- 3.2 In fulfilling these roles, some 77 full-time equivalent staff and 5 seasonal staff are employed by Guernsey Harbours. The Public Sector Remuneration Committee (PSRC) sets the pay and terms and conditions.
- 3.3 It is unusual for all of the above functions to be undertaken by a single port organisation, thus it is difficult to directly compare Guernsey Harbours to other ports.

#### Overarching Aim

- 3.4 As with all of the reviews undertaken of Department Business Units, the main focus in examining Guernsey Harbours has been **value for the community**.
- 3.5 At the foundation of any desire to deliver better value, is the need for the service to function in a more effective and efficient manner. A factor that can, in turn, have significant bearing on a business’s ability to function effectively and efficiently is the underlying funding mechanism in place – whether it enables expenditure to take place when it is advisable from the perspective of business operations (to accrue operational efficiencies and long-term savings) or, rather, only as and when finances are made available via competitive prioritisation systems.

#### The Review

- 3.6 In its 2009 report, which was presented to the States in Billet I of 2011, the OUR concluded that the option of incorporating the Harbours (creating a wholly-owned States Trading Company) may be feasible, but there were issues to consider (such as the need to deliver ‘public-good’ services, like the Coastguard,

alongside commercial services). It suggested that consideration could be given to moving Guernsey Harbours' status to that of a 'Revocable Trust'<sup>1</sup>.

- 3.7 The Department commissioned a further study from Fisher Associates to provide advice on the most suitable business model for the future management of the Harbours, with the objective of giving management more commercial freedom, whilst maintaining public ownership of assets.
- 3.8 Fisher Associates examined a range of business models during the course of their investigations:
- Status quo ('Do Nothing');
  - Implementation of 'Best Practice' for ports owned by local authorities, as based upon the findings of the 'Municipal Ports Review' for England and Wales (a 'Do Something' option);
  - Creation of an 'arm's-length' company, wholly owned by the States of Guernsey (incorporation to a States Trading Company (STC));
  - Creation of a Trust Port (an independent statutory undertaking run on a not-for-dividend basis, with profits re-invested back in the Port).
- 3.9 The subsequent reports are attached as Appendix 2 (Baseline Report) and Appendix 3 (Structural Report).

#### **4.0 Drivers for Change (as Highlighted in the Fisher Associates Review)**

- 4.1 In their examination, Fisher Associates identified a number of shortcomings in the current structure and operations, which indicate a need to change. This is not a criticism of the existing staff team, which is hard working and conscientious. Rather, it is in recognition that the current governance structures do not lend themselves to the running of a commercial port business. These issues include:
- i) Compared to an incorporated port or Trust Port, Guernsey Harbours enjoys considerably less relevant maritime and specialist commercial expertise in its governance;
  - ii) There is no long-term plan to deliver, step-by step:
    - Modern fit for purpose port facilities;
    - Economic benefits arising from maritime activity;
    - Economic benefits arising from non-marine areas.

A harbour should be leading development of ideas, and then plans, which would seek to realise all of the above benefits;

---

<sup>1</sup> A Trust Port is an independent statutory undertaking run on a not-for-dividend basis, with profits re-invested back in the Port. A 'Revocable' status would present the States with greater means to intervene in circumstances where it believed the interests which the Trust was assigned to serve, were not being met.

- iii) There are significant constraints on Guernsey Harbours' ability to make decisions. Decisions related to the Harbours, from the near-trivial to the profound, are not taken in the manner that is needed. Political constraints are present, whilst decisions are not made in a timely manner (it can take months or even years as various components are dealt with by different States departments);
- iv) Guernsey Harbours' management do not control the land use of assets that clearly should be part of the port estate. They are prevented from determining land use to make better use of assets;
- v) Guernsey Harbours' employees work under the States terms and conditions of employment. These bear little resemblance to the operational needs of the port and lead to high overtime costs which could be avoided if Guernsey Harbours had the freedom to set their own terms and conditions of employment. In the context of any other port in the UK, they are antiquated. Smarter working is required with more flexibility – deploying people when they are needed for the business;
- vi) The requirement for Guernsey Harbours to transfer all of its operating surplus to General Revenue, while being required to bid for its investment capital in competition with other projects requiring funding from the States, acts as a disincentive for Guernsey Harbours' management to maximise the surplus generated by their activities;
- vii) Major capital investment projects outlined for the period 2011 – 2020 amount to an estimated £260 million.

## **5.0 Fisher Associates Recommendations**

- 5.1 Fisher Associates highlighted that the 'Do Nothing' option, 'has nothing to recommend it'. They recommend that Guernsey Harbours be placed on a more commercial footing, which means that:
- The organisation will make decisions more quickly with a commercial, rather than political, agenda;
  - Management will be empowered, but also accountable;
  - Profit will be improved by increasing efficiency and revenues (not just by putting up prices), including applying cost reflective tariffs, working with commercial customers to develop marginal revenue, policing income etc;
  - The organisation will make commercial investments that enhance its financial self-sustainability.
- 5.2 There is a question, however, of whether Guernsey Harbours could be run more effectively than it is at the moment, with only limited change (retaining the Unit

within full States control). Fisher Associates indicated that, in their examination, the 'Do Something' option (consistent with Municipal Ports Review best practice) offered an opportunity to improve, but only to an extent, and in its ability to meet the above 'commercial' objectives, it had the disadvantage of falling well behind creating either a States Trading Company or a Trust Port.

- Vision and Leadership would improve, but not in the same league;
- Decision making would be improved, but significant decisions would continue to go through similar channels to existing;
- In regard to improving efficiency and use of assets/accountability, in practice improvements could only be made at the margins.
- Post implementation, there would be no material change to the problems that the States faces.

In short, the strictures of the current government arrangements would still prevent the full scope of potential benefits that could otherwise be achieved, from being attainable.

- 5.3 On balance, Fisher Associates considered that reconstituting Guernsey Harbours as a States Trading Company (a company wholly owned by the States of Guernsey) would have the most merit at this time. It would offer the chance to make real improvements, whilst being a more deliverable option than creating a Trust Port, with lower risk that implementation could fail. Turning Guernsey Harbours into a company would mean that:

- Land and assets would be vested in the company (still ultimately owned by the States);
- The Ports would be legally separated from the States general activities;
- The Ports would be subject to the company tax regime;
- Governance would take the form of a new Board;
- Employees would no longer be direct employees of the States, but would be employed by the company, at arm's length to the States;
- Port development could be funded partly by borrowing – subject to the provisions of the company's articles and shareholder's policy;
- Some public services functions currently undertaken by Guernsey Harbours (such as Guernsey Coastguard) would need to be separated in principle and either provided separately by an independent body, or by the company under a public service contract or some other acceptable means;
- Services provided centrally by the States would be charged.

- 5.4 On the information gathered to date, the Department considers that the current arrangements for the Harbours are far from ideal and should not continue. At this stage it further concurs with Fisher regarding the formation of an STC. However, the Department recognises that this would be a significant step and believes that the States should be in possession of a fuller account of implications, benefits and costs etc before such a strategy could be put forward as a firm recommendation.

- 5.5 In line with the above, the Department would propose to conduct additional investigations to gather such additional detail, with a view to return to the States in due course.

## **6.0 Implications**

- 6.1 The Department appreciates that, should the States ultimately wish to form a Harbours STC, there would be a number of issues to be examined and addressed. Exploration of these matters would form part of the proposed further investigations:

### **Shareholder**

- 6.2 Under current legislation, the automatic default shareholder for any STC is, in effect, the Treasury and Resources Department.
- 6.3 Given its continuing mandate in regard to maritime matters generally, the Public Services Department considers that, should a Harbours STC ultimately be formed, it could be well placed and suitably equipped to discharge similar functions as shareholder of that STC.
- 6.4 The Department considers that thought should be given to the best way to deliver the shareholder function for a Harbours STC and would intend to consult with the Treasury and Resources Department into the possibilities, before reporting back to the States. The Department understands that matters of corporate governance (which include matters relating to share capital and company membership) may be dealt with by means of an amending Ordinance under the States Trading Companies (Bailiwick of Guernsey) Law, 2001.

### **Regulation**

- 6.5 In regard to regulation, Fisher Associates observed that a port is a complex business, serving many different markets, and is less homogenous than say an airport or a train company. They advised that the practical approach generally adopted is to undertake implicit regulation of prices via approval of a business plan, which also internalises the potential for efficiencies, increased revenue by other means etc. In the case of Trust Ports, in the UK, the charges are determined (in line with the business plan) and introduced by the Port and users have the right to appeal against them.
- 6.6 By comparison, the complexity and cost of trying to regulate charges (through a separate Regulator), prior to their introduction, would be high in comparison to the value of the business itself. Fisher Associates advised that they knew of no port regulated in such a way, even those that were sole ports for an island.

- 6.7 The Department considers that, should the Harbours eventually move towards STC status, provided that there was clear direction, including objectives and measureable targets, separate economic regulation would be unlikely to be needed, and that the Harbours could indeed be effectively run through a 'Business Plan', which had been submitted to, and agreed by, the States, and which would be followed by Harbours management, with the shareholder monitoring compliance.

## **Financial Issues**

### **Ports Holding Account**

- 6.8 In the past, any surpluses generated by the Harbours were paid into the Ports Holding Account (PHA), enabling the Airport and Harbours to largely fund their own capital expenditure.
- 6.9 However, the matter of the Ports Holding Account was considered during the 2009 debate on Capital Prioritisation (Billet IX). At that time, the States resolved 'That the Ports Holding Account shall not be collapsed in advance of the consideration by the States of a report from the Public Services Department in December 2009 on the options for moving the trading entities of Guernsey Harbours and Guernsey Airport into a different business environment, BUT THAT, in any event, the operating surplus before depreciation shall be transferred to the Capital Reserve from the Ports Holding Account from 2010 until such time as the Ports Holding Account may be discontinued'.
- 6.10 Therefore, from 2010 (and to continue until the States considers a report with proposals on business environment and different financial arrangements are put in place), the Ports' surpluses have been transferred into the States Capital Reserve. In this interim period, the residual balance in the Account has been available for routine capital expenditure for the Airport and Harbours but, when depleted, they will have to bid for capital in competition with other States bodies, with the risk that the ability to undertake both routine maintenance and advance appropriate developments at these vital locations, may suffer.
- 6.11 In its update report, 'States Trading Entities – A New Business Environment', presented in January 2011 (Billet I), the Department explained why it had not reported in December 2009. It also acknowledged that, at the time of presenting its 2011 update, neither it nor the States were in a position to determine the long-term shape of Port finances. It further highlighted that this would have to remain a live issue to be addressed when specific proposals in respect of the future structure of the trading entities were presented for debate.
- 6.12 As indicated earlier in this report, the Department feels that, even now, additional research needs to be conducted before it can present firm proposals for Guernsey Harbours (and report on the resultant financial implications). However, it is anticipated that the balance of the Ports Holding Account will be

exhausted during 2013 and, therefore, under the current arrangements, no funding would be available for routine capital expenditure. This matter is under discussion with the Treasury and Resources Department and it is intended, as part of the 2013 Budget Report, to report back with an interim proposal for funding the Ports routine capital expenditure. This is likely to result in a reduction in the transfer from the Ports to the Capital Reserve (budgeted to be £2.8 million in 2012). In conjunction with the Treasury and Resources Department, the current accounting and reporting arrangements for the Ports, including the mechanism of the Ports Holding Account, are being reviewed.

- 6.13 The Fisher report highlighted that a key objective of any change to status must be that Guernsey Harbours should be in a position to determine how it spends its operating surplus on its own investment needs. Fisher Associates considered that the changes in corporate structure anticipated in their report had the potential to reverse the situation, leading to an operation that was financially independent of the States on a sustainable basis.
- 6.14 Fisher Associates assessed that, through a combination of borrowings and the investment of its annual operating surplus, Guernsey Harbours appeared to have sufficient capacity to meet its maintenance investment needs over the coming decade, provided that its financing capacity did not drop below £2 million per annum following any changes in structure. However, in order to be in a position to finance any of the identified £260<sup>2</sup> million worth of strategic capital investment projects, other solutions would be required. Therefore, longer term, the whole question of funding for Guernsey Harbours' capital expenditure may need to be re-examined.

## **7.0 Practical Considerations**

- 7.1 Currently the States, through the Public Services Department, has ultimate responsibility for the provision of services under the departmental mandate and various pieces of legislation. The property and physical resources required to provide the services (the assets), and any contracts/leases and other debts and obligations etc, are ultimately owned by or are binding on the States. The staff required to provide the services are employed by the States under centrally negotiated terms and conditions.
- 7.2 Any change of business environment from the status quo would inevitably present a range of issues for consideration. [Sections 7.3-7.15 largely replicate material previously seen in the 'Future Business Environment for Guernsey Water and Guernsey Wastewater' report (Billet III of 2012).]
- 7.3 Prior to 2001, States Trading Companies (STCs) were unknown in Guernsey. However, a trail was then established by the postal, electricity and

---

<sup>2</sup> These capital investment projects are detailed on P25 of the Baseline Review (Appendix 2)

telecommunications utilities. The path and steps along it are now well known and understood.

7.4 Should the States ultimately decide to move to a situation where Guernsey Harbours was to be formed into an STC with its activities being undertaken ‘at arm’s-length’ from the States, this would involve taking a number of steps. Legislation that was developed for the 2001 process for postal, electricity and (initially) telecoms services could be extended for use. Steps included would be as follows:

- Create a new independent body owned by the States (i.e. a States Trading Company (STC)), with a Memorandum and Articles of Association which, via an appropriate mechanism<sup>3</sup>, would be required to follow the strategic direction of the States and whose activities could be adequately scrutinised;
- Transfer to the new body:
  - Responsibility for provision of services;
  - The employment of staff required for the provision of services, without detriment to their terms and conditions, including pension entitlements<sup>4</sup>;
  - The assets required for the provision of services, which would include contracts with other bodies and other rights, debts and obligations.

#### **Human Resource Issues: Protecting the Interests of Employees and Pension Issues**

7.5 The rights and entitlements of a States employee include terms and conditions of employment (and the right to negotiate a change to these); annual leave entitlement; the right to be a member of a union; and redundancy provisions.

7.6 Where the States Trading Company (Bailiwick of Guernsey) Ordinance, 2001 is utilised to create a new States Trading Company, this transfers to an STC any contracts entered into by, and all other assets and liabilities of, the States undertaking being transferred. Special arrangements, however, are required in respect of contracts of employment. The Transfer of States Undertakings (Protection of Employment) (Guernsey) Law, 2001 (TUPE) enables the States to enact Ordinances to transfer a contract of employment with the States to another entity in a way that preserves the above rights and entitlements except in regard to pensions.

7.7 TUPE only applies at the point where the employee moves across to the new employer - it does not apply long-term. TUPE does not give any more protection to an employee than they would enjoy if they had continued to be an

---

<sup>3</sup> This could, for example, be set out in the company’s Memorandum & Articles of Association; in a contract/Memorandum of Understanding (MOU) between the States and the company; in legislation; or in licence conditions.

<sup>4</sup> This may require amendment by the States of the 1972 Pension Rules.



employee of the States. The States may itself have sought to renegotiate terms and conditions or to make an employee redundant. TUPE would not prevent the new employer from taking such action but it would ensure that the employee enjoyed the same rights and entitlements as if they were in States employ. After the change in employer, the STC would assume responsibility for fulfilling, and negotiating any changes to, terms and conditions.

- 7.8 In regard to pensions, the transferring business must provide benefits broadly comparable to those enjoyed by the employee under the Public Servants' Pension Scheme (PSPS). Only employees of specified States or quasi States bodies can be members of the PSPS. In 2001 the PSPS rules changed to:
- Enable employees of those STCs defined in the Rules (namely Guernsey Electricity Limited and Guernsey Post Limited) to remain in/join the scheme;
  - Allow the States body charged with managing the application of the PSPS rules to individual cases to continue to undertake this role for STC employees;
  - Ensure that STCs were obliged to pay in the level of contributions necessary to fund the entitlements of their employees (the contributions then being ring-fenced).
- 7.9 Prior to the transfer of staff to an STC, a decision would have to be taken (in consultation with the workforce) as to whether there would be a transfer of existing employees to a new and comparable pension scheme, or whether arrangements would be put in place whereby existing and new employees would remain in or join the PSPS (which would require the States to approve an amendment to the PSPS rules).
- 7.10 There are, therefore, mechanisms to ensure that States staff transferring to an STC would not be disadvantaged in terms of their rights and entitlement (and pensions).
- 7.11 Initial discussions have previously taken place at officer level with senior representatives of the Public Sector Remuneration Committee (PSRC). Staff at Guernsey Harbours are aware of the continued exploration into the potential to change business environment, whilst informal discussions have in the past been held with both the Association of Guernsey Civil Servants (AGCS) and Unite. At this very early stage, until firm recommendations are placed before the States for consideration and the States confirms the direction of its will, taking larger steps in these areas would have been inappropriate.
- 7.12 Initial discussions have also taken place with the Head of Human Resources and Organisational Development over the potential future need for provision of necessary human resources business partner expertise, should the States, in due course, be asked (and agree) to progress further along the STC route.

- 7.13 Should the States ultimately resolve to pursue a changed business environment for Guernsey Harbours, the Department would intend to enter into detailed discussions with the workforce, the Policy Council and relevant employee unions at an early opportunity following such decision. When discussions were either complete, or at least nearly complete, the Department would report back to the States with firm recommendations as to pension provision.
- 7.14 The Department is aware of the concerns in certain quarters about the potential for senior managers to receive significant pay increases should an STC eventually be formed. It recognises that any company needs to have the freedom to hire, fire and remunerate staff in a way that best guarantees productivity. Equally, however, for so long as the States remains the sole shareholder there is a need to introduce safeguards to prevent salaries being excessive. The Department understands that this could be managed through a clear Memorandum of Understanding between the shareholder and the STC. This option will be explored in more detail in advance of the next report to the States on the proposed changes.

### **Business Management**

- 7.15 Any change to a business environment would require that business to have a robust and appropriate management structure. If this was not in place, the viability of the business would be compromised and, at the least, the full extent of potential benefits would not be realised.
- 7.16 Moving to an 'arm's-length' position would be a significant change from the current status. It is suggested that, should such a situation eventually come to pass, the responsible STC Board would be in the best position to review the appropriateness of the management/structure and tailor the business as required to ensure it was able to effectively meet its obligations and demands.

## **8.0 Future Steps**

- 8.1 As clearly stated earlier, the Department would intend to conduct further investigation into establishing a Harbours STC, before forming its conclusions and placing a firm recommendation on business environment to the States for consideration.
- 8.2 Similar to the Airport situation, the Department also believes that overall 'Objectives' for the Harbours should be established, regardless of governance structure. Objectives must be clear and must be agreed by the States as a whole, so that future decisions can be made in a focused manner. These objectives should be linked to clear performance monitoring criteria, and should feed-in to the business plan.

- 8.3 As indicated earlier, the future of the Ports Holding Account and potential future funding mechanisms for an STC must also be established.
- 8.4 From their perspective, Fisher Associates identified 6 steps required to implement their recommendation to create an arm's length business:
- Prepare a business plan;
  - Undertake a review of assets and propose and agree what constitutes the Port estate;
  - Implement ring-fenced accounts that give a proper view of the Port;
  - Set up a shadow board;
  - Prepare a vision for the harbour sea-front and develop a Port Master Plan;
  - Prepare a detailed plan for incorporation, setting out key steps and milestones (to present to the States).
- 8.5 Even though the Department is not placing a recommendation to create an STC at this point, some of these steps are appropriate for advancement now. Indeed, the first 5 of these are valuable contributions to creating a commercial environment for the business, regardless of whether it goes on to be formed into a States Trading Company or not. Some of the above steps can also be done in parallel.
- 8.6 Movement has already been made on some of the above (for example, the Department has tendered for companies capable of assisting with the preparation of a Port Master Plan).

## **9.0 Legislative Implications**

- 9.1 St James' Chambers have been consulted in regard to the legislative implications associated with the recommendations presented in this report.
- 9.2 Should the outcome of the proposed additional investigation yield a firm recommendation to establish an arm's-length trading company, it would be necessary to designate the company as an STC and address the issues of governance and transfer of relevant assets by means of an Ordinance under the States Trading Companies (Bailiwick of Guernsey) Law, 2001. Whilst further investigation will be necessary, it is possible that an amendment to the existing States Trading Companies (Bailiwick of Guernsey) Ordinance, 2001 may be all that would be required in relation to this issue.
- 9.3 It would also be necessary to address the issue of transfer of any relevant contracts of employment by way of an Ordinance made under TUPE (see paragraph 7.6 above).
- 9.4 The functions currently undertaken by Guernsey Harbours are governed by a number of pieces of legislation. These are listed in an appendix to the Fisher

Baseline Review (Appendix 2). Were the Harbour to become an STC, as part of the transition, responsibility for some functions arising under the legislation would need to be transferred to the new commercial entity.

- 9.5 Whilst it might be appropriate to transfer certain of those functions to a Harbours STC (e.g. statutory powers to impose charges for use of harbour facilities), it might be appropriate for others to remain vested in the States of Guernsey or the Harbourmaster.
- 9.6 It would also be necessary to consider whether any additional legislative provision would be required. For example, in 2001, new utility ‘Sector Laws’ to govern the provision of services (and associated matters, such as recovery of expenditure, technical, safety, environmental and access matters etc) were produced for telecoms, post and electricity services, and came into force at the time that the relevant STCs were established. A similar Sector Law may be required in relation to the provision of harbour services.
- 9.7 At this early stage, many legislative aspects have not been investigated in detail and currently remain undetermined. The proposed detailed investigation into establishing an STC would examine the degree of legislative change that would be required.

## **10.0 Compliance with the Principles of Good Governance**

- 10.1 From a strategic / government perspective, the establishment of a Guernsey Harbours STC with set Objectives could be considered to comply with the following Principle of Good Governance:

“Focusing on the organisation’s purpose and on outcomes for citizens and service users”

- 10.2 Further, converting Guernsey Harbours to an STC could support the below States of Guernsey Objectives:

- Wise long-term management of Island resources
- Co-ordinated and cost-effective delivery of public services
- Maintenance and enhancement of Guernsey’s standing in the global community.

## **11.0 Consultation**

Fisher Associates consulted widely during the review period. Consultees included:

Chamber of Commerce

Commerce & Employment Department  
 Condor  
 Environment Department  
 Guernsey Boat Owners  
 Guernsey Commercial Port Users Association  
 Guernsey Electricity Ltd  
 Guernsey Fishermans Association  
 Guernsey Harbours  
 Guernsey Marine Traders  
 Guernsey Post Ltd  
 Guernsey Yacht Club  
 Office of Utility Regulation  
 Public Services Department  
 Royal Channel Islands Yacht Club  
 St Peter Port Services  
 Treasury and Resources Department

## **12.0 Recommendations**

The States are recommended:

1. To note the reports prepared by Fisher Associates (Appendices 2 & 3 to this report);
2. To agree that the Public Services Department should undertake appropriate consultation prior to returning to the States with a report proposing clear Objectives that should apply to the operation of the Harbours, regardless of any future commercial re-structuring;
3. To note the Public Services Department's current view that establishment of a States Trading Company might present the most effective way forward for Guernsey Harbours;
4. To agree that the Public Services Department should conduct more detailed investigation into, and consultation concerning, the option of establishing a Guernsey Harbours States Trading Company, before reporting back to the States, such investigation and consultation to include (but not be limited to):
  - a) Financial issues (costs, savings etc)
  - b) Consultation with employees likely to be affected by any proposals to create a States Trading Company
  - c) Consultation with service users
  - d) Potential for the shareholder role
  - e) Potential regulation mechanism

f) Legislative implications;

5. To note that the funds that will be required to progress this additional investigation and consultation, (provisionally estimated not to exceed £50,000) will be funded by Guernsey Harbours;
6. To note that the Public Services Department is working to progress preparation of a Ports Master Plan, incorporating commercial port needs but also taking a wider strategic view on the economic potential that this might unlock;
7. To note that the Public Services Department, working in conjunction with the Treasury and Resources Department, will be reviewing the current accounting and reporting arrangements for the Ports, including the mechanism of the Ports Holding Account; and
8. To note the intention of the Treasury and Resources Department to report, as part of the 2013 Budget Report, with an interim proposal for funding the Ports routine capital expenditure.

Yours faithfully

B M Flouquet  
Minister

Deputy S Ogier (Deputy Minister)  
Deputy T M Le Pelley  
Deputy A Spruce  
Deputy J Kuttelwascher

**Appendix 1 – Glossary**

AGCS     Association of Guernsey Civil Servants

OUR     Office of Utility Regulation

PHA     Ports Holding Account

PSPS     Public Servants' Pension Scheme

PSRC     Public Sector Remuneration Committee

STC     States Trading Company

TUPE     The Transfer of States Undertakings (Protection of Employment) (Guernsey) Law, 2001.

SPECIALIST

MARITIME

CONSULTANCY

SERVICES

Review of Guernsey Harbours:  
Stage 1 Baseline Review

Prepared for

Public Services Department, States of Guernsey

Final Report

July 2011



FISHER

ASSOCIATES

Fisher Assoc. Ltd, April House, Rowes Lane, East End,  
Lymington, SO41 5SU, UK

[www.fisherassoc.co.uk](http://www.fisherassoc.co.uk)

Tel: 01590 626 220 Fax: 01590 626 359





# **Review of Guernsey Harbours**

**Prepared for**

**Public Services Department, States of Guernsey**

**by Fisher Associates**

## **Stage 1: Baseline Review**

### **Final Report**

#### **Document History**

| Document     | Date                       | Notes  |
|--------------|----------------------------|--|
| Draft Report | 6 <sup>th</sup> July 2011  |  |
| Final Report | 28 <sup>th</sup> July 2011 | Incorporates Client comments from review session |

## Contents

|  |           |
|--|-----------|
| <b>Executive summary .....</b>   | <b>3</b>  |
| Introduction .....   | 3         |
| Key findings .....   | 3         |
| Conclusion .....   | 4         |
| <b>1 Introduction .....</b>  | <b>5</b>  |
| 1.1 Objective of study .....   | 5         |
| 1.2 Approach .....   | 5         |
| <b>2 Description of Guernsey Harbours .....</b>                                    | <b>6</b>  |
| 2.1 Roles and functions .....  | 6         |
| 2.2 Legal framework .....  | 6         |
| 2.3 Governance .....   | 7         |
| 2.4 Management structure .....   | 8         |
| <b>3 Operations review .....</b>   | <b>10</b> |
| 3.1 Physical overview .....  | 10        |
| 3.2 Key functions .....  | 10        |
| 3.2.1 Marine services .....  | 10        |
| 3.2.2 Engineering .....  | 11        |
| 3.2.3 Administration .....   | 12        |
| 3.3 Cargo handling operations .....  | 12        |
| 3.3.1 LoLo / container operations .....  | 12        |
| 3.3.2 Ro-Ro operations .....   | 15        |
| 3.3.3 Road haulage / distribution .....  | 16        |
| 3.3.4 St Sampson's .....   | 16        |
| 3.4 Other operations .....   | 17        |
| 3.4.1 Marinas .....  | 17        |
| 3.4.2 Fisheries .....  | 17        |
| 3.4.3 Cruise .....   | 17        |
| <b>4 Financial review .....</b>  | <b>19</b> |
| 4.1 Financial performance .....  | 19        |
| 4.1.1 Reported figures and basis of analysis of financial performance .....        | 19        |
| 4.1.2 Reported results .....   | 19        |
| 4.1.3 Overview of profitability .....  | 20        |
| 4.1.4 Analysis of results .....  | 20        |
| 4.1.5 Analysis of expenditure .....  | 22        |
| 4.1.6 Balance sheet review .....   | 23        |
| 4.2 Future investment needs .....  | 25        |
| 4.2.1 Capital investment forecast .....  | 25        |
| 4.2.2 Maintenance investment projects .....  | 26        |
| 4.2.3 Strategic investment projects .....  | 26        |
| 4.3 Financing the investment needs .....   | 27        |
| 4.3.1 Guernsey Harbours as a division of Guernsey Public Services Department ..... | 27        |
| 4.3.2 Financing capacity .....   | 28        |
| 4.3.3 Matching the financing capacity to the investment needs .....                | 29        |
| <b>5 Conclusion .....</b>  | <b>30</b> |
| 5.1 Governance and management .....  | 30        |
| 5.2 Operations .....   | 30        |
| 5.3 Financial .....  | 32        |

## Executive summary

### Introduction

Public Services Department (PSD) is mandated to look after harbours and maritime matters, and management of these is combined under “Guernsey Harbours”, which fulfils a variety of roles:

- ◆ Harbour authority
- ◆ Pilotage authority
- ◆ Lighthouse authority
- ◆ Coast Guard
- ◆ Maritime Safety Administration
- ◆ Registrar of Shipping

PSD has commissioned Fisher Associates to provide advice related to the most suitable business model for the future management of Guernsey Harbours, with the objective of giving management more commercial freedom, whilst maintaining public ownership of assets. We have approached this work in two stages:

- ◆ Stage 1: Baseline Review presents an assessment of the current situation at Guernsey Harbours, based upon our experience and discussion with States’ representatives, management and other stakeholders.
- ◆ Stage 2: Structural Review provides a discussion and analysis of the options identified for the new business model – primarily transforming Guernsey Harbours into a limited company (incorporation), or into a Trust Port.

This document presents the Baseline Review, and presents a review of several key aspects of Guernsey Harbours:

- ◆ Governance and management
- ◆ Operations
- ◆ Its financial position

### Key findings

With respect to governance and management, the key findings are:

- ◆ Governance requires significant improvement with creation of a “fit for purpose Board” as described by the UK’s Trust Ports Review (whether or not Guernsey Harbours actually becomes a Trust Port).
- ◆ The legal framework needs to be updated as appropriate.
- ◆ The organisation structure should better reflect the business drivers.
- ◆ Management needs to be empowered and made accountable.

The key conclusions related to operations include:

- ◆ LoLo and RoRo operations are highly inadequate, and the commercial port area requires replanning to improve these, utilising some of the car park space.
- ◆ There are numerous operational improvements to be made at St Peter Port.
- ◆ A new acceptable and safe alternative is needed for the discharge and storage of bulk liquids currently taking place at St Sampson's.
- ◆ The control of land in the port estates, and accountability for its efficient use, should be addressed.
- ◆ Both stevedoring and pilotage might benefit from being brought in house.
- ◆ Terms and conditions of employment require reform to increase flexibility.
- ◆ All revenue should be policed and captured.
- ◆ A full review of all charges is needed.

In financial terms, the key findings are:

- ◆ Guernsey Harbours has been consistently profitable for the last decade.
- ◆ Only its commercial activities are profitable. It loses money on moorings and leisure after allocating common costs, and on its other activities, some of which are statutory obligations.
- ◆ Its balance sheet net assets far exceed its financial value, and this should be reviewed.
- ◆ Any change in corporate structure of Guernsey Harbours should result in it retaining all operating surpluses to finance as much of its own investment requirements as practicable, and it should be able to borrow. The recent cessation of the Ports Holding Account was a step in the opposite direction.
- ◆ Long term strategic investment needs should be viewed in their strategic and socio-economic context, with consideration of how these might be funded.

## Conclusion

The issues related to governance, operations and financing should be brought together in a comprehensive business plan, which we believe may demonstrate that Guernsey Harbours can become financially self-sustainable in future, although strategic projects will still require a partnership approach.

The extent to which Guernsey Harbours can reduce costs and achieve self-financing, will depend on the extent to which the States allows it to implement efficiencies, and increase its revenue (not just by putting up charges). The Structural Review considers how changing the business model of Guernsey Harbours could facilitate this.

# 1 Introduction

## 1.1 Objective of study

Within the States of Guernsey, the Public Services Department (PSD) is mandated to look after harbours and maritime matters (including Guernsey Coast Guard), and management of this role is combined under “Guernsey Harbours”.

The States desires to investigate alternative business models for Guernsey Harbours, whilst maintaining public ownership of assets. PSD has therefore commissioned Fisher Associates, a specialist management consultancy practice, to provide advice on the future corporate structure of Guernsey Harbours.

The brief required consideration of transformation into a limited company (incorporation), or constituting some part of Guernsey Harbours as a Trust Port. This is the focus of our investigations, however, we have also considered a “do something” option – that is a way of realising some of the desired benefits of both options, which may bring benefits in the short term.

## 1.2 Approach

We have approached this work in two stages:

- ◆ Stage 1: Baseline Review
- ◆ Stage 2: Structural Review

The **Baseline Review** presents an assessment of the current situation at Guernsey Harbours, based upon discussion with States’ representatives, management and other stakeholders. It considers Guernsey Harbours’ recent history, policy objectives, strengths and weaknesses of the current organisational set up, port operations, and any other relevant factors. It also includes a high level financial review.

The **Structural Review** explains the core anatomy of the following options:

- ◆ Status quo (“do nothing”).
- ◆ Incorporation and Trust Port options.
- ◆ An additional shorter-term “do something” scenario lying between the do nothing and other options.

It assesses the objectives for change, and identifies criteria against which options can be assessed including implications for funding investment needs, and explains the pros and cons of the options, with recommendations on the options for changing the corporate structure and an associated implementation plan.

**This document presents the Baseline Review.**

## 2 Description of Guernsey Harbours

### 2.1 Roles and functions

The stated vision of Guernsey Harbours is to “Safeguard, secure and provide for the maritime needs of the Island”. Guernsey Harbours lacks a written down and thought through strategy, and stated objectives to achieve this.

Its vision reflects the variety of roles that Guernsey Harbours fulfills including:

- ◆ Harbour authority
- ◆ Pilotage authority
- ◆ Lighthouse authority
- ◆ Coast Guard
- ◆ Maritime Safety Administration (MSA)
- ◆ Registrar of Shipping

In the event that Guernsey Harbours is incorporated or reconstituted as a Trust Port, delivery of the first two roles would transfer to this new organisation. For the remaining roles, it would have to be determined whether some or all of these would continue to be provided by the new entity under a public service contract, or whether these would be separated out into a new organ of the States.

In the case of Jersey, the lighthouse and Coast Guard function has been left within Jersey Harbours, but the MSA and Registrar of Shipping functions were transferred to a new “Maritime Compliance” unit. All things being equal, this might be likely to apply to Guernsey.

### 2.2 Legal framework

A list of the regulatory framework is provided in Appendix A. It can be seen from this that there is a mixture of Laws and Ordinances applicable to the above roles, at least some of which might benefit from updating, and also a number of international IMO conventions that apply to Guernsey.

The Merchant Shipping (Bailiwick of Guernsey) Law, 2002 is in place, however we understand that much subsidiary legislation is still required to make the law workable. This is a specialist and time consuming task that would benefit from more attention.

The regulations will require individual review to assess whether a change of constitution of Guernsey Harbours would trigger the need to change any of these. Many of these regulations are probably vested in the States (with powers of delegation) or in the Harbour Master. This would imply that in practice there might not be a large task arising from the need to harmonise regulations.

## 2.3 Governance

Guernsey Harbours is an operating unit within “Public Services”, a States of Guernsey Government Department. PSD employees 600 staff, has a turnover of about £40 million, and comprises 5 “business units”:

- ◆ Central Services
- ◆ Guernsey Airport
- ◆ Guernsey Harbours
- ◆ Guernsey Water
- ◆ States Works

The PSD mandate of May 2004 sets out its mandate to “advise on matters” including:

- ◆ St Peter Port and St Sampson’s Harbours
- ◆ Alderney breakwater
- ◆ Maritime affairs

It also sets out responsibility to provide and administer facilities and services for:

- ◆ St Peter Port and St Sampson’s Harbours.
- ◆ The provision of Coast Guard services.
- ◆ The Guernsey Register of British Ships and the surveying and licensing of local passenger and commercial vessels.
- ◆ Monitoring compliance of all vessels within Bailiwick waters with international and local laws and control of shipping in Bailiwick waters.
- ◆ Maritime safety, the investigation of marine accidents, provision of navigational aids and maritime safety information.
- ◆ Liaison with the Guernsey branch of the Royal National Lifeboat Institution.
- ◆ Pilotage Services.
- ◆ The maintenance of Alderney breakwater.
- ◆ The management of environmental emergencies, control of essential commodities and receivership of wrecks.

PSD is governed by a Board of five people comprising a Minster and four States members. There is an option (not exercised) to appoint two non-voting co-opted members. The Board considers the business for all PSD’s functions. Compared to an incorporated port, or a Trust Port, Guernsey Harbours enjoys considerably less relevant maritime and specialist commercial expertise in its governance.

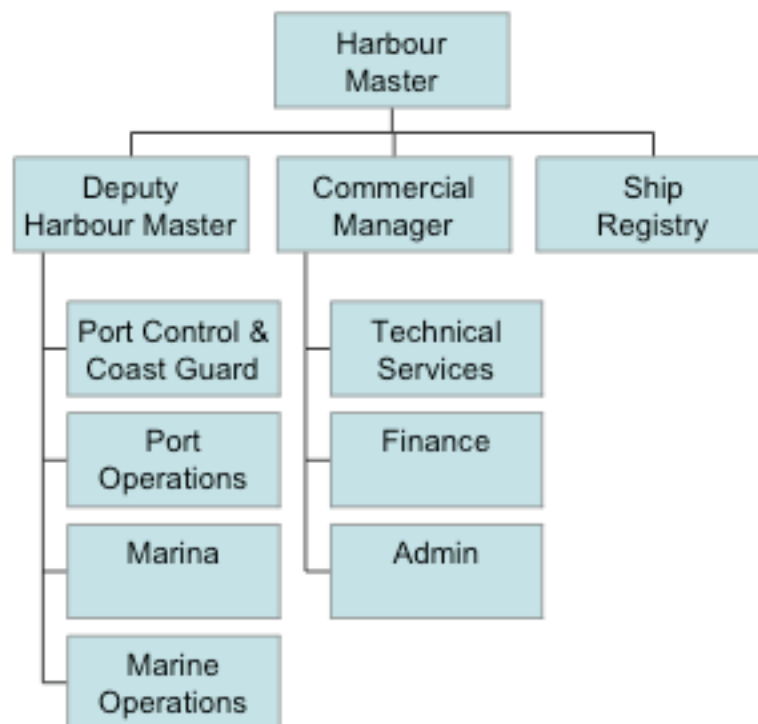
The governance of Guernsey Harbours via PSD does not accord with best practice. There is an absence of i) a clear vision, adopted and championed by the Board, ii) an agreed medium term business plan to deliver the vision, iii) empowered and accountable management, and iv) control over the assets and decisions that this needs. This is explained in more detail in the Structural Review, and is referred to in the next section.

## 2.4 Management structure

Guernsey Harbours employs about 75 staff, and the organisation structure is detailed below. Key comments on this are:

- ◆ Overall the structure is based on functions rather than business units.
- ◆ The Harbour Master, in whose post much of the regulations are vested, has quite a small span of control, with three subordinates.
- ◆ The Commercial Manager role might better be described as Administration.
- ◆ There is no qualified accountant.
- ◆ There is no marketing or commercial role in the sense of customer liaison. Such activity seems to rest mainly with the Harbour Master.

Management Structure



Strengths and weaknesses of management (rather than the structure) include:

- ◆ There is a positive and cohesive team spirit within Guernsey Harbours.
- ◆ The key strength of the management is in its considerable practical maritime experience, and the basic management skills that result in a good team.
- ◆ Consultees indicate that customer liaison is good, with an open door policy.
- ◆ It is less strong in terms of LoLo terminal operations.
- ◆ The opportunity for improvement in some issues is apparent, e.g. the use of key performance indicators (KPIs) is somewhat perfunctory.



Although Guernsey Harbours is criticised for lack of commercial thinking, this is unfair. The evidence presented in the Structural Review shows that many commercial decisions require participation of various States Departments, stall with the Board that can take a political view, and take an unreasonable time to be made.

Management is not empowered to act commercially, therefore it cannot be held accountable for failing to do so. A real danger is that this lack of empowerment results in a resigned attitude that trying to develop the business is unproductive, and this needs to be avoided.

For example, the operations review in the next section explains that commercial and passenger vehicle flows need to be re-routed, and that a weighbridge is needed for commercial and safety reasons. It is highly regrettable that management has not been able to implement such basic measures, but due to its lack of control over the port estate, it cannot be held accountable for this.

The need to create management accountability is a major theme in the Structural Review. Notwithstanding this, areas where management might have made improvements include:

- ◆ **Regulatory environment:** More might have been achieved in updating the legal framework, although constraints external to Guernsey Harbours have a significant bearing on this.
- ◆ **Key performance indicators:** More thought might have been given to this, including development of quantitative KPIs, although it is in fact for the Board to demand that these be provided.

### 3 Operations review

#### 3.1 Physical overview

The first impression when visiting St Peter Port is that it is difficult to identify the location of the commercial port other than seeing some old cranes in the distance. It resembles a port that has lost its traditional identity. There is very little evidence in the majority of the port footprint that St Peter Port is vital to the economic life of the Island, and that the commercial port provides most of the revenue, and all of the profit made by Guernsey Harbours, and subsidises leisure activities and pays for Guernsey Harbours' national responsibilities such as the Coast Guard and Lighthouse Authority.

The "Future Harbour Requirements Study" in July 2010 highlighted the severe land and marine constraints limiting the effective operation of the commercial port. The States has lost its focus on the importance of its Harbours as the lifeline of the Island, and is now in the position where insufficient area is allocated to commercial port activities.

Land in the designated port areas of both harbours, which is not used directly for port activities, is managed by other States Departments. In most ports in the world this would be part of the port estate, and the port would be managing, developing and receiving the income from those areas. The revenue generated would then be used to support the financial self-sustainability of the enterprise.

#### 3.2 Key functions

##### 3.2.1 Marine services

The marine operations staff at Guernsey Harbours are of a very high calibre with extensive shipping backgrounds and experience. Some were born on the Island, went away to sea as a first career, and returned as experienced seafarers to share their knowledge with the Island.

There is a strong team spirit in the Department, and they are all keen to play their part in improving the two ports. As they have considerable experience, they are very conscious of the shortfalls and hazards that continue. They are keen to seek solutions where appropriate and their recommendations should be given careful consideration. In the case of recommendations related to health, safety and environment, there should be a presumption of acceptance but with appropriate scrutiny.

Key marine services include:

- ◆ Port control: Directing movements of vessels to / from / within the harbours.
- ◆ Guernsey Coast Guard: Providing a maritime information service, monitoring for calls for assistance, and coordinating a search and rescue response.
- ◆ Pilotage: assisting ships to enter and leave port.

There are synergies between the experience and skills required of port control and the Coast Guard. If Guernsey Harbours was incorporated or became a Trust Port, the Coast Guard service might still be provided by the new entity under a public service agreement with a contribution to cover the costs of this service.

Another possibility is that the Jersey and Guernsey Coast Guards might be combined, but this requires careful review in terms of whether cost savings can be really achieved, and the impact upon the effectiveness of the service.

The Port Control and Coast Guard functions are in separate locations, even though the staff are common, and there would be benefits in co-location. This should be changed in the near future.

Pilotage at the two ports is undertaken by private individuals providing the pilot boat and pilot service. There may be benefits to Guernsey Harbours taking this in house, in terms of revenue (the cost of pilotage at Guernsey is half the industry norm), putting staff back on ships on a regular basis (Assistant HMs often act as pilots), and providing a pilot boat that can be used for other purposes. The pros and cons of this require consideration, and we note that the provision of this service is already under review.

### 3.2.2 Engineering

The engineering function generally appears to operate to high standards throughout the two ports. Housekeeping could be improved as follows:

- ◆ Spare parts and equipment appear haphazardly stored throughout the ports, and this should be consolidated for better control.
- ◆ Security into the maintenance storage areas could be improved. Indeed some equipment could be directly accessed by the general public walking to a ferry. Fork lift trucks were also left running whilst unattended. This practice wastes fuel and is a security risk.
- ◆ There are too many floating pontoons around the quays awaiting repair or disposal. An area should be identified specifically for this work.

Terms and conditions of employment need to be reviewed. Most ports have more flexibility and less overtime costs. In the development of a flexible workforce it is recommended to develop some of the engineering staff as crane drivers (when undertaking repairs on the cranes they usually drive them for testing). This practice has been very successful in other ports as it leads to fewer breakdowns, less misuse of cranes and shorter stoppage times when issues do occur.

More fundamentally, the question of contracting out engineering arises. Many ports have found it beneficial to outsource some or all of their engineering requirements to contractors. Jersey Harbours awarded their maintenance contract to another States Department (T.E.S.). Guernsey Harbours could consider a similar course of action, but careful appraisal of this is needed to determine i) that costs will in fact decrease whilst ii) maintaining an appropriate responsiveness when things go wrong in the middle of the night.

The scope of services provided in-house should also be considered. It is unusual to find a port making its own harbour craft, and the true cost of this versus buying one off the shelf needs verifying. Some work, such as specialist repair to quay walls, needs specific skilled workers, who are externally sourced.

### 3.2.3 Administration

The administrative staff are very keen to improve the effectiveness and profitability of Guernsey Harbours, and are very aware of the shortcomings that presently exist. Issues that need to be addressed are as follows:

- ◆ Self-certification of cargo weights by the shipping lines.
- ◆ There are no reviews of the ships manifests to verify the tonnage declarations.
- ◆ Wrong weight declarations can cause crane or ramp failure.
- ◆ Different shipping lines pay different tariffs and have different charging structures, with some paying directly (hourly) for crane usage and others indirectly based on weight of cargo handled. This is an administrative complexity when attempting to raise invoices, and raises issues of fairness in the tariff.
- ◆ There are no operating licenses in the port, so all port service providers operate without agreed terms and conditions or payment to Guernsey Harbours.
- ◆ Operational staff complete their own overtime sheets. It would appear to the administration staff that much of the costs could be avoided with updated terms and conditions.

## 3.3 Cargo handling operations

Guernsey Harbours' management team has marine backgrounds (often bulk liquids), and therefore their port operational experience is from a ship perspective rather than from a terminal management approach.

Over the last forty years the handling of cargo in ports has been revolutionised, not only in the introduction of new types of ships, equipment and handling techniques, but also in the working practices of the labour force:

- ◆ Guernsey has tried to move with the times by accepting new types of ships, but the cranes have remained the same.
- ◆ The workforce have tried to adapt to new equipment and ships, but the manning levels and demarcation of work have remained the same.

### 3.3.1 LoLo / container operations

**Quay loadings:** Containers are handled on a “suspended quay” type of construction. This is unusual in the port industry as the inherent strength is not as robust as a solid quay. (It should be noted that when three loaded twenty foot containers are stacked, their total loaded weight might be over 60 tonnes).

As fork lift trucks are also used to move containers around the terminal and to service road vehicles, the recommended surface should be constructed to accommodate a 90 tonne axle load. Failure to construct to these standards throughout the terminal may eventually result in the collapse of the quay.

**Stevedoring:** The handling of LoLo ships at the port is undertaken by three separate companies. The cranes are operated by Guernsey Harbours' crane drivers. From the ships hold to the quay, Guernsey Stevedores undertake the work. Thirdly, the landside equipment namely the forklift trucks are owned and operated by the shipping companies.

These working arrangements prevent the terminal from operating efficiently and safely. The demarcation of the operation has resulted in the total inflexibility of the workforce, costly manning levels and archaic handling practices. Furthermore, without a formal licensing agreement with the stevedoring companies, Guernsey Harbours cannot influence safe working practices, risk management, insurance cover, or adequate training for the workforce.

A full appraisal of the three parties needs to be undertaken. A fully flexible labour force cannot be achieved with three companies involved. Furthermore, the legal liabilities of three entities under Health and Safety at Work potentially leaves Guernsey Harbours severely exposed to litigation even though it might not have been their work force that caused an accident.

The time is right to undertake this review as the purchase of new cranes are being considered and the workforce is ageing (mostly mid fifties). There may be merit in Guernsey Harbours taking complete control of the stevedoring operation, as does its equivalent in Poole.

**Working practices:** The cranes being used for the handling of containers and platform flats are old and were not designed for the operation. They have been maintained to a very high standard and the Engineering Department should be proud that they have managed to keep the cranes operating. However, spare parts are now difficult to source and the cranes are becoming costly to maintain. Their very existence forces Guernsey Harbours and the shipping lines into additional costs because to handle a ship with them invites archaic labour practices.

The major areas of concern when operating the cranes are as follows:

1. In order for ships to be turned around at an industry level of performance (15 lifts per hour) two cranes have to be operated. This not only requires the use of two crane drivers and two electricity charges for the cranes, but it also increases the manning of the labour gangs handling the ship. Whilst Guernsey operate at a manning level of between 13 and 14 dockworkers, most container terminals using modern equipment would undertake the same work with between 6 and 7 men.
2. Due to the restricted space and the type of cranes used, all containers and flats have to be moved into the storage area by forklift trucks. This results in multiple moves, requires additional costly equipment, men and fuel, as well as causing extra wear on the quay surface.

3. The workforce are undertaking outdated handling practices, and this is influenced by weight lifting restrictions on the cranes, and their poor suitability for such operations. For example, they use wires to lift platform flats instead of chains attached to a proper container spreader to reduce the load on the lifting equipment.

4. The forklift truck drivers are positioning platform flats on the quay by pushing them along the floor rather than lifting them. This is a very poor practice and should be stopped.

More thought needs to be given to improving productivity and safety through alternative operations. Forty-foot platform flats without ends could be utilised for project cargoes of over length steel beams, timber, and concrete structures.

**Efficiency:** As noted in the Structural Review, the report on charging (“Estimating tax sensitivity of harbour transited goods and harbour users” referred to as the “Revenue Report”) was the wrong response to the right question. Consideration of the cost structure of the operation, and how efficiencies can be gained, should be the first line of investigation.

Guernsey Harbours’ employees work under the States terms and conditions of employment. Operational ports require flexible working arrangements as the harbours are open 24 hours per day seven days per week. Therefore, the contracts under which the staff work are not suited to a port environment and tend to lead to high overtime costs which could be avoided if Guernsey Harbours had the freedom to set their own terms and conditions of employment. Note that this does not mean more work for less money. It means smarter working with more flexibility, with deployment of people when they are needed by the business.

For example, Guernsey Harbours’ management are fully aware that their crane drivers undertake far too much work in overtime hours, and by using two cranes the electricity use is greatly increased.

We have already noted how cargo operations result in extremely high costs due to the way these are provided.

**Charging practices:** At present Huelin Renoulf are charged nothing for the use of the cranes (hence their eagerness to use two cranes). Nor do they pay for any empty equipment loaded onto vessels. As these account for over 20% of the handling work of the cranes and the labour force, it needs to be charged. In the event that containers need re-stowing (from one place on the ship to another) the work is undertaken free of charge. There is also no charge made for containers brought into the port empty and then reloaded onto vehicles for a backload.

Some shipping lines pay an hourly craneage charge, which includes an element of cargo dues in the rate, and others pay indirectly based on weight of cargo handled.

We understand that all price increases and variations on the published tariff have to receive approval from the Board and then the States. The Board can determine if a discount may be granted, but this only occurs in exceptional circumstances.

The charging structure needs to be fully reviewed, including the law and legal framework on which charges are made and approved, with the charges based on:

- ◆ Investment in the infrastructure of the port and navigable channels
- ◆ Maintenance of the quay wall and quay surfaces
- ◆ Labour costs
- ◆ Equipment costs including maintenance and depreciation
- ◆ Utilities used
- ◆ Overheads

It is common practice that shipping lines are charged a container rate based on size, type of equipment, and whether it is loaded or empty. The rate is usually fully inclusive of all non-statutory charges. By undertaking this review all LoLo shipping services calling at Guernsey will have the same simple tariff structure based on the number of units handled. If required a throughput incentive for higher customer volumes can be built into the tariff.

As the majority of the charges levied by Guernsey Harbours to the shipping lines are based on tonnages handled, it is extraordinary that the port has no means of checking the tonnages declared by the Lines. A weighbridge should be constructed at the entrance/exit to the port for this purpose. The facility will also have the added benefit of enabling those entering the secure area to be issued with Health and Safety instructions prior to access.

### 3.3.2 Ro-Ro operations

**Operations:** The Land available for the operation of the RoRo berths is insufficient for the marshalling and free flowing of private vehicles and freight lorries. At peak times there is insufficient capacity in the marshalling yard for outbound cars and this results in queues back to the roundabout at the port entrance. Similarly, there is insufficient capacity for inbound unaccompanied trailers within the restricted area. This is unacceptable to Customs, and they could restrict the number of trailers for discharge on each vessel. This practice also forces the vehicles to undertake additional moves.

Furthermore, when discharge of RoRo vessels takes place, three special constables (harbour staff) have to control the interchange at the top of the ramps to ensure that vehicles can cross over the restricted area at the same time as allowing vehicles to leave the container terminal, and cars to access the Ferry Terminal. The operation is very poor, and very costly. It slows down the handling of the RoRo ships.

Terms & conditions need reform. For example Guernsey Harbours is paying a crane driver one hour of pay each time he presses a button to either raise or lower a ramp.



The key recommendations are:

- ◆ An adequate marshalling area with good traffic flows should be provided by use of some of the existing car parking areas.
- ◆ The Customs building should be relocated to prevent private vehicles having to cross and interact with freight traffic being loaded and unloaded.

**Charging practices:** The present tariff should be reviewed, and this should include a complete assessment of all the costs incurred in order to handle RoRos.

**Contracting:** We note that many ferry operators are ceasing their **fast** ferry operations (in general) due to high fuel costs and unreliability in adverse weather conditions. (Dover has no fast ferry operators left, and Stena are selling their craft that operate on the Irish Sea).

Guernsey and Jersey need to discuss with Condor the viability of this type of craft on the Channel Island routes. A long-term agreement with Condor Ferries should be considered in order to give them security of tenure that would then allow them to invest in new craft and ships. It might be better for all parties to encourage the investment of faster conventional ferries such as those developed by SeaFrance on the Dover/Calais route.

### 3.3.3 Road haulage / distribution

The present arrangement whereby containers and trailers are transported to warehouses in St Sampson's for stripping and redistribution imposes large costs on the Island's economy.

The location of the warehouses increases transport costs of the goods to the end user, and necessitates further handling which can lead to damage. The cost of the maintenance of the main road should also be considered. The warehouses operate under very restrictive footprints, and separate labour forces should be employed to operate them.

These are all additional costs that the Island must pay for when purchasing goods.

### 3.3.4 St Sampson's

St Sampson's Port does not meet acceptable standards for the handling of petroleum and gas products. There are about 4,500 tanker harbours around the world containing 25,000 tanker berths, of which only two dry out, and both are in St Sampson's. It is a Victorian solution that does not meet modern standards.

The States of Guernsey has placed an unacceptable burden on management to continue to accept the risks inherent in this operation. Given that the Island will continue to require the import of oil products, and will continue to require adequate storage facilities, an alternative means of safe discharge and tank storage needs to be found. The management in Guernsey is very experienced in handling these commodities, and it is recommended that the States follow its guidance in producing an acceptable safe solution for the Island.



### 3.4 Other operations

#### 3.4.1 Marinas

The marinas provided by Guernsey Harbours are well maintained and highly regarded within the industry. In fact they are the preferred call in the Channel Islands for visiting yachts, although geography has something to do with this.

Guernsey receives a deluge of visitors during the summer season, and thought might be given to the possibility of better managing / controlling yachts entering the harbours. Visitor berths in the summer months are oversubscribed and are expensive to operate because of the need to run a boat service from the pontoons to the shore (visitor berths in marinas often have direct access to land).

There is a large waiting list for local boat owners (in excess of 1,000) and the demand for facilities for larger boats is increasing. The Careening Hard area has been identified as offering an opportunity for Super Yachts and additional large yacht berths, and this should be properly assessed.

Charges for resident boat owners are relatively low, and marine leisure activity is subsidised by commercial users. Charges should be increased, and the case for this must be made on the basis of a proper investigation of the costs of providing facilities and services. Many pontoons are over twenty years old, and a refurbishment programme is presently taking place. As the work is now being undertaken it is an appropriate time to consider increasing marina fees.

Consideration should also be given to improving revenue from a structural viewpoint:

- ◆ If some marina berths are better for access and tides, then as these become available they should be offered for long-term contract at an enhanced price.
- ◆ Where boats are in berths that are too large for their size, the boat owner should be either forced to move or pay a premium.

#### 3.4.2 Fisheries

The facilities for the Fishing Fleet are constrained due to berth limitations, and the lack of an ice plant and suitable storage facilities ashore. If the Island considers it important to maintain this industry, then these issues need to be addressed.

#### 3.4.3 Cruise

Guernsey has been phenomenally successful as a port of call for cruise ships operating in Northern Europe. Despite the Island only being able to offer anchorage facilities, Guernsey is the third largest port in terms of number of ships calling and passengers handled in the British Isles. Only Southampton and Dover have greater numbers and they are turnaround ports.

Some of the success is due to the fact that a cruise calling at Guernsey is able to claim VAT exemption. However, the very low charges that Guernsey levy is also a factor. In the Revenue Report, it was recognised that a passenger fee should be charged for the use of the pontoon. This charge should be placed on the number of passengers on board the ship. As new pontoon facilities are being introduced by Guernsey this year, and there is also the provision of a small waiting shelter, it is an appropriate time to introduce this charge. As some of the passengers have limited mobility, transportation from the port to the town should be provided free in the form of a shuttle bus or mini train. This cost can be built into the passenger fee.

Guernsey should consider an alongside berth, not only to increase the number of cruise calls, but also to allow vessels to call all year - even in winter. This should be considered when looking at schemes that satisfy wider objectives. It should be noted that a cruise ship making an alongside call would expect to pay up to twenty times more port costs than they presently pay at anchorage.

The real potential economic impact of cruise shipping to the Island is not appreciated by either the States or the community. The passenger and crew spend if developed and encouraged in a planned manner should amount to between £5 to £10 million pa. Many parts of the economy would benefit, including tourism sites, transport companies, local shops and restaurants etc.

## 4 Financial review

This section reports on the following:

- ◆ Financial performance of Guernsey Harbours including:
  - Overview of profitability and returns from different activities;
  - Analysis of cost structure;
  - Balance sheet review.
- ◆ Future investment needs.
- ◆ Financing investment needs.

### 4.1 Financial performance

#### 4.1.1 Reported figures and basis of analysis of financial performance

Guernsey Harbours' results are published annually as part of the Public Services Department's Statement of Activities and Performance for Ports, which also incorporates figures for Guernsey Airport. This statement is audited by Deloitte LLP. The trading results for both St Peter Port and St Sampson's can be extracted from this statement, together with certain year-end balances (fixed assets and stock). The supplemental statements provide further analysis of the trading activities, together with the so-called Ports Holding Account, which is discussed further below.

We have based our analysis of the financial performance of Guernsey Harbours on the information contained in the Statements of Activities for years to 31<sup>st</sup> December 2010. Where necessary, we have supplemented this by further detail provided to us by staff at Guernsey Harbours, and while we have not verified this further information, we have ensured that it is consistent with the published information as far as is possible.

#### 4.1.2 Reported results

Appendix B shows the reported results for each of the two ports and in total for Guernsey Harbours for the years since 2001 and the budget for 2011. A summary of the results since 2008 is given in Table 4.1.

**Table 4.1: Guernsey Harbours Summary Financial Results (£'000)**

|                                    | <b>2011<br/>(budget)</b> | <b>2010</b>  | <b>2009</b>  | <b>2008</b>  |
|------------------------------------|--------------------------|--------------|--------------|--------------|
|                                    |                          |              |              |              |
| <b>Income</b>                      | <b>7,602</b>             | <b>7,929</b> | <b>7,560</b> | <b>7,225</b> |
| Expenditure                        | (6,143)                  | (5,786)      | (5,927)      | (5,175)      |
| <b>Surplus before depreciation</b> | <b>1,459</b>             | <b>2,143</b> | <b>1,633</b> | <b>2,050</b> |
| Depreciation                       | (1,300)                  | (1,164)      | (1,146)      | (1,006)      |
| <b>Surplus after depreciation</b>  | <b>159</b>               | <b>979</b>   | <b>487</b>   | <b>1,044</b> |

#### 4.1.3 Overview of profitability

Guernsey Harbours has been consistently profitable in recent years, albeit that in 2009 profitability declined before recovering in 2010. The analysis of income and expenditure by port shows that both locations have been profitable, after allocating common overheads. Overall Guernsey Harbours is expected to continue to make money in 2011, although St Peter Port is budgeted to make a small loss after depreciation, based on cautious assumptions of both a decline in revenue and an increase in costs compared with 2010.

The activities in St Peter Port have historically accounted for some 87% of the income of Guernsey Harbours and over 90% of the costs.

The level of profitability can be assessed in several ways, but one common measure used to benchmark a port's results is its EBITDA margin, i.e. the surplus before depreciation as a percentage of revenue. For Guernsey Harbours the figure in 2010 was 24%, which is lower than many UK ports, which typically return in excess of 40%. Part of the explanation for this is the inclusion in Guernsey Harbours' activities of the costs of certain statutory functions on behalf of the States that UK ports do not bear. The marginal costs of these functions are estimated by management to amount to £719,000 pa, and if they were excluded, EBITDA return would increase to a more typical 36%.

In 2010 Guernsey Harbours were tasked with improving their financial results to assist the Public Services Department in its objective of raising additional net revenue of between £1.5m and £2.0m per annum. The Revenue Report provided a comprehensive analysis of the opportunities for, and consequences of, increasing revenue by putting up prices.

We note that if Guernsey Harbours' total revenue in 2010 had been £8.8 million, an increase of £1.8 million on its actual revenue, and operating costs had remained unchanged, it would have shown a surplus before depreciation of 40% of revenue. We conclude that, if Harbours were to seek to achieve the profitability of other ports *solely through increasing its prices*, it would need to increase these by the order of magnitude considered in the Revenue Report.

#### 4.1.4 Analysis of results

Guernsey Harbours analyses income and expenditure between three broad headings – commercial activities, moorings and leisure activities, and other activities. Appendix C shows the detail within each heading for the last 2 years and budgeted for 2011. Table 4.2 summarises the analysis.

**Table 4.2: Analysis of Results by Area of Activity (£'000)**

|                              | <b>2011<br/>(budget)</b> | <b>2010</b>  | <b>2009</b>  |
|------------------------------|--------------------------|--------------|--------------|
| <b>Income</b>                |                          |              |              |
| Commercial                   | 4,993                    | 5,449        | 5,196        |
| Moorings/leisure             | 2,450                    | 2,339        | 2,227        |
| Other                        | 159                      | 141          | 137          |
| <b>Total income</b>          | <b>7,602</b>             | <b>7,929</b> | <b>7,560</b> |
| <b>Expenditure</b>           |                          |              |              |
| Commercial                   | 4,207                    | 3,975        | 3,979        |
| Moorings/leisure             | 2,792                    | 2,592        | 2,727        |
| Other                        | 444                      | 383          | 367          |
| <b>Total expenditure</b>     | <b>7,443</b>             | <b>6,950</b> | <b>7,073</b> |
| <b>Surplus/(deficit)</b>     |                          |              |              |
| Commercial                   | 786                      | 1,474        | 1,217        |
| Moorings/leisure             | (341)                    | (254)        | (500)        |
| Other                        | (285)                    | (242)        | (230)        |
| <b>Total surplus/deficit</b> | <b>159</b>               | <b>979</b>   | <b>487</b>   |

While the analysis of income by area of activity can be derived precisely, the analysis of expenditure by trading area inevitably includes an allocation of common costs between the three areas. This means that while it is not possible to conclude that deficits shown above would certainly be avoided by discontinuing such activities, the analysis could identify areas where current charging policies do not allow for a full recovery of all relevant costs.

We note that the method of cost allocation on which the figures above are based results in a lower level of expenditure being allocated to “other activities” than would be expected from management’s analysis of the costs of the statutory functions undertaken by Guernsey Harbours referred to in 4.1.3. Further work may be needed to analyse more precisely the actual contributions made by, or the costs of, each area of activity. This work would be a necessary part of the development of a full business plan for Guernsey Harbours.

The analysis above shows that it is only the commercial activities of the ports that generate a surplus. They also constitute the major source of revenue, accounting for some 69% of income in 2010. Commercial income is derived principally from shipping dues, charges for use of cranes, ramps and other equipment, and rental income.

In contrast, the income from moorings and leisure and from other activities does not cover the costs of these activities. Other activities include the statutory responsibilities undertaken by Guernsey Harbours on behalf of the States (e.g. Coast Guard and registration services), and it is perhaps not surprising that these costs are not fully recovered. However, we would have expected the mooring and leisure activities to make a positive contribution. The Revenue Report addressed the opportunities for Harbours to increase its income from these activities.

As discussed further below, it may be that the depreciation charge included in Harbours' results should be greater. There are two arguments in support of this view. Firstly, depreciation policies used by Guernsey Harbours write off the cost of fixed assets over longer periods than those adopted by other ports (albeit that, by including the majority of the assets at a 2002 replacement cost figure means that there is a very high figure, relative to the size of the operation, to be depreciated).

The second reason is that the annual depreciation charge is less than the average annual amount that needs to be spent over the next 10 years on what we have described below as "maintenance investment projects". A higher depreciation charge would result in lower returns by activity shown in Table 4.2 above, and support the view that Guernsey Harbours should increase profitability by appropriate means.

#### 4.1.5 Analysis of expenditure

Appendix D shows the analysis of expenditure by both cost type and by area of activity. The detail in this appendix is summarised below in Tables 4.3 and 4.4.

**Table 4.3: Summary of Expenditure by cost type (£'000)**

|                          | <b>2011<br/>(budget)</b> | <b>2010</b>  | <b>2009</b>  |
|--------------------------|--------------------------|--------------|--------------|
| Premises                 | 1,099                    | 977          | 1,221        |
| Staff                    | 3,977                    | 3,545        | 3,377        |
| Supplies & services      | 1,190                    | 1,410        | 1,478        |
| Less: recoveries         | (123)                    | (146)        | (134)        |
| Depreciation             | 1,300                    | 1,164        | 1,131        |
| <b>Total expenditure</b> | <b>7,443</b>             | <b>6,950</b> | <b>7,073</b> |

**Table 4.4: Summary of Expenditure by area (£'000)**

|                          | <b>2011<br/>(budget)</b> | <b>2010</b>  | <b>2009</b>  |
|--------------------------|--------------------------|--------------|--------------|
| Administration           | 3,138                    | 2,607        | 2,604        |
| Harbour infrastructure   | 1,490                    | 1,669        | 1,807        |
| Marinas & moorings       | 1,049                    | 1,028        | 1,150        |
| Navigational services    | 1,766                    | 1,646        | 1,512        |
| <b>Total expenditure</b> | <b>7,443</b>             | <b>6,950</b> | <b>7,073</b> |

Staff costs account for just over half the costs incurred by Guernsey Harbours, and were 45% of turnover in 2010. This is a relatively high proportion of both turnover and total costs compared with other ports, where staff costs may be typically 35-40% of turnover. However, this figure is affected by the degree of outsourcing activities such as engineering to third parties, which varies between ports, and Guernsey Harbours' additional services (e.g. Coast Guard).

Guernsey Harbours' employees are members of the States of Guernsey Superannuation Scheme. At present, Guernsey Harbours pays a contribution rate of 14.1% into the Scheme on behalf of its staff. We note that, when other State bodies have been set up as independent entities, a separate actuarial account for their employees has been created which has resulted in a different (higher) employer's contribution rate.

Administration costs comprised 38% of all costs in 2010 and were 33% of turnover. This is some twice the level seen at other ports, although it is recognised that Guernsey Harbours is a relatively small operation, and by their nature, some elements of administration costs are fixed regardless of size.

The costs of maintaining the harbour infrastructure are more readily predictable if a proper planned maintenance regime is operated. However, if expenditure has been cut back historically, the need for emergency repair work can arise causing spikes in the trend of costs incurred in this area of expenditure. We were informed that planned maintenance work has been dropped in 2009 and 2010 to accommodate emergency repair work on ramps of around £0.5m pa.

#### 4.1.6 Balance sheet review

Guernsey Harbours does not publish a separate balance sheet, as it has no separate legal identity from the States as a whole. However, certain balance sheet figures relating to Guernsey Harbours are separately reported in the Public Services Department's Statement of Activities and Performance for Ports while the records held by Guernsey Harbours permit the completion of a balance sheet for its own activities. The position as at 31 December 2010 is summarised in Table 4.5.

**Table 4.5: Summary Balance Sheet at 31 December 2010**

|   | £'000 | £'000   |
|---|-------|---------|
| <b>Fixed assets</b>                                   |       |         |
| Tangible fixed assets                                 |       | 132,272 |
| <b>Current assets</b>                                 |       |         |
| Stock   | 398   |         |
| Debtors and prepayments                               | 1,022 |         |
| Balances with States Treasury                         | 0     |         |
| <b>Creditors: amounts falling due within one year</b> | (4)   |         |
| <b>Net current assets</b>                             |       | 1,416   |
| <b>Total net assets</b>                               |       | 133,688 |

The most striking feature of Guernsey Harbours' balance sheet is the high net book value of its tangible fixed assets. The composition of this figure is given in Table 4.6 below.

**Table 4.6: Tangible fixed assets at 31 December 2010**

|   | <b>£'000</b>   | <b>£'000</b>          |
|---|----------------|-----------------------|
|   | <b>Cost</b>    | <b>Net book value</b> |
| Land                                    | 87,515         | 87,515                |
| Buildings                               | 48,531         | 42,871                |
| Plant and machinery                     | 2,424          | 1,134                 |
| Equipment, fixtures and fittings        | 1,922          | 712                   |
| Motor vehicles and electrical equipment | 450            | 40                    |
| Computers and ICT                       | 64             | 0                     |
| <b>Total</b>                            | <b>140,906</b> | <b>132,272</b>        |

Land comprises principally blockwork walls, infill and reclamation at the two harbours, for which "cost" represents replacement cost at August 2002, when a full valuation of all the assets was undertaken. The actual costs of construction of the harbours were incurred in the 19<sup>th</sup> century. No depreciation is charged in respect of these assets, a normal accounting policy in respect of freehold land, which the infill and reclamation costs may be regarded as being.

The cost of buildings includes not only actual building structures, but also expenditure on jetties and various piled or buoyant structures. Buildings are depreciated over 60 years, a longer period than that typically adopted by other ports, which rarely exceeds 50 years. The cost of buildings at the August 2002 asset valuation was £28.7 million, but the remainder of the cost, almost £20 million, has been invested in the 8 years since then and includes the costs of constructing the marina in St Sampson's Harbour.

The high value attributed to fixed assets as a result of the 2002 valuation means that Guernsey Harbours shows a very low return on capital employed compared to other ports. The 2010 return was 0.7%, whereas a typical return for other UK ports might be between 5% and 10%, after bearing a charge for corporation tax, which is not a burden on Guernsey Harbours at present. Guernsey Harbours' return would be lower still if it adopted the more conservative depreciation policies for buildings and plant applied by other ports.

In our view, the inclusion of the harbour walls and buildings in the accounts of Guernsey Harbours at their 2002 replacement cost valuation results in a balance sheet that overstates the enterprise value of Guernsey Harbours. A valuation based on the maintainable earnings stream of Guernsey Harbours, would be an order of magnitude less than the net assets shown by Guernsey Harbours' 2010 balance sheet in Table 4.5. If Guernsey Harbours is to be set up as an independent financial entity, capable of raising finance on the basis of its own balance sheet, we recommend that further consideration be given to the basis on which the fixed assets are incorporated into the balance sheet of the new entity.



## 4.2 Future investment needs

### 4.2.1 Capital investment forecast

In 2008, Guernsey Harbours' management prepared a summary of potential major capital investment projects that could be required over the 12 years to 2020, totaling some £261.4 million. This amount excluded £6.3 million of costs of new jetty cladding replacement, which was incurred in 2008. Although £23.0 million of this total was scheduled to be incurred between 2008 and 2010, in practice total capital expenditure in those 3 years (apart from the £6.3 million) amounted to just £1.8 million. The 2008 summary has therefore been used as our starting point to identify potential medium and long-term capital investment requirements of Guernsey Harbours, with projects previously identified for years between 2008 and 2012 deferred by 3 years. It is summarised in Appendix E.

As with any port, these investment needs can be broadly classified between those projects that have to be undertaken to maintain the fabric of Guernsey Harbours' operations, to allow them to continue to operate as they do at present in a short to medium term horizon, and those that enable it to sustain its operations in the long term, or open up opportunities for developing new streams of business. Based on the 2008 analysis, we have summarised the capital investment requirements of Guernsey Harbours accordingly as shown in Table 4.7.

**Table 4.7: Major capital investment projects 2011-20**

|                                       | £ m           | £ m           | £ m           |
|---------------------------------------|---------------|---------------|---------------|
|                                       | St Peter Port | St Sampson's  | Total         |
| <b><u>Maintenance projects</u></b>    |               |               |               |
| Cranes                                | 3.00          | 3.00          | 6.00          |
| Ramps, pontoons and jetties           | 8.50          | 1.15          | 9.65          |
| Buildings refurbishment & replacement | 2.00          | 0.00          | 2.00          |
| Vessels                               | 1.00          | 0.00          | 1.00          |
| Miscellaneous                         | 2.50          | 0.00          | 2.50          |
| <b>Total maintenance projects</b>     | <b>17.00</b>  | <b>4.15</b>   | <b>21.15</b>  |
| <b><u>Strategic projects</u></b>      |               |               |               |
| Berths 4, 5 and 6                     | 10.50         | n/a           | 10.50         |
| Deep water berths                     | n/a           | 153.00        | 153.00        |
| Careening hard development            | 10.00         | n/a           | 10.00         |
| Havelet Bay development               | 60.00         | n/a           | 60.00         |
| Commercial facilities expansion       | 6.00          | n/a           | 6.00          |
| <b>Total strategic projects</b>       | <b>86.50</b>  | <b>153.00</b> | <b>239.50</b> |
| <b>Total all projects</b>             | <b>103.50</b> | <b>157.15</b> | <b>260.65</b> |

#### 4.2.2 Maintenance investment projects

It is in the nature of port investment that such expenditure does not arise evenly, year on year, as can be seen from Appendix E. Guernsey Harbours have identified a requirement to spend, on average, some £2 million per annum on maintenance capital projects, which is slightly below the level of actual capital expenditure incurred between 2008 and 2010, including the exceptional £6.3 million of expenditure in 2008.

It should be noted that this annual investment requirement is greater than the annual depreciation charge, which is budgeted at £1.3 million for 2011. A business might normally anticipate re-investing an amount equivalent to its depreciation charge in replacing its fixed assets to maintain the overall age profile of its asset base. The fact that Guernsey Harbours' investment need is greater could indicate that either there is a backlog of investment requirements that need to be addressed, or that it is not charging sufficient depreciation against its results. A combination of both of these factors may well be the actual explanation.

#### 4.2.3 Strategic investment projects

The requirements for major investment in berths at both harbours were addressed in 2010 in a report entitled "Future Harbour Requirements Study" in July 2010. This report presented options for investment at both harbours to better suit the current needs, and to meet the future requirements that would arise from projected medium to long term growth in the traffic and goods handled. It also included cost estimates for the options it identified and implementation programmes spanning the current decade.

This work is a relatively recent analysis of the first two strategic projects included in Table 4.7, and provides a current estimate of the amount of the investment required. It concluded that, at St Peter Port "the structures and equipment are reaching the end of their serviceable life and without significant investment in the near future will expose the States to unacceptable levels of risk in terms of the imports required". It also recommended "relocation of bulk liquid facilities from St Sampson's to an offshore facility.....to mitigate navigation risk and eliminate security of supply issues".

At St Peter Port, the preferred option involved remedial works to berths 4 and 6 at a cost of £6.6 million, improvement works to berth 5 costing £7.2 million and landside work of £5.3 million, making a total investment requirement of £19.1 million.

At St Sampson's, the preferred option involved the construction of a new outer harbour, including breakwaters, dredging and a new berth, for an estimated cost of £116.5 million. The Future Harbour Requirements Study recommended retaining the LoLo facility at St Peter Port rather than relocating it to St Sampson's, which explains the major differences in cost estimates with Guernsey Harbours' 2008 projections shown in Table 4.7. It is nonetheless still a very substantial sum.

It will be challenging to construct a business case for projects to replace or enhance the present berths that require such substantial amounts of money to be invested.

The Future Harbour Requirements Study provides a good technical review of some of the options for port development. The conclusions and recommendations however are of limited value, because they consider only Guernsey Harbours' technical needs, and lack a strategic and economic context. Such a context would consider the financial value of land and opportunities generated by moving operations from St Sampson's and St Peter Port to a new location, the reductions in logistics costs that would result, and the economic impacts from opportunities generated. Based on our experience, there should be a reasonable expectation that a project can be constructed incorporating wider economic benefits, and this is a major role for the Board of a remodeled Guernsey Harbours.

In addition to the strategic berth projects, three others were identified in 2008 that would grow the activities undertaken by Guernsey Harbours, as listed in Table 4.7. In all cases, a full business case evaluation of the project should identify whether it is financially viable, economically desirable, and should be undertaken.

### 4.3 Financing the investment needs

#### 4.3.1 Guernsey Harbours as a division of Guernsey Public Services Department

The published results of the Ports Division of the Public Services Department have been based on a "Ports Holding Account". Operating surpluses before depreciation from both Guernsey Harbours and the Airport have been credited to this account, and capital expenditure and depreciation debited to it. We understand that this mechanism has been used to ensure that, taken together, the Airport and Guernsey Harbours have funded their own capital expenditure (although it has meant that there has been competition for resources between the two). There is a question of equity in this policy, because surpluses from commercial port activities have arguably been used to fund the Airport, implying that customers of Guernsey Harbours have been subsidising their competitors.

We have been informed that, with effect from 2011, the Ports Holding Account will be discontinued, although the residual balance in the account will be available for routine capital expenditure by the Airport and Guernsey Harbours. In future, all surpluses generated by Guernsey Harbours will accrue to the States general fund, and when the Ports Holding Account is depleted, Guernsey Harbours will have to bid for capital expenditure in competition with all other bodies funded by the States. As a result, Guernsey Harbours will have much less incentive to generate the operating surpluses required to meet their own investment needs. Unless they can secure sufficient funds in competition with a wide range of public bodies, they face being starved of capital to meet their investment requirements, with the result that maintenance costs will increase in the short term and the long-term viability of Guernsey Harbours' operations will be compromised.

The discontinuation of the Ports Holding Account has resulted in an increase in the financial dependence of Guernsey Harbours upon the States general budget. The changes in corporate structure anticipated in this report have the potential to reverse this situation, leading to an operation that is financially independent of the States on a sustainable basis.

The remainder of this section assumes that following such a change in structure, Guernsey Harbours will be in a position to determine how it spends its operating surplus on its own investment needs. This must be a key objective of any change to its status.

#### 4.3.2 Financing capacity

A full assessment of Guernsey Harbours' ability to finance the investment requirements would require the construction of a financial model to develop projections of operating cash flows based on traffic forecasts, projected tariffs and future cost structures, as well as a full profiling over time of the investment required. This needs undertaking in a business plan and tariff study, as explained in the Stage 2 Structural Review. We provide here a high level indicative consideration of the issues.

Guernsey Harbours has a fairly stable level of business, as shown by the relatively consistent level of its results over the last decade. The average annual surplus before depreciation between 2001 and 2010 shown in Appendix B was £2.1 million pa, with actual annual surpluses varying by up to plus or minus £0.5 million from this figure. If this core level of surplus can be sustained, principally through stable activity levels and tariffs being increased to offset the impact of cost inflation, it provides the basis from which to assess the capacity of Guernsey Harbours to finance its investment needs.

The actual financing capacity could be different as a result of a number of factors, some of which might only arise on the creation of a new corporate structure. These might include the following:

- ◆ The separation of the statutory activities presently undertaken by Guernsey Harbours from its commercial operations carried forward to the new entity, and the avoidance of those costs by Guernsey Harbours in the future.
- ◆ Additional employer contributions to the States of Guernsey Superannuation Scheme following separation of Guernsey Harbours from the Public Services Department.
- ◆ Any new costs that arise as a result of the change in Guernsey Harbours' corporate structure. Such costs might include cross charges for services currently provided at no cost to Guernsey Harbours, for example payroll services. They could also include company taxes (for example on rental activities), or the requirement to generate a return on the investment in the new structure made by the States, for example, by way of interest or dividend on any loan stock or share capital created as a consequence of the new structure.
- ◆ Any changes in the working capital investment arising from changes in payment terms for customers and supplier, or the need to change levels of stock holdings. In practice, in a stable business, such requirements are unlikely to be material.

These will require consideration in addition to the opportunities for increasing efficiency and the revenue base.

### 4.3.3 Matching the financing capacity to the investment needs

The available financing capacity might be used in either of the following ways to finance the investment needs of the port:

- ◆ Investing directly in new fixed assets out of the cash generated each year. We have shown above that the average annual requirement for maintenance investment projects is some £2 million pa, the same order of magnitude as the average financing capacity, subject to the potential and unquantified changes to that capacity identified above. However, in practice no year will be an average year.
- ◆ Borrowing money to finance specific tranches of investment, and spreading the cost over a number of years. We understand that the States of Guernsey do not borrow. However, if Guernsey Harbours were set up as a discrete legal entity this might be possible. Commercial ports finance major port investment by borrowings, and this is particularly appropriate when such investment does not fall evenly each year. For illustrative purposes, if half of Guernsey Harbours' annual base financing capacity (£1.0 million pa, and perhaps an upper limit for a prudent level of debt financing obligation) were committed to finance and repay a 7 year term loan at an interest rate of 5% pa, a loan of £5.8 million could be secured. It is conceivable that a commercial lender might seek a guarantee from the States in respect of any such borrowing.

Through a combination of borrowings and the investment of its annual operating surplus, Guernsey Harbours appears to have sufficient capacity to meet its maintenance investment needs over the coming decade, provided that its financing capacity does not drop below £2.0 million pa following any change in structure.

However, in order to be in a position to finance any of the projects identified above as strategic investment projects, other solutions are required. These could include:

- ◆ Development of a strategic and economic context for the projects.
- ◆ The development of business cases for these projects identifying potential growth in business and hence additional profitability out of which to finance the investment.
- ◆ Improvements in retained profit generated by various means, including reasonable exploitation of all assets in the port estate, increased efficiency, and improved revenue recovery. Substantial improvement would be needed if all of the new berth investment in St Peter Port, let alone the St Sampson's development, recommended in the Investment Report were to be solely financed this way.
- ◆ Specific support from the States, either by way of grants or soft loan capital, in support of economic benefits arising from development, and to maintain the core infrastructure of the States of Guernsey.

## 5 Conclusion

### 5.1 Governance and management

Governance requires significant improvement. The key areas to target are:

- ◆ Providing a greater level of specialist maritime and commercial experience to support development of Guernsey Harbours.
- ◆ Making quicker decisions based on commercial rather than political criteria.

We recommend creation of a “fit for purpose Board” as described by the UK’s Trust Ports Review (whether or not Guernsey Harbours actually becomes a Trust Port).

The supporting legal framework needs to be updated as appropriate.

In terms of management, this needs to be empowered to make and act upon decisions, and then made accountable for the outcomes of these. For example, some current operations and working practices are very poor in terms of efficiency and safety, but management cannot at present be held to account because it lacks the resources and powers to address these issues.

In parallel with this, the organisation structure should better reflect the commercial business drivers, with more emphasis on working with commercial customers to do what can be done at the margins to encourage business.

Many issues related to management and governance are discussed in more detail in the Stage 2 Structural Review.

### 5.2 Operations

Key conclusions of the operations review are:

- ◆ The operational land available for LoLo and RoRo berths is highly inadequate. Both types of cargo handling require adequate areas of hard standing for storage. Failure to provide adequate storage areas leads to double handling and even multiple moves of the cargo, which increase labour costs, time and potential for damage. Clearly designated vehicle movement flows must be available at all times to ensure operational safety and efficiency.
- ◆ The Customs shed is located in the wrong place. It restricts the “free flow” on and off RoRo ships and forces the intermingling of private and commercial traffic. Its location creates bottlenecks of traffic within the very limited operational area.
- ◆ The commercial port area requires complete replanning, utilising some of the current car park space, to solve these problems.
- ◆ The commercial port area should be clearly defined and surrounded by a secure fence to improve security and safety.



- ◆ LoLo stevedoring requires complete review to improve safety and efficiency, with consolidation to one integrated service provider, a full review of working practices, and potentially bringing stevedoring in house concurrent with deployment of new cranes.
- ◆ Third party providers of port services should be licensed by Guernsey Harbours.
- ◆ Warehouses for stripping of containers and trailers should be located in or adjacent to the Port's operational storage areas. This would limit the number of times equipment and goods are handled, reduce the haulage charges to St Sampson's (where many sheds are currently located), and reduce the cost of maintenance of the road between the two locations.
- ◆ Many Island shipping services are heavily subsidised by their Governments, as limited throughputs and high capital expenditure negate operational profitability. The Channel Islands are fortunate that they have not been forced to do this. However, if operational facilities are not improved, and significant efficiencies found to contribute to lower costs, the viability of shipping services to the Islands may increasingly be in jeopardy.
- ◆ A new acceptable and safe solution is needed for the discharge and storage of bulk liquids. Had there been an international regulator, such as is the case with the Airport, the practice of drying out tankers in St Sampson's would not be permitted. The risks inherent in this practice are very high.
- ◆ The creation of an alongside cruise ship berth should be a priority in the overall objectives for development of new facilities.
- ◆ Terms and conditions of employment need to be revised to match the deployment of labour to the operational requirements of the business, and reduce the level of overtime. A flexible approach is needed.
- ◆ The Coast Guard service might continue to be provided by an incorporated body or a Trust Port, under a public service contract. The alternative of merging this service with Jersey Coast Guard can be considered with care.
- ◆ Consideration should be given to bringing the pilotage service in house.
- ◆ Careful consideration should also be given to contracting out some or all of the engineering function.
- ◆ Revenue protection should be enhanced, including comparisons of declarations for charging against manifests, and weighing cargo. A weighbridge is needed.
- ◆ Tariffs and charging structures for commercial traffic require a complete overhaul, with charges to be based on the cost of services provided, and all services to be charged.
- ◆ A strategy for gradual increasing of yield from leisure craft should be developed, with higher charges for better berths.
- ◆ All revenue generated within the port estate should accrue to Guernsey Harbours. This will substantially improve its financial self-sustainability, and prevent potential developments that are not compatible with port operations.

### 5.3 Financial

Guernsey Harbours has been consistently profitable for the last decade, showing a stable level of surplus before depreciation, albeit at a rate that is less than other commercial ports. This may be explained in part by its public service obligations (e.g. Coast Guard and Lighthouse Authority). However, Guernsey Harbours also benefits from central services provided by the States without charge, and this would reduce the surplus if addressed.

Only Guernsey Harbours' commercial activities are profitable. It loses money on moorings and leisure after allocating common costs, as well as having to fund its public service obligations. We recommend that the tariffs for moorings and leisure be increased to ensure this area of activity makes a positive contribution. The Revenue Report illustrates the potential for this.

Expenditure has been reduced on planned maintenance in recent years, and this is not a sustainable policy.

Balance sheet net assets far exceed the financial value of Guernsey Harbours as a business by virtue of the inclusion of its principal assets at a 2002 valuation based on replacement cost, despite many actual costs having been incurred in the 19<sup>th</sup> century. We recommend that the basis of valuing assets, and the depreciation policy for such assets, be re-assessed in any transfer of the business to a new corporate structure.

Discontinuation of the Ports Holding Account has increased the financial dependence of Guernsey Harbours upon the States general budget. Any change in corporate structure of Guernsey Harbours should target retaining all operating surpluses to finance as much of its own investment as it can from its own resources. There must be strong incentives to improve margins by increasing efficiency and revenues (not just by putting up charges) to fund investment. In a new corporate structure, Guernsey Harbours should be able to access commercial borrowing facilities to finance its investment needs.

Through a combination of borrowings and the investment of its annual operating surplus, Guernsey Harbours appears to have sufficient capacity to meet its maintenance investment needs over the coming decade.

Guernsey Harbours needs to prepare a full business plan that identifies how it can generate improved profits to fund its activities, and the impact of measures such as proper exploitation of assets in the port estate to support this.

Specific solutions involving funding support from the States will be required to allow Guernsey Harbours to develop strategic projects, as exemplified in the Future Harbour Requirements Study, over the coming decade. A full business case evaluation of all strategic investment projects should be undertaken to identify whether they are financially and / or economically viable. The strategic and socio-economic case for such investments, viewed in a much wider context, needs to be developed, with consideration of how such projects might be funded.



## **HARBOUR LEGISLATION as at May 2009**

### *Laws*

- Loi relative a la Marine Marchande dans le Bailliage de L'Ile de Guernsey 1916
- The Merchant Shipping (Guernsey) Law, 1953
- The Harbour Dues (Saint Peter Port and Saint Sampson) Law, 1957
- The Merchant Shipping (Guernsey) Law, 1957
- The Pilotage (Guernsey) Law, 1966
- The Merchant Shipping (Guernsey) Law, 1970
- The Vessels and Speedboats (Compulsory Third Party Insurance, Mooring Charges and Removal of Boats) (Guernsey) Law, 1972
- The Vessels and Speedboats (Compulsory Third Party Insurance, Mooring Charges and Removal of Boats) (Amendment) (Guernsey) Law, 1988
- The Vessels and Speedboats (Compulsory Third Party Insurance) (Amendment) (Guernsey) Law, 1994
- The Harbours, Moorings and Pilotage (Fees and Dues) Law, 1986
- Wreck and Salvage (Vessels and Aircraft) (Bailiwick of Guernsey) Law, 1986
- Hired Boats and Passenger Boats (Guernsey) Law, 1989
- Merchant Shipping (Bailiwick of Guernsey) Law, 2002 – Not all sections yet enacted

### *Ordinances*

#### *Pilotage*

- The Pilotage Ordinance 1967
- The Pilotage (Amendment) Ordinance, 1975. (Repealed).
- The Pilotage (Amendment) (No2) Ordinance, 1975.
- The Pilotage (Amendment) Ordinance, 1976. (Repealed).
- The Pilotage (Amendment) Ordinance, 1977. (Repealed).
- The Pilotage (Amendment) Ordinance, 1978. (Repealed).
- The Pilotage (Amendment) Ordinance, 1979. (Repealed).
- The Pilotage (Amendment) Ordinance, 1981. (Repealed).
- The Pilotage (Amendment) (No2) Ordinance, 1981. (Repealed).
- The Pilotage (Amendment) Ordinance, 1982. (Repealed).
- The Pilotage (Amendment) Ordinance, 1983. (Repealed).
- The Pilotage (Amendment) Ordinance, 1984.
- The Pilotage (Amendment) Ordinance, 1985. (Repealed).
- The Pilotage (Amendment) Ordinance, 1992.
- Pilotage (Dues and Fees) Ordinance, 1987
- The Harbours, Moorings and Pilotage (Fees and Dues) Law, 1986 Commencement Ordinance 1987

#### *Passenger Vessels*

- The Passenger Vessels (Bailiwick of Guernsey) Ordinance, 1953 (Repealed)
- The Passenger Vessels (Bailiwick of Guernsey) Ordinance, 1970

- The Passenger Vessels (Amendment) (Bailiwick of Guernsey) Ordinance, 1974
- The Passenger Vessels (Amendment) (Bailiwick of Guernsey) Ordinance, 1995

*Charges and Dues*

- The Harbours Facilities (Charges) Ordinance 1976
- The Harbours Facilities (Charges) (Amendment) Ordinance 1977
- The Harbours Facilities (Charges) (Amendment) Ordinance 1978 (Repealed)
- The Harbours Facilities (Charges) (Amendment) Ordinance 1979
- The Harbours Facilities (Charges) (Amendment) Ordinance 1980
- The Harbours Facilities Charges Ordinance 1982 (Repealed)
- The Harbours Facilities (Charges) (Amendment) Ordinance 1984
- The Harbours Facilities Charges Ordinance 1986 (Repealed)
  
- The Harbour Dues Ordinance 1976
- The Harbour Dues Ordinance 1976 (Repealed)
- The Harbour Dues (Amendment) Ordinance 1977
- The Harbour Dues (Amendment) (No2) Ordinance 1977 (Repealed)
- The Harbour Dues Ordinance 1978 (Repealed)
- The Harbour Dues Ordinance 1979 (Repealed)
- The Harbour Dues Ordinance 1980 (Repealed)
- The Harbour Dues Ordinance 1982 (Repealed)
- The Harbour Dues Ordinance 1984 (Repealed)
- The Harbour Dues Ordinance 1986 (Repealed)
- 
- The Mooring Charges (Guernsey) Ordinance 1986 (Repealed)
- The Mooring Charges (Amendment) (Guernsey) Ordinance 1977(Repealed)
- The Mooring Charges (Amendment) (Guernsey) Ordinance 1979 (Repealed)
- The Mooring Charges (Amendment) (Guernsey) Ordinance 1980 (Repealed)
- The Mooring Charges (Amendment) (Guernsey) Ordinance 1981 (Repealed)
- The Mooring Charges (Amendment) (Guernsey) Ordinance 1982 (Repealed)
- The Mooring Charges (Amendment) (Guernsey) Ordinance 1986 (Repealed)
- The Harbour Dues and Mooring Charges (Repeals) Ordinance 1987
- 

Note: Mooring Charges are now set and payable by virtue of Sec 2(1) of the Vessels and speedboats(Compulsory etc) Gsy Law 1971 at rates set by States Resolution. This further amended to permit increase by Board of PSD up to and including RPI without recourse to States.

Facilities Charges are now raised by virtue of Sec 33-35 of the Harbours Ordinance at rates set by States Resolution. This further amended to permit increase by Board of PSD up to and including RPI without recourse to States.

*Others*

- Boats and Vessels (Registration, Speed Limits and Abatement of Noise) Ordinance, 1970
- The Vessels and Speedboats (Compulsory Third Party Insurance) (Variation of Cover) (Guernsey) Ordinance, 1981.
- The Vessels and Speedboats (Variation of Insurance Cover) Ordinance, 1994.
- 
- The Harbours Ordinance, 1988
- The Harbours (Amendment) Ordinance, 1988
- The Harbours (Amendment) Ordinance, 1994
- 
- Vessels and Speedboats (Variation of Insurance Cover) Ordinance, 1994
- 1990 SI No 1 Boats (Guernsey) Regulations 1990
- 1991 SI No 41 Boats (Amendment) (Guernsey) Regulations 1991
- 1993 SI No 18 Boats (Amendment) (Guernsey) Regulations 1993
- 
- 2004 SI No 30 The Security of Ship and Port Facilities (Guernsey) Order 2004.
- The Small Fishing Vessels (Safety) (Bailiwick of Guernsey) Regulations, 2007
- The Merchant Shipping (Tonnage) (Bailiwick of Guernsey) Regulations, 2009
- The Merchant Shipping (Registration of Ships) (Bailiwick of Guernsey) Regulations, 2009
- The Merchant Shipping (Accident Reporting and Investigation) (Bailiwick of Guernsey) Regulations, 2009

#### Misc

2005 No 5 The Harbours (Cycling etc Prohibition) Regulations, 2005

#### UK

- SI 1988 No. 1991 - The Merchant Shipping (Certification of Deck Officers and Marine Engineer Officers) (Guernsey) Order 1988.
- SI 2003 No 1248 - The Merchant Shipping (Categorisation of Registries of Relevant British Possessions) Order 2003.
- 

#### **IMO Convention Status - UK & Guernsey**

**i.e. Those Conventions extended by UK to cover Bailiwick of Guernsey.**

| Convention Name            | Entry into Force | Guernsey  |
|----------------------------|------------------|-----------|
| <b>IMO Convention</b>      | 17-Mar-58        | N/A       |
| <b>SOLAS 1974</b>          | 25-May-80        | 30-Jan-04 |
| <b>SOLAS Protocol 1978</b> | 01-May-81        | -         |
| <b>SOLAS Protocol 1988</b> | 03-Feb-00        | 30-Jan-04 |
| <b>COLREG 1972</b>         | 15-Jul-77        | 15-Jul-77 |
| <b>LL Protocol 1988</b>    | 03-Feb-00        | -         |
| <b>Tonnage 1969</b>        | 18-Jul-82        | 01-Jan-89 |

|                                   |                  |           |
|-----------------------------------|------------------|-----------|
| <b>Intervention Protocol 1973</b> | 30-Mar-83        | In hand-  |
| <b>CLC Protocol 1992</b>          | 30-May-96        | 20-Feb-98 |
| <b>FUND Protocol 1992</b>         | 30-May-96        | 20-Feb-98 |
| <b>FUND Protocol 2003</b>         | 03-Mar-05        | In hand-  |
| <b>CSC 1972</b>                   | 06-Sep-77        | 01-May-92 |
| <b>PAL 1974</b>                   | 28-Apr-87        | 28-Apr-87 |
| <b>PAL Protocol 1976</b>          | 30-Apr-89        | 30-Apr-89 |
| <b>Athens Protocol 2002</b>       | Not yet in force | -in hand  |
| <b>LLMC 1976</b>                  | 01-Dec-86        | 01-Dec-86 |
| <b>LLMC Protocol 1996</b>         | 13-May-04        | In hand-  |
| <b>SAR 1979</b>                   | 22-Jun-85        | 22-Jun-85 |
| <b>SALVAGE 1989</b>               | 14-Jul-96        | 14-Sep-01 |
| <b>HNS 1996</b>                   | Not yet in force | In hand-  |
| <b>BUNKERS 2001</b>               | 21-Nov-08        | In hand-  |
| <b>LC 1972</b>                    | 30-Aug-75        | 17-Nov-75 |
| <b>LC 1978 Amendments</b>         | Not yet in force | 21-Mar-80 |
| <b>LC Protocol 1996</b>           | 24-Mar-06        | 24-Mar-06 |

#### Other Conventions

|   |                  |           |
|---|------------------|-----------|
| <b>UNCLOS</b>                           | 16-Nov-94        | 25-Jul-97 |
| <b>Maritime Labour Convention (ILO)</b> | Not yet in force | In hand   |

## Appendix B

|                          |                             | Notes | 2011<br>(budget)<br>£'000 | 2010<br>£'000 | 2009<br>£'000 | 2008<br>£'000 | 2007<br>£'000 | 2006<br>£'000 | 2005<br>£'000 | 2004<br>£'000 | 2003<br>£'000 | 2002<br>£'000 | 2001<br>£'000 |
|--------------------------|-----------------------------|-------|---------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| <b>St Peter Port</b>     |                             |       |                           |               |               |               |               |               |               |               |               |               |               |
| 1                        | Income                      |       | 6,599                     | 6,975         | 6,611         | 6,356         | 6,250         | 6,043         | 6,035         | 5,839         | 5,777         | 5,736         | 5,111         |
| 1                        | Expenditure                 |       | 5,607                     | 5,278         | 5,395         | 4,468         | 4,411         | 3,856         | 4,079         | 3,792         | 3,463         | 3,605         | 3,374         |
|                          | Surplus before depreciation |       | 992                       | 1,697         | 1,216         | 1,888         | 1,839         | 2,187         | 1,956         | 2,047         | 2,314         | 2,131         | 1,737         |
| 2                        | Depreciation                |       | 1,050                     | 936           | 918           | 886           | 849           | 885           | 833           | 823           | 1,031         | 948           | 956           |
|                          | Surplus after depreciation  |       | -58                       | 761           | 298           | 1,002         | 990           | 1,302         | 1,123         | 1,224         | 1,283         | 1,183         | 781           |
| <b>St Sampson</b>        |                             |       |                           |               |               |               |               |               |               |               |               |               |               |
| 1                        | Income                      |       | 1,003                     | 954           | 949           | 869           | 891           | 868           | 677           | 582           | 638           | 585           | 587           |
| 1                        | Expenditure                 |       | 536                       | 508           | 532           | 707           | 583           | 450           | 566           | 531           | 485           | 355           | 323           |
|                          | Surplus before depreciation |       | 467                       | 446           | 417           | 162           | 308           | 418           | 111           | 51            | 153           | 230           | 264           |
| 2                        | Depreciation                |       | 250                       | 228           | 228           | 120           | 108           | 115           | 44            | 44            | 288           | 293           | 328           |
|                          | Surplus after depreciation  |       | 217                       | 218           | 189           | 42            | 200           | 303           | 67            | 7             | -135          | -63           | -64           |
| <b>Guernsey Harbours</b> |                             |       |                           |               |               |               |               |               |               |               |               |               |               |
| 1                        | Income                      |       | 7,602                     | 7,929         | 7,560         | 7,225         | 7,141         | 6,911         | 6,712         | 6,421         | 6,415         | 6,321         | 5,698         |
| 1                        | Expenditure                 |       | 6,143                     | 5,786         | 5,927         | 5,175         | 4,994         | 4,306         | 4,645         | 4,323         | 3,948         | 3,960         | 3,697         |
|                          | Surplus before depreciation |       | 1,459                     | 2,143         | 1,633         | 2,050         | 2,147         | 2,605         | 2,067         | 2,098         | 2,467         | 2,361         | 2,001         |
| 2                        | Depreciation                |       | 1,300                     | 1,164         | 1,146         | 1,006         | 957           | 1,000         | 877           | 867           | 1,319         | 1,241         | 1,284         |
|                          | Surplus after depreciation  |       | 159                       | 979           | 487           | 1,044         | 1,190         | 1,605         | 1,190         | 1,231         | 1,148         | 1,120         | 717           |

## Notes

1. Cost recoveries are netted off expenditure in all years. In the published accounts for 2008-10 income and expenditure was grossed up for recoveries.
2. In years before 2004, the results bore a capital charge rather a depreciation charge, computed on a different basis. Consequently the surpluses after depreciation before 2004 are not comparable with those from this year onwards.

**Appendix C**

|                              | 2011<br>(budget)<br>£k | 2010<br>£k   | 2009<br>£k   |
|------------------------------|------------------------|--------------|--------------|
| <b>INCOME</b>                |                        |              |              |
| <b>Commercial</b>            |                        |              |              |
| Shipping dues                | 1,487                  | 1,476        | 1,449        |
| Cranes, ramps etc            | 2,800                  | 3,146        | 3,021        |
| Rental                       | 701                    | 822          | 722          |
| Pilotage dues                | 400                    | 401          | 4            |
| Pilotage payments            | -395                   | -396         | 0            |
|                              | <u>4,993</u>           | <u>5,449</u> | <u>5,196</u> |
| <b>Moorings / leisure</b>    |                        |              |              |
| Local mooring fees           | 1,960                  | 1,866        | 1,768        |
| Visitor mooring fees         | 490                    | 473          | 459          |
|                              | <u>2,450</u>           | <u>2,339</u> | <u>2,227</u> |
| <b>Other</b>                 |                        |              |              |
| Sundries                     | 95                     | 102          | 93           |
| Navigation                   | -1                     | -1           | 0            |
| Registration fees            | 65                     | 40           | 44           |
|                              | <u>159</u>             | <u>141</u>   | <u>137</u>   |
| <b>Total Income</b>          | <b>7,602</b>           | <b>7,929</b> | <b>7,560</b> |
| <b>EXPENDITURE</b>           |                        |              |              |
| <b>Commercial</b>            |                        |              |              |
| Administration               | 1,763                  | 1,416        | 1,433        |
| Harbour infrastructure       | 1,172                  | 1,391        | 1,455        |
| Marinas & moorings           | 64                     | 54           | 52           |
| Navigational services        | 1,208                  | 1,114        | 1,039        |
|                              | <u>4,207</u>           | <u>3,975</u> | <u>3,979</u> |
| <b>Moorings / leisure</b>    |                        |              |              |
| Administration               | 1,246                  | 1,079        | 1,065        |
| Harbour infrastructure       | 321                    | 286          | 358          |
| Marinas & moorings           | 667                    | 695          | 831          |
| Navigational services        | 558                    | 532          | 473          |
|                              | <u>2,792</u>           | <u>2,592</u> | <u>2,727</u> |
| <b>Other</b>                 |                        |              |              |
| Administration               | 129                    | 111          | 106          |
| Harbour infrastructure       | -3                     | -6           | -6           |
| Marinas & moorings           | 318                    | 278          | 267          |
| Navigational services        | 0                      | 0            | 0            |
|                              | <u>444</u>             | <u>383</u>   | <u>367</u>   |
| <b>Total Expenditure</b>     | <b>7,443</b>           | <b>6,950</b> | <b>7,073</b> |
| <b>SURPLUS/(DEFICIT)</b>     |                        |              |              |
| Commercial                   | 786                    | 1,474        | 1,217        |
| Moorings / leisure           | -342                   | -253         | -500         |
| Other                        | -285                   | -242         | -230         |
| <b>Net surplus/(deficit)</b> | <b>159</b>             | <b>979</b>   | <b>487</b>   |

## Appendix D

|                               | 2011<br>(budget)<br>£k | 2010<br>£k   | 2009<br>£k   |
|-------------------------------|------------------------|--------------|--------------|
| <b>Administration</b>         |                        |              |              |
| Premises                      | 48                     | 43           | 24           |
| Staff                         | 2,552                  | 2,227        | 2,166        |
| Supplies & services           | 578                    | 418          | 489          |
| Less recoveries               | -40                    | -81          | -74          |
| Depreciation                  | 0                      | 0            | 0            |
|                               | <u>3,138</u>           | <u>2,607</u> | <u>2,604</u> |
| <b>Harbour infrastructure</b> |                        |              |              |
| Premises                      | 924                    | 815          | 1,102        |
| Staff                         | 410                    | 351          | 338          |
| Supplies & services           | 187                    | 568          | 426          |
| Less recoveries               | -31                    | -65          | -60          |
| Depreciation                  | 0                      | 0            | 0            |
|                               | <u>1,490</u>           | <u>1,669</u> | <u>1,807</u> |
| <b>Marinas &amp; moorings</b> |                        |              |              |
| Premises                      | 127                    | 119          | 95           |
| Staff                         | 527                    | 489          | 467          |
| Supplies & services           | 317                    | 304          | 475          |
| Less recoveries               | -52                    | 0            | 0            |
| Depreciation                  | 130                    | 116          | 113          |
|                               | <u>1,049</u>           | <u>1,028</u> | <u>1,150</u> |
| <b>Navigational services</b>  |                        |              |              |
| Premises                      | 0                      | 0            | 0            |
| Staff                         | 488                    | 478          | 406          |
| Supplies & services           | 108                    | 120          | 88           |
| Less recoveries               | 0                      | 0            | 0            |
| Depreciation                  | 1,170                  | 1,048        | 1,018        |
|                               | <u>1,766</u>           | <u>1,646</u> | <u>1,512</u> |
| <b>Total Expenditure</b>      |                        |              |              |
| Premises                      | 1,099                  | 977          | 1,221        |
| Staff                         | 3,977                  | 3,545        | 3,377        |
| Supplies & services           | 1,190                  | 1,410        | 1,478        |
| Less recoveries               | -123                   | -146         | -134         |
| Depreciation                  | 1,300                  | 1,164        | 1,131        |
|                               | <u>7,443</u>           | <u>6,950</u> | <u>7,073</u> |

## Appendix E

ST PETER PORT HARBOUR

Crane replacement Nos 4/5 berths

**Crane replacement strategy**

Replacement of west ramp

Replacement of marina pontoons &amp; piles from 2011 to 2015

Pool improvements, pontoons/breakwater etc.

Replacement of east ramp

**Ramps, pontoons and jetties**

Improvements to No4, No5 &amp; No6 berths

**Berths and infrastructure works**

Development of harbour facilities, offices, stores - retail

Jetty buildings terminal &amp; offices

**Refurbishment/replacement of buildings**

Replacement for Sarnia vessel

**Vessels**

Miscellaneous unforeseen essential works

**Miscellaneous works**

Careening hard development

Havelet Bay development - Super yacht facilities

Expand St Peter Port commercial facilities, move customs shed

**Strategic work****ST PETER PORT TOTAL**ST SAMPSONS HARBOUR

Replacement of Northside G Cranes

**Crane replacement strategy**

Wave screens at HSS marina (or alternative solution)

**Marina improvements**

Deep water berths at St Sampsons harbour/NAABSA issues

**Berths and infrastructure works****ST SAMPSONS HARBOUR TOTAL****GUERNSEY HARBOURS TOTAL**

| Total<br>£ m  | 2011<br>£ m | 2012<br>£ m | 2013<br>£ m  | 2014<br>£ m | 2015<br>£ m | 2016<br>£ m | 2017<br>£ m | 2018<br>£ m | 2019<br>£ m | 2020<br>£ m   |
|---------------|-------------|-------------|--------------|-------------|-------------|-------------|-------------|-------------|-------------|---------------|
| 3.00          | -           | 3.00        | -            | -           | -           | -           | -           | -           | -           | -             |
| <b>3.00</b>   |             |             |              |             |             |             |             |             |             |               |
| 3.00          |             |             |              |             | 3.00        |             |             |             |             |               |
| 1.25          | 0.25        | 0.25        | 0.25         | 0.25        | 0.25        |             |             |             |             |               |
| 1.25          |             |             |              | 0.25        | 0.25        | 0.25        | 0.25        | 0.25        |             |               |
| 3.00          |             |             |              |             |             |             |             |             |             | 3.00          |
| <b>8.50</b>   | <b>0.25</b> | <b>0.25</b> | <b>0.25</b>  | <b>0.50</b> | <b>3.50</b> | <b>0.25</b> | <b>0.25</b> | <b>0.25</b> | -           | <b>3.00</b>   |
| 10.50         | -           | 5.00        | 2.50         | 2.50        |             |             |             |             |             | 0.50          |
| <b>10.50</b>  |             | <b>5.00</b> | <b>2.50</b>  | <b>2.50</b> | -           | -           | -           | -           | -           | <b>0.50</b>   |
| 1.00          |             |             |              |             | 0.50        | 0.50        |             |             |             |               |
| 1.00          |             |             |              | 1.00        |             |             |             |             |             |               |
| <b>2.00</b>   | -           | -           | -            | <b>1.00</b> | -           | -           | -           | -           | -           | -             |
| 1.00          |             |             |              | 1.00        |             |             |             |             |             |               |
| <b>1.00</b>   | -           | -           | -            | <b>1.00</b> | -           | -           | -           | -           | -           | -             |
| 2.50          | 0.25        | 0.25        | 0.25         | 0.25        | 0.25        | 0.25        | 0.25        | 0.25        | 0.25        | 0.25          |
| <b>2.50</b>   | <b>0.25</b> | <b>0.25</b> | <b>0.25</b>  | <b>0.25</b> | <b>0.25</b> | <b>0.25</b> | <b>0.25</b> | <b>0.25</b> | <b>0.25</b> | <b>0.25</b>   |
| 10.00         |             |             | 10.00        |             |             |             |             |             |             |               |
| 60.00         |             |             |              |             |             |             |             |             |             | 60.00         |
| 6.00          |             |             |              |             |             |             | 6.00        |             |             |               |
| <b>76.00</b>  | -           | -           | 10.00        | -           | -           | -           | <b>6.00</b> | -           | -           | 60.00         |
| <b>103.50</b> | <b>0.50</b> | <b>8.50</b> | <b>13.00</b> | <b>5.25</b> | <b>3.75</b> | <b>0.50</b> | <b>6.50</b> | <b>0.50</b> | <b>0.25</b> | <b>63.75</b>  |
| 3.00          |             |             |              |             |             | 3.00        |             |             |             |               |
| <b>3.00</b>   | -           | -           | -            | -           | -           | <b>3.00</b> | -           | -           | -           | -             |
| 1.15          |             | 1.00        |              |             |             |             |             |             | 0.15        |               |
| <b>1.15</b>   | -           | <b>1.00</b> | -            | -           | -           | -           | -           | -           | <b>0.15</b> | -             |
| 153.00        |             |             |              |             |             |             |             |             |             | 153.00        |
| <b>153.00</b> | -           | -           | -            | -           | -           | -           | -           | -           | -           | <b>153.00</b> |
| <b>157.15</b> | -           | <b>1.00</b> | -            | -           | -           | <b>3.00</b> | -           | -           | <b>0.15</b> | <b>153.00</b> |
| <b>260.65</b> | <b>0.50</b> | <b>9.50</b> | <b>13.00</b> | <b>5.25</b> | <b>3.75</b> | <b>3.50</b> | <b>6.50</b> | <b>0.50</b> | <b>0.40</b> | <b>216.75</b> |



SPECIALIST

MARITIME

CONSULTANCY

SERVICES

Review of Guernsey Harbours:  
Stage 2 Structural Review

Prepared for

Public Services Department, States of Guernsey

Final Report

July 2011



FISHER

ASSOCIATES

Fisher Assoc. Ltd, April House, Rowes Lane, East End,  
Lymington, SO41 5SU, UK

[www.fisherassoc.co.uk](http://www.fisherassoc.co.uk)

Tel: 01590 626 220 Fax: 01590 626 359



# **Review of Guernsey Harbours**

**Prepared for**

**Public Services Department, States of Guernsey**

**by Fisher Associates**

## **Stage 2: Structural Review**

### **Final Report**

#### **Document History**

| Document     | Date                       | Notes  |
|--------------|----------------------------|--|
| Draft Report | 6 <sup>th</sup> July 2011  |  |
| Final Report | 28 <sup>th</sup> July 2011 | Incorporates Client comments from review session |

## Contents

|  |           |
|--|-----------|
| <b>Executive summary .....</b>   | <b>3</b>  |
| Introduction.....  | 3         |
| Key findings.....  | 3         |
| Conclusion.....  | 5         |
| <b>1 Introduction .....</b>  | <b>6</b>  |
| 1.1 Objective of study .....   | 6         |
| 1.2 Approach.....  | 6         |
| <b>2 Options for future business model.....</b>                            | <b>7</b>  |
| 2.1 Status quo.....  | 7         |
| 2.2 Incorporation.....   | 7         |
| 2.2.1 Description.....   | 7         |
| 2.2.2 Application to Guernsey Harbours.....                                | 8         |
| 2.3 Trust Port .....   | 8         |
| 2.3.1 Description.....   | 8         |
| 2.3.2 Application to Guernsey Harbours.....                                | 9         |
| 2.4 “Do something” .....   | 11        |
| 2.4.1 Description.....   | 11        |
| 2.4.2 Application to Guernsey Harbours.....                                | 12        |
| <b>3 Options evaluation .....</b>  | <b>14</b> |
| 3.1 Objectives .....   | 14        |
| 3.1.1 A) Provide long term stable vision and leadership .....              | 14        |
| 3.1.2 B) Make independent and timely decisions.....                        | 14        |
| 3.1.3 C) Implement financial self-sustainability.....                      | 17        |
| 3.1.4 D) Respond better to opportunities for increasing revenue .....      | 17        |
| 3.1.5 E) Respond better to opportunities to improve efficiency .....       | 18        |
| 3.1.6 F) Improve use of assets.....  | 18        |
| 3.1.7 G) The deliverability of the option and risks to implementation..... | 19        |
| 3.1.8 H) Post-implementation .....   | 19        |
| 3.2 Appraisal.....   | 19        |
| 3.3 Conclusions / pros and cons .....                                      | 24        |
| 3.3.1 Status Quo.....  | 24        |
| 3.3.2 Trust Port.....  | 25        |
| 3.3.3 Incorporation .....  | 25        |
| 3.3.4 Do something (consistent with Municipal Ports Review) .....          | 25        |
| <b>4 Case study: Jersey Harbours .....</b>                                 | <b>26</b> |
| <b>5 Conclusion.....</b>   | <b>28</b> |

## Executive summary

### Introduction

Public Services Department (PSD) is mandated to look after harbours and maritime matters, and management of these is combined under “Guernsey Harbours”, which fulfils a variety of roles:

- ◆ Harbour authority
- ◆ Pilotage authority
- ◆ Lighthouse authority
- ◆ Coast Guard
- ◆ Maritime Safety Administration
- ◆ Registrar of Shipping

PSD has commissioned Fisher Associates to provide advice related to the most suitable business model for the future management of Guernsey Harbours, with the objective of giving management more commercial freedom, whilst maintaining public ownership of assets. We have approached this work in two stages:

- ◆ Stage 1: Baseline Review presents an assessment of the current situation at Guernsey Harbours, based upon our experience and discussion with States’ representatives, management and other stakeholders.
- ◆ Stage 2: Structural Review provides a discussion and analysis of the options identified for the new business model – primarily transforming Guernsey Harbours into a limited company (incorporation), or into a Trust Port.

This document presents the Structural Review.

### Key findings

The Stage 1 Baseline Review identifies many shortcomings with respect to governance, management, operations and finances. It concludes that the issues related to these should be brought together in a comprehensive business plan, which we believe may demonstrate that Guernsey Harbours can become financially self-sustainable in future, although strategic projects will still require a partnership approach.

The extent to which Guernsey Harbours can reduce costs and achieve self-financing, will depend on the degree to which the States allows it to make decisions, utilise assets, implement efficiencies, and increase revenues (not just by putting up charges).

This Stage 2 Structural Review considers how changing the business model of Guernsey Harbours would facilitate this. The options considered are:

- ◆ Reconstituting Guernsey Harbours as Guernsey Ports Ltd (known as incorporation), which would be separate from the States, but 100% owned by it.
- ◆ Transforming Guernsey Harbours into a Trust Port, which is an independent statutory undertaking run on a not-for-dividend basis, with profits reinvested back into the port.
- ◆ A “do something” option, based upon the findings of the “Municipal Ports Review” for England and Wales, which sets out a best practice template for ports owned by local authorities.

The options were evaluated against the following criteria:

**A) Provide long term stable vision and leadership** - Objective: a vision for the harbour seafront, incorporating Guernsey’s needs for safe commercial port services, should be developed, and implemented, and survive / be delinked from political cycles and appointments.

**B) Make independent and timely decisions** - Objective: make timely decisions free of political constraint, and take these within the governance / management / operation of its own organisation.

**C) Implement financial self-sustainability** - Objective: a financially self-sustainable business as far as practicable: i) incentives to deliver higher profits (not just by putting up charges); ii) ring-fenced finances; iii) powers to borrow; iv) a sustainable balance sheet.

**D) Respond better to opportunities for increasing revenue** - Objective: identify the opportunities for enhancing revenue, and then act upon these.

**E) Respond better to opportunities to improve efficiency** - Objective: empower management and make them accountable for improving efficiency.

**F) Improve use of assets** - Objective: empower and hold management accountable for i) using Harbours’ assets to provide efficient operation, whilst ii) making a contribution from those that are peripheral ... to support financial self-sustainability.

**G) The deliverability of the option and risks to implementation** - Objective: consider how soon improvements can be made, and the risk that the options may not be successfully implemented.

**H) Post-implementation** - Objective: indicate the robustness of the options to remaining in place and delivering benefits, and the issues in “living with” the new business model.

We undertook a qualitative review of each option against these eight criteria, awarding up to 5 marks for each. The results of this (marks out of 40) are illustrated in the following graph.

The “do nothing” option clearly has little to recommend it. The merits of other options can be summarised as:

- ◆ **Trust Port:** Maximises benefits against the objectives, but as experience in Jersey shows, there is a very high risk in implementation.
- ◆ **Incorporation:** Underperforms the Trust Port option somewhat, but significantly outperforms “do something”, although it also offers risks that it may not be implemented.
- ◆ **“Do something”:** implementing improvements which would be consistent with the Municipal Ports Review would be relatively quick and low risk, with modest cost, but the States should aim higher.

## Conclusion

We recommend that Guernsey Harbours should be placed on a more commercial footing with the goal of improving financial self-sustainability. Despite its advantages on paper, the Trust Port option is discounted due to the need to transfer ownership of assets, and (probably) to provide it with a dowry.

We recommend incorporating Guernsey Harbours by reconstituting it into “Guernsey Ports Ltd”, because this offers the chance to make significant improvements, and is a more deliverable option.

The six key steps for implementation of this option are:

- ◆ Prepare a business plan.
- ◆ Undertake a review of assets.
- ◆ Implement ring fenced accounts.
- ◆ Set up a Shadow Board.
- ◆ Prepare a vision and a port masterplan.
- ◆ Prepare a detailed plan for incorporation.

Steps 1 to 5 above are valuable contributions to commercialising Guernsey Harbours whether or not it is eventually incorporated.

# 1 Introduction

## 1.1 Objective of study

Within the States of Guernsey, the Public Services Department (PSD) is mandated to look after harbours and maritime matters (including Guernsey Coast Guard), and management of this role is combined under “Guernsey Harbours”.

The States desires to investigate alternative business models for Guernsey Harbours, whilst maintaining public ownership of assets. PSD has therefore commissioned Fisher Associates, a specialist management consultancy practice, to provide advice on the future corporate structure of Guernsey Harbours.

The brief required consideration of transformation into a limited company (incorporation), or constituting some part of Guernsey Harbours as a Trust Port. This is the focus of our investigations, however, we have also considered a “do something” option – that is a way of realising some of the desired benefits of both options, which may bring benefits in the short term.

## 1.2 Approach

We have approached this work in two stages:

- ◆ Stage 1: Baseline Review
- ◆ Stage 2: Structural Review

The **Baseline Review** presents an assessment of the current situation at Guernsey Harbours, based upon discussion with States’ representatives, management and other stakeholders. It considers Guernsey Harbours’ recent history, policy objectives, strengths and weaknesses of the current organisational set up, port operations, and any other relevant factors. It also includes a high level financial review.

The **Structural Review** explains the core anatomy of the following options:

- ◆ Status quo (“do nothing”).
- ◆ Incorporation and Trust Port options.
- ◆ An additional shorter-term “do something” scenario lying between the do nothing and other options.

It assesses the objectives for change, and identifies criteria against which options can be assessed including implications for funding investment needs, and explains the pros and cons of the options, with recommendations on the options for changing the corporate structure and next steps.

**This document presents the Structural Review.**

## 2 Options for future business model

The purpose of this section is to set out in factual terms what the options are, and how they compare with the status quo, and with each other. The merits of these options are discussed in the following Section 3.

### 2.1 Status quo

Maintaining the status quo is the “do nothing” option. This means no change to the business model for the future management of Guernsey Harbours.

### 2.2 Incorporation

#### 2.2.1 Description

This would require the States to set up an arms length company (Guernsey Ports Ltd), and to vest in this the assets and liabilities that are currently only nominally linked to Guernsey Harbours.

The Company would be legally separate from the States per se, although as the sole shareholder it would exercise control over the company according to Company Law.

Financially speaking, Guernsey Ports Ltd would continue to be linked to the States, both in terms of paying dividends (depending upon the dividend policy), and calling for additional shareholder capital or loan capital (depending on investment needs).

Incorporation is a popular option worldwide for ports. Examples range from huge ports such as Singapore and Rotterdam (both incorporated relatively recently), and all the main commercial ports in Ireland, where the State implements a rigid policy of taking no dividends, but also providing no additional shareholder capital.

Guernsey is familiar with the incorporation model, as it was used for both Post and Electricity. During discussions with key stakeholders, it was evident that this familiarity generally made people comfortable with the concept of incorporating Guernsey Harbours. Several people noted, however, that incorporation per se is not the answer – it is how it is done that is important. Reflecting upon experience and perceptions of Post and Electricity, the success factors highlighted were:

- ◆ The shareholder needs to undertake its role effectively.
- ◆ The Board should have the right people, with selection and appointments according to best practice.
- ◆ There should be a change in the culture of the organisation, and this requires management leadership.
- ◆ Revision of terms & conditions of employment to fit the business needs is necessary following incorporation.



- ◆ The approach to regulating Post and Electricity ex ante was widely held to be divisive and expensive (we note that a more recent review has suggested moving to a more ex post approach).

### 2.2.2 Application to Guernsey Harbours

Reconstituting as an incorporated company would result in several significant changes compared to the status quo:

- ◆ Land and assets would be vested in Guernsey Ports Ltd, and therefore still owned by the States but at arms length.
- ◆ The ports would be legally separated from the States' general activities.
- ◆ The ports will be subject to the company tax regime.
- ◆ Governance would take the form of a new Board.
- ◆ Employees would no longer be direct employees of the States, but would be employed by the Company, at arms length to the States.
- ◆ Port development could be funded partly by borrowing – subject to the provisions of the company's articles and shareholder's policy.
- ◆ Public service functions currently undertaken by Guernsey Harbours (such as Guernsey Coast Guard), would need to be separated in principle, and either provided separately by an independent body or provided by Guernsey Ports Ltd under a public service contract, supported by funding from the States in some form.
- ◆ Services provided centrally by the States would be charged.

## 2.3 Trust Port

### 2.3.1 Description

The United Kingdom currently has around 100 Trust Ports, of which some 20 have turnover > £1 million. They were originally set up as an alternative to both private and public ownership of ports, and were intended to retain the best elements of both. Trust Ports in general have proved to be successful.

Trust Ports exist by virtue of individual Acts of Parliament or other statutory instruments, which vest ownership of the port in the Trust and define its powers, including powers to raise revenue from goods and vessels, and their duties with regard to the acceptance of vessels and the safety of navigation.

Each Act defines the form of capitalisation of the port, and specifies the constitution of the Board of Directors and their method of appointment and/or their election, including reserve powers for the government (sometimes) regarding such appointments. The Boards of these Trust Ports are charged with the responsibility to run the port in a self-financing but not-for-dividend manner, with any surplus being reinvested in the port.

A common feature of Trust Ports is their powers to raise external finance. These powers are contained in their enabling legislation, which defines the type of external financing that is permitted, the security to back the external financing and the limits of borrowing, including the provision to review these limits periodically or by application.

The main criticism leveled at Trust Ports over the years was that their Boards were controlled by Port Users who had conflicts of interest, or local interests that were not qualified to run a statutory body combined with a serious trading business. This was one reason why the Government embarked on the review called Modernising Trust Ports in 1999, which concluded that a significant number of Boards did not have appropriate ability or relevant expertise. However, Government still concluded that Trust Ports had a positive role to play as locally accountable bodies if they are governed according to best practice.

Modernising Trust Ports highlighted the potential for Trust Ports to benefit their region and become key players in supporting regional economic development. It also recommended a number of best practices to promote effectiveness, particularly with respect to national standards for Port Boards to become both fully accountable and fit to fulfill an important role in wider economic and transport strategies.

In short, ports should be governed by a fit for purpose Board offering a balance of qualities:

- ◆ Entrepreneurial skills v Public service commitment
- ◆ Independence with relevant life experience v Specialist professional experience

A fit for purpose Board would have 8 to 12 people. The Harbour Master should have a direct line of contact with the Board. The other members may include local and commercial interests and independent members. Independent means not beholden to any particular interest group. Board members should be trained to be familiar with ports policy, Board procedures, port operations and current strategies, and their statutory duties.

Modernising Trust Ports was updated in January 2009. To summarise the thrust of this update, it sharpens the advice on the desirability of Trust Ports to act commercially and efficiently, and to challenge their current ways of doing business, and to demonstrate that they are doing this. It also now specifically incorporates elements of the “Combined Code”, which sets standards / guidance for governance.

### 2.3.2 Application to Guernsey Harbours

Applying this to Guernsey Harbours would require the States to pass a statute that sets up the new Trust Port. (There is a precedent for this in Jersey, which went down this path with Jersey Harbours, but after some considerable effort and time decided not to proceed – see case study in Section 4.)

Reconstituting as a Trust Port would result in several significant changes compared to the status quo:

- ◆ The States would no longer be the owner of the ports.
- ◆ The Ports would be both legally and financially separated from the States.
- ◆ The ports will be subject to the company tax regime.
- ◆ Governance would take the form of a new and independent Board.
- ◆ Employees would no longer be employees of the States.
- ◆ Port development could be funded by borrowing – subject to the provisions of its enabling statute.
- ◆ Public service functions currently undertaken by Guernsey Harbours (such as Guernsey Coast Guard), would need to be separated in principle, and either provided separately by an independent body or provided by the Trust Port under a public service contract.
- ◆ Services provided centrally by the States would be charged.

To be clear, the key differences *between the Trust Port and the incorporation model* are that, under the Trust Port model:

- ◆ The States would no longer be the owner of the assets.
- ◆ The Ports would be financially separate from the States (but see below).
- ◆ The Board would be independent (but see below).
- ◆ Employees would have no employment link with the States.

There are two subtleties here:

- ◆ The Trust Port's enabling statute could make provision for reserving the appointment of one or more Board members by the States. This situation applies in the UK to only a few "strategic" port authorities such as Harwich Haven and Milford Haven.
- ◆ Public money can still contribute to port development in the form of grants to serve an agenda that is external to the port. The usual reason for this is to support economic development / regeneration, where a development is not financially viable, but is economically viable, with cruise terminals being a typical example.

Trust Ports can change their status (i.e. they are revocable), for example by being wound up or privatised, by force of another statutory measure.<sup>1</sup> In addition, and for example, the Port of Sunderland was a Trust Port prior to it being taken over by Sunderland City Council via the Sunderland Corporation Act 1972. This would be analogous to a new Trust Port in Guernsey being taken back into States' ownership at some time in the future.

---

<sup>1</sup> In the UK, Harbour Revision orders can be used to close a port, and the Ports Act 1991 provides the basis for privatising Trust Ports, including the requirement for approval by the Secretary of State for Transport, and the receipt of some of the proceeds of privatisation by Government.

## 2.4 “Do something”

### 2.4.1 Description

The rationale for this rests on improving the current model rather than changing it. Considering that the States is analogous in some respects to a local authority in the UK (although it obviously has much broader powers), the template for improving the current model would be based on best practice for Municipal Ports (i.e. those owned by local authorities).

Following the Government’s work on Modernising Trust Ports in 1999, it issued “Opportunities for Ports in Local Authority Ownership” (known as the Municipal Ports Review) in May 2006. This sets out the challenges for local authority-owned ports and recommends a number of measures that local authorities may pursue to align successful port operations more effectively with the structures and obligations placed on local authorities.

The central recommendation was that local authorities should consider restructuring the governance into a harbour management committee, resembling the Board of a Trust Port, and introducing a degree of operational independence from the parent authority. Municipal Ports should consider adopting and adapting the recommendations made in “A Guide to Good Governance” (a companion document to Modernising Trust Ports). This sets out the benchmarks in terms of Board composition, appointment, performance and accountability.

The other key findings of the review are summarised as:

**1 Accountability and decision making:** As a direct result of the “Modernising Local Government” initiative many ports reported to a small committee, portfolio holder or cabinet member. This has led to concerns about the capacity and capability of harbour management.

**2 Strategy and business planning:** Local authorities needed to have a clear idea of what they wanted to achieve from ownership – particularly of commercial ports. Municipal ports should produce business plans that looked at the future prospects of the port and how it would meet the requirements of the stakeholders, who should be involved in its development. The plan should review the strategy of the port and present measurable objectives.

**3 Management and performance review:** Like Trust Ports, Municipal Ports were operated for the benefit of stakeholders including the local community but, unlike these, they were not in general governed by an independent, bespoke, expert and directly accountable body. Instead Municipal Ports generally formed an integral part of the local authority and were treated the same way as any other service. Port management of commercial ports should have the appropriate level of independence and flexibility.

**4 Municipal port finances:** *Local authority accounting methods may not have been well suited to the needs of a commercial body. Failure to separate ports in financial terms from the finances of the owning authorities had also hindered*

*systematic provision for maintenance and development, and prevented sensible commercial business planning.* Municipal ports would benefit from the introduction of “assured accounts” (ring fencing). There should be a memorandum of understanding between the port managing body (the suggested “harbour management committee”) and the owning authority that sets out financial ground rules. Prudent and adequate provision should be made for capital asset replacement and future development. Local authorities should allow ports to undertake capital expenditure financed by unsupported borrowing where they can show that they can afford this.

#### 2.4.2 Application to Guernsey Harbours

Based upon the advice of the Municipal Ports Review, and also incorporating the advice in Modernising Trust Ports, the generic issues that are of relevance to Guernsey Harbours and questions that may be posed have been summarised below.

| Key issues   | Assessment of Guernsey Harbours   |
|--|---|
| Is there a fit for purpose Board? Does it provide the expertise needed in finance, operations, planning / development?             | No, the Board of PSD covers a wide remit, and does not provide the specialist focus or skills required.   |
| Do co-opted members with voting rights participate in decision-making?   | No, PSD Board has no external members (although it's charter does permit it to have two non-voting external members).                                       |
| Is the decision making process responsive?   | No, it is very slow and often politically motivated.  |
| Is there separation of owning authority and managing body?   | Partially, in that Guernsey Harbours is essentially an operational unit within PSD, but little accountability.  |
| Is there a clear agreement with the managing body on policy and performance, including specification of internal services?         | No, there is no plan setting this out.  |
| How well does stakeholder involvement work, and can it be improved?  | There are generally good relationships with stakeholders, however improvements could be made.   |
| Is there an evidence base for the economic role of the harbour?  | Minimal, there is no proper research on this.   |
| Is the strategy of the harbour authority clear and sustainable, and does the harbour have a place in the States' overall strategy? | No, there is no stated strategy or robust business plan for Guernsey Harbours.  |
| Are the appropriate assets vested with the harbours?   | No, there are significant issues around i) determination of what are Guernsey Harbours' assets, and ii) retention of their management and income from this. |

| Key issues   | Assessment of Guernsey Harbours  |
|--|--|
| Is there a 5 year financial plan plus a 6 to 10 year financial outlook to identify significant expenditures that may fall in this period?      | There is a high level plan for future capital expenditure, and there is a 5 year budget in place, albeit not informed by a detailed business plan.   |
| Is there a Port Masterplan, which shows in physical terms how the harbour is likely to evolve based on a clear market analysis?                | No, however PSD is progressing this.   |
| Are finances fully assured in all directions? Are there subsidies that need to be addressed? Where are financial risks carried?                | Finances are not ring fenced. <i>The cessation of the Ports Holding Account has moved Guernsey Harbours in the opposite direction</i> , and it has in effect no ability now to generate capital reserves.  |
| Are accounts prepared to full commercial accounting standards, and is a true picture of Guernsey Harbours' financial sustainability available? | Partially, accounts are not GAAP compliant, but relevant financial information is available. However, the absence of both a medium term financial plan and a detailed analysis of investment requirements means that its financial sustainability is not assessed. |
| Do the harbour authority's powers need to be modernised?   | It seems that at least some of the regulatory framework requires updating.   |

It is clear that Guernsey Harbours would have some way to go to be compliant with the Municipal Ports Review / Modernising Trust Ports. The key actions that would be required to implement this "do something" option include:

- ◆ Set up a fit for purpose Board with co-opted members with voting rights.
- ◆ Separate ownership from management via an agreement between the Board and PSD (a memorandum of understanding).
- ◆ Identify and implement a business plan incorporating market analysis, tariff review, improvements in operational efficiencies and essential asset renewal, all leading to improved financial self-sustainability.
- ◆ Ring fence the accounts (make these "assured"), reversing the decision to cease the Ports Holding Account, and improving this so that all profits generated by Guernsey Harbours accrue to it and not the Airport (a situation which meant that commercial port users were funding their air transport competitors).

The objective of this "do something" option would thus be to build up a position where Guernsey Harbours operates as a semi-autonomous financially self-sustaining unit, to the benefit of all its stakeholders.

### 3 Options evaluation

#### 3.1 Objectives

This section develops a number of criteria for appraisal of the options. This is achieved by developing objectives for assessment and explaining why these have been adopted.

##### 3.1.1 A) Provide long term stable vision and leadership

The **objective** is that a vision for the harbour seafront, incorporating Guernsey's needs for safe commercial port services, should be developed, and implemented, and survive / be delinked from political cycles and appointments.

**Why?** The built environment at the harbour seafront on the central east coast is dominated by the ports of St Peter Port and St Sampson's, and the (significantly) industrial area between them where much of the Island's logistics activity is based.

In the long term, a plan is needed that delivers, step-by-step, modern fit for purpose port facilities, significantly more economic benefits arising from maritime activity (notably the cruise market), and from "non-marine" areas significantly more economic contribution to Island life (e.g. by enhancing the tourism product). The unquantified opportunity cost of leaving things as they are must be very high indeed.

A transformed Guernsey Harbours should be leading development of ideas and then plans, which would seek to realise all of the above benefits, in full partnership and consultation with the States and its local stakeholders. Catalysing and implementing such a 10 to 20 year task could be tackled only by a Board that can develop and sustain the vision. The Board would set this out in its strategy, and masterplans pursuant to this.

##### 3.1.2 B) Make independent and timely decisions

The **objective** is that Guernsey Harbours should make decisions free of political constraint, and take these within the governance / management / operation of its own organisation. *This does not mean that there should be no political influence, just that the right place to exert this is through the planning process and other such public policy measures (e.g. environmental).* It should make decisions in a timely manner, not takes months or even years as various components of decisions are dealt with different States' Departments.

**Why?** There are significant constraints on Guernsey Harbours' ability to make decisions. The political implications of decisions are naturally one of the key considerations for PSD's political Board, which currently governs Guernsey Harbours. This means that decisions that either should have been made, or should not have been made, are sometimes contrary to what an objective observer would expect. We have documented a number of examples overleaf.

| <b>Project / Decision<br/>Date first proposed</b>   | <b>Description</b>  | <b>History / current status<br/>June 2011</b>   |
|---|---|---|
| Replacement of <b>cranes</b> St Peter Port. Board advised of condition of jetties and cranes <b>Jan 2006</b> .  | To replace very old quay cranes that have high risk of failure and are expensive to maintain. Risk of crane failure continues to increase.  | States approved tender process July 2008, but instructed to return to States for consideration when tendered costs were received. Invitations to tender are about to be sent out again.         |
| Development of <b>Careening Hard</b> into marina. Proposal submitted to commission a report to investigate and demonstrate commercial viability <b>Dec 2007</b> . | To turn an area currently earning £10k pa into one potentially earning +/- £1m.   | May 2009 States decided not a priority development. May 2011 Board meeting agreed to further consider a business case to prove the advantages of redeveloping the Careening Hard.               |
| Replacement of <b>Workboat 'Sarnia'</b> . Recommendation made <b>Feb 2010</b> .   | The 'Sarnia' is reaching the end of its useful life, and operating costs are increasing to the point where replacement is necessary. Recommendation made for new vessel.  | Board approved development of a costed specification and delivery of such to Treasury and Resources for their approval and budget allocation. Waiting for approval to permit tender for vessel. |
| Development of <b>model yacht pond</b> area. Proposal submitted <b>Nov 2005</b> .   | To turn an area, currently a drain on funds, to one which would deliver £100k pa or more.   | Rejected on political grounds.  |
| Revision of <b>local mooring charges</b> . Attempts to revise in <b>2008</b> and <b>2010</b> .  | Two attempts have been made to increase local mooring charges to make them more comparable to charges made elsewhere. Local leisure moorings are subsidised by commercial port.   | Rejected on political grounds.  |
| Development of <b>Additional Commercial Property</b> – Castle Emplacement. <b>2009</b>  | Guernsey Harbours has no vacant space or lettable areas for warehousing, storage etc. for marine based businesses. It has developed working drawings for 1 or 2 x 1,600sqm buildings at a cost circa £1.8m each including office space. Pay back anticipated 12-15 years. | Currently lacking the managerial capacity to develop this idea.   |



| <b>Project / Decision<br/>Date first proposed</b>   | <b>Description</b>   | <b>History / current status<br/>June 2011</b>   |
|---|--|---|
| Development of <b>Trafalgar Quay</b> , St. Sampson's. <b>2009</b>   | An area of some 1,800 sqm remains primarily unusable due to limited load bearing capability. Investment of c. £300-500k could enable marine businesses to prosper on harbour frontage. Indication by the previous tenant that design for a marine shop required total investment c. £2m, however, his lease of 7years did not make the proposition viable. | Currently lacking the managerial capacity to develop this idea.<br><br>Advised by Treasury and Resources, June 2011 that development of site would sit with contractor with a suitable long term lease.   |
| <b>Deep Water Berths</b> at St Sampson's Harbour <b>1990</b>  | Long term plan to move commercial operations to St. Sampson's / develop always afloat oil berth.<br>No attempt to develop a wider vision delivering such needs.  | "Future Harbour Requirements Study" recently undertaken 2010 on costs for new Outer Harbour. Costs in excess of £150 million.<br><br>Considered in isolation, current view in the financial climate is that the States is unlikely or unable to consider this level of expenditure. |
| Repositioning of the <b>Customs Hall and traffic reorganisation</b> within St. Julian's Emplacement - <b>2011</b> | Need to provide greater use of the existing quays' workable area whilst providing safer access and egress to users within the harbours whilst improving the administration arrangements for the Border Agency. Costs likely to be in excess of £5million.  | Study recently investigated this.<br><br>Not as yet openly discussed outside of PSD.  |

Guernsey Harbours should not be *compelled* to use any other Department of the States to undertake investigations, studies etc. Two recent examples are the management of the "Future Harbour Requirements Study", and the current Careening Hard development review. The latter has taken 3.5 years to get to the stage of developing a business plan, whereas most ports would have acted commercially and had this facility completed and contributing to profitability within a couple of years.

We conclude from this evidence that decisions related to Guernsey Harbours, ranging from the near trivial to the profound, are not taken in the manner that is needed.

### 3.1.3 C) Implement financial self-sustainability

The **objective** is to become a financially self-sustainable business as far as practicable. This means that Guernsey Harbours should:

- ◆ Operate with incentives to deliver higher profits (not just by putting up charges).
- ◆ Have ring-fenced finances that are not subject to raid through windfall taxes or dividends.
- ◆ Have powers to borrow, and a balance sheet that sustains an appropriate level.

**Why?** Through a combination of borrowings and the investment of its annual operating surplus, a modified Guernsey Harbours appears to have sufficient capacity to meet its maintenance investment needs over the coming decade, provided that its financing capacity does not drop below £2.0 million pa following any change in structure. It should have well in excess of this if it were permitted to manage the whole port estate as other ports do, thereby contributing much more to longer term investment needs.

Specific solutions involving additional support from the States are required to fund strategic investment in port facilities that meet the long-term needs of the Island (financial modeling is required to appraise this).

The recent decision to abolish the Ports Holding Account system and require Guernsey Harbours to transfer all of its operating surplus centrally, while being required to bid for its investment capital in competition with other projects requiring funding from the States, acts as a disincentive for Guernsey Harbours' management to maximise the surplus generated by their activities.

### 3.1.4 D) Respond better to opportunities for increasing revenue

The **objective** is to identify the opportunities for enhancing revenue, and then act upon these.

**Why?** The recent review of Guernsey Harbours' potential to increase prices illustrates this. The States has arguably exhibited the wrong response to the right question asked for the wrong reasons.

*Wrong response:* The response to more profit was to look at increasing prices rather than improving revenues through other means such as:

- ◆ Even though the ports have no competition, consultees have often taken the view that there are untapped opportunities for adding value and gaining revenue.
- ◆ Some of these will require investment to benefit from the returns on offer.
- ◆ Some of these are related to land use within what would (normally) be called the ports' estates.
- ◆ Guernsey Harbours is certainly losing significant revenue by not policing its charges (e.g. checking declarations against manifests; physically weighing cargo).

The response should equally have looked at improving efficiency – this is dealt with in the next criterion E).

*Right question:* This was “how can Guernsey Harbours increase profits?” and is included in criterion C).

*Wrong reason:* The question was motivated by the wish to increase the States’ revenue overall. It might better have been posed in the context of improving the financial self-sustainability of Guernsey Harbours (criterion C).

### 3.1.5 E) Respond better to opportunities to improve efficiency

The **objective** is to empower management to improve efficiency, and make it accountable for this.

**Why?** Guernsey Harbours should increase profit (and retain this) to fund future investment, and improved efficiency will contribute to this.

The current overall situation imposes high extra costs due to inefficiencies within Guernsey’s logistics chain arising from double / triple handling, over manning linked with archaic cargo handing and anachronistic employment practices, excess energy use, wear on equipment and infrastructure etc. These arise not just within Guernsey Harbours, but also within key partners / stakeholders, and how these interact.

Within Guernsey Harbours itself, the States’ terms and conditions of employment bear little resemblance to the operational needs of the port. In the context of any other port in the UK, they are antiquated. Terms and conditions of operational port employees need to be changed to address this, but we understand that it is difficult to do this whilst employees remain direct employees of the States. Note that this does not mean more work for less money. It means smarter working with more flexibility, with deployment of people when they are needed by the business.

### 3.1.6 F) Improve use of assets

The **objective** is to hold management accountable for i) using harbours’ assets to provide an efficient operation, whilst ii) at the same time make a contribution from those that are peripheral (such as car parking) to support financial self-sustainability.

**Why?** There is currently no accountability on the Island for making the trade offs that are necessary between these. Logistics operations are grossly inefficient, but Guernsey Harbours’ management are not accountable for this because they do not control land use of assets that clearly should be part of the port estate, and are needed to address this. Areas of land, such as the “Model Yacht Pond” generate a high opportunity cost, but again management are not accountable for this since they are prevented from determining land use.

### 3.1.7 G) The deliverability of the option and risks to implementation.

The **objective** is to consider how soon improvements can be made, and the risks that the options may not be successfully implemented.

**Why?** Whatever the merits are of an option, it would add no value if it is selected but not then implemented.

- ◆ An option that takes longer than a political cycle to implement is in danger from change of policy. Longer implementation times mean potential for mission creep.
- ◆ Risk also increases as the number of parties involved increases, and where a judicial process is required.
- ◆ It is axiomatic that options that take longer to implement and have highest risks also tend to be the most costly to implement.

The States Guernsey could learn from the experience of Jersey, which over the past decade has switched policies on incorporation / Trust Port but not implemented these, and be honest with itself when considering the implications of this (Section 4).

### 3.1.8 H) Post-implementation

The **objective** is to indicate the robustness of the options in terms of remaining in place and delivering benefits, and the issues in “living with” the new business model.

**Why?** The models offer differences in robustness to future changes in policy direction. In essence, the further removed that ownership / governance / management / finances of Guernsey Harbours are from the States, the more robust the option will be. In terms of living with the options, the question is what role will the States have, for example acting as a shareholder, or a price regulator (see box).

#### Price regulation of ports

The States has been much exercised with ex ante price regulation. We know of no port that is regulated in this way, even those that are sole ports for an Island.

A port is a complex business, serving many different markets, and is less homogenous than say an airport or a train company. The complexity and cost of trying to regulate prices ex ante would be high in comparison to the value of the business itself. The practical approach generally adopted is to undertake implicit regulation of prices via approval of the business plan, which also internalises the potential for efficiencies, increased revenue by other means etc.

In the case of Trust Ports, in the UK these are subject to statutory ex post price regulation, which gives port users the right to appeal against statutory charges. There have been several cases of this recently.

## 3.2 Appraisal

The following sets out our assessment of the options against these criteria.

|                          | Do nothing  | Incorporation   | Trust Port  | Consistent with<br>Municipal Ports Review  |
|--------------------------|-------------|---|---|--|
| A) Vision and leadership | 0           | 4   | 5   | 2  |
|                          | ◆ No change | ◆ Should be good, however there is a tendency for the shareholder's values and wider agenda to underlie management thinking in practice   | ◆ A well run Trust Port benefits from strong vision and leadership  | ◆ Vision and leadership would certainly improve, but not in the same league as incorporation or Trust Port                               |
| B) Independent decisions | 0           | 3   | 5   | 1  |
|                          | ◆ No change | ◆ In practice there would be a requirement for any matters that have political implications to be discussed with the shareholder in advance<br>◆ There would be restrictions on disposal of assets<br>◆ Less robust than Trust Port | ◆ All decisions would be completely independent, although may be influenced to some extent by States' appointees to the Board (but only 1 or 2) | ◆ Decision making should be improved, however, any <b>significant</b> decisions will continue to go through similar channels to existing |

|                                  | Do nothing  | Incorporation   | Trust Port  | Consistent with Municipal Ports Review   |
|----------------------------------|---|---|---|--|
| C) Financial self-sustainability | 0   | 4   | 5   | 2  |
|                                  | <ul style="list-style-type: none"> <li>◆ No change</li> </ul> | <ul style="list-style-type: none"> <li>◆ The company should be able to develop a viable business plan, but surpluses accruing for future investment will be vulnerable to dividend grabs by shareholder</li> <li>◆ Equally management will have recourse to additional shareholders funds</li> <li>◆ Company will also pay taxes</li> </ul> | <ul style="list-style-type: none"> <li>◆ A Trust Port would be completely independent, and would be required to reinvest all surpluses, BUT note possible challenge under equivalent of S31 of HA 1964 (see H)</li> <li>◆ Assumed statute will confer power to borrow</li> <li>◆ Trust Ports have no funder of last resort</li> <li>◆ It would pay tax</li> </ul> | <ul style="list-style-type: none"> <li>◆ There would be some improvement with the Board in effect able to stand its ground over Harbour funding etc.</li> <li>◆ Unable to borrow.</li> </ul> |
| D) Improve revenues              | 0   | 4   | 5   | 2  |
|                                  | <ul style="list-style-type: none"> <li>◆ No change</li> </ul> | <ul style="list-style-type: none"> <li>◆ Management has good commercial incentive to increase revenue, but the strength of this depends upon dividend policy</li> </ul>   | <ul style="list-style-type: none"> <li>◆ Management has a stronger commercial incentive to increase revenue since this generates funds for investment not dividends</li> </ul>  | <ul style="list-style-type: none"> <li>◆ The expertise of the Board, and the authority that it develops, can make a real impact on improving the revenue base</li> </ul>                     |

|                                   | Do nothing  | Incorporation   | Trust Port  | Consistent with<br>Municipal Ports Review  |
|-----------------------------------|---|---|---|--|
| E) Improve efficiency             | 0   | 3   | 5   | 1  |
|                                   | <ul style="list-style-type: none"> <li>◆ No change</li> </ul> | <ul style="list-style-type: none"> <li>◆ The underlying political implications of doing this mean that this may be achieved more slowly than the Trust Port option</li> </ul>   | <ul style="list-style-type: none"> <li>◆ Trust Ports can respond quickly to improving efficiency (e.g. Port of Poole recently)</li> <li>◆ Management has a stronger commercial incentive to reduce costs since this generates funds for investment not dividends</li> </ul> | <ul style="list-style-type: none"> <li>◆ In practice improvements can only be influenced at the margins</li> </ul> |
| F) Use of assets / accountability | 0   | 4   | 5   | 1  |
|                                   | <ul style="list-style-type: none"> <li>◆ No change</li> </ul> | <ul style="list-style-type: none"> <li>◆ Once assets have been transferred to the Company, management would be accountable</li> <li>◆ Underlying political influence</li> <li>◆ Restrictions on disposal of assets</li> </ul> | <ul style="list-style-type: none"> <li>◆ Complete control over assets</li> <li>◆ Management fully accountable</li> </ul>  | <ul style="list-style-type: none"> <li>◆ In practice improvements can only be influenced at the margins</li> </ul> |

|                           | Do nothing   | Incorporation   | Trust Port   | Consistent with Municipal Ports Review  |
|---------------------------|--|---|--|---|
| G) Deliverability / risks | N/A  | 3   | 1  | 4   |
|                           | <ul style="list-style-type: none"> <li>Nothing to deliver</li> </ul>   | <ul style="list-style-type: none"> <li>Guernsey has experience of incorporation</li> <li>The legal framework is in place</li> <li>Nonetheless, this would require complete political support</li> <li>Would take 1 to 2 years to accomplish</li> </ul>                  | <ul style="list-style-type: none"> <li>It can be done if the will is there, BUT</li> <li>The legislative process will be new and open to political disagreement</li> <li>The Trust Port will most likely need a dowry to ensure its future financial self-sustainability</li> <li>Likely to take 2 to 3 years to accomplish</li> </ul> | <ul style="list-style-type: none"> <li>This is relatively easy to deliver and could be implemented within PSD alone</li> </ul>  |
| H) Post implementation    | 0  | 4   | 4  | 0   |
|                           | <ul style="list-style-type: none"> <li>The States faces the problem of huge financial challenges in the future in the event that there is no change</li> </ul> | <ul style="list-style-type: none"> <li>States needs to act in role as shareholder, but this should not be onerous</li> <li>Price regulation achieved through the approval of the Company's business plan</li> <li>Other ex-post price regulation unnecessary</li> </ul> | <ul style="list-style-type: none"> <li>No ongoing role for States – frees central resources</li> <li>Friction can develop between the Trust Port and the local authority</li> <li>Pricing principles embodied in statute</li> <li>Customers need ex post right to appeal against statutory port charges</li> </ul>                     | <ul style="list-style-type: none"> <li>This will not materially change the future problems that the States faces.</li> <li>Management of the new Board may increase call upon States' Managers' time</li> </ul> |
| Total                     | 0  | 29  | 35   | 13  |



### 3.3 Conclusions / pros and cons

#### 3.3.1 Status Quo

This “option” means that several key problems afflicting the governance / management / operation / financing of Guernsey Harbours will remain.

The essential problem is that the States is a political body supported by a professional civil service that balances multiple community and social agendas. The *raison d'être* for the harbours is primarily specifically commercial, and this fits ill with the States' general *modus operandi*.

The requirement for the States to act across a range of services (e.g. covering education and health) means that the Port is unlikely to get the prominence and focus that it deserves, even though it is one of the most important facilities on the island. The following evidences this:

- ◆ There is no maritime or specialist commercial expertise outside of the operating unit of Guernsey Harbours to provide strategic guidance and commercial support. In strategic terms, there is no vision. Commercially speaking, the States has on occasion quixotically ignored the commercial experience within the operating unit when this could have been used.
- ◆ The political exigencies that drive the States are applied to governance and management of Guernsey Harbours, even though this may not be appropriate.
- ◆ Guernsey Harbours competes for resources with the States' other obligations. There is a backlog of maintenance and renewal.
- ◆ If this were in the UK, it would no longer be considered satisfactory to run Guernsey Harbours as a just one of a basket of services. There are clear pointers to this in the Municipal Ports Review.
- ◆ There is no champion for Guernsey Harbours who is expressing the vision for Guernsey Harbours, or explaining the lack of credibility in current thinking about the port facilities that the Island should have in the future.
- ◆ Guernsey Harbours should at some point within the medium term (5 to 10 years) progress major physical development. This can create internal conflicts with the States' other functions such as planning control.

This lack of focus on the harbours, and lack of vision, is unsustainable because Guernsey Harbours is a 21st Century business that must respond to modern needs. But it is operating with 20th Century practices for governance and operations, and with 19th Century infrastructure.

“Do nothing” has nothing to recommend it, and the States should now consider what it could be handing to future generations, and make some searching decisions.

### 3.3.2 Trust Port

The big advantage of a Trust Port is that the ports would be set free of the States to pursue sustainable physical / commercial / financial agendas, but at the same time retain a wider stakeholder persona and appeal. In the appraisal against the key criteria, the Trust Port options generally goes one better than incorporation. Its independence is the underlying reason for this.

The difficulties with this option include requiring substantial management time, including the nursing of a new statute. We consider that this is likely to take 2 to 3 years, and will require a big political commitment if it is to be achieved.

Another key problem is that a Trust Port could go bankrupt like a commercial company if it did not have sufficient reserves to meet both expected and unforeseen capital expenditure. A new Trust Port would almost certainly require a dowry. The scale of this requires financial modeling to determine, but it could be substantial.

As one consultee commented, *“This seems like a long way from where we are now”*.

The Trust Port option therefore has a lot to recommend it in terms of achieving the objectives, but with a very high risk that implementation will fail.

### 3.3.3 Incorporation

In this option, the ports would be run fully commercially as a business under new articles of association, and all things being equal with governance according to best practice.

This would result in improved separation between the Ports and the States’ multiple objectives, whilst the States would still retain ownership and benefit from rights appropriate to a controlling shareholder.

Incorporation would also make a substantial call on management time. The company’s assets would have to be legally defined, it would need articles of association, and various other legal hurdles might be required. Based on the States’ practice with Post and Electricity, a memorandum of understanding setting out the States’ role as shareholder and the Board’s obligations would be required.

This option has a lot to offer, and is notably likely to be more doable than the Trust Port option.

### 3.3.4 Do something (consistent with Municipal Ports Review)

This option has the disadvantage of falling well behind in meeting the objectives compared to either Trust Port or incorporation. It lacks teeth, but despite this it offers a real opportunity to improve institutional effectiveness and meet the demands of best practice to some extent.

This option also has the major advantage of being the most readily implementable.

## 4 Case study: Jersey Harbours

The States of Jersey has been considering changing the business model of Jersey Harbours for some time. The following presents a timeline of the various reviews, decisions, and events that have shaped Jersey Harbours over the last 12 years.

| Time       | Decisions / events  |
|------------|---|
| Early 1999 | Strategic Service Review of Jersey Harbours recommended incorporation.  |
| Late 1999  | Proposition for incorporation lodged.   |
| Late 2000  | Proposition was withdrawn without debate in the face of strong opposition from the workforce, and demands from key States' Committees for more detailed information.  |
| 2001       | Plans made for implementation of Trust Port option progressed.  |
| early 2002 | TGWU ballot rejects Trust Ports option.   |
| 2002       | Proposition on Trust Port lodged but not debated due to Finance & Economic Committee opposition to transferring the asset outside of the direct control of the States, and case not made that Trust Port option in best interests of the Island.          |
| 2004       | High Level Options Review recommended incorporation.  |
| 2005       | Scrutiny Panel endorses incorporation. "The project management team will be formalised further to progress the recommendations, operating under the direct guidance of the Chief Executive and an independent project Chair."                             |
| 2005       | Creation of CEO (1999 recommendation). Chair etc. not enacted.  |
| End 2005   | Move to Ministerial / Cabinet Government.   |
| 2006       | Separation of some maritime regulatory functions from commercial port operation by transferring to a new Maritime Compliance unit.  |
| 2008       | Registrar of Shipping function removed from Jersey Harbours to Maritime Compliance.   |
| 2008       | Review of the Harbours Owned and Operated by the States of Jersey identifies benefits of a model based on Municipal Ports Review, on the grounds that this would "do something" and improve governance and help Jersey Harbours to act more commercially. |
| Early 2010 | Precursor to a "Shadow Board" set up (equivalent to a Harbour Management Committee as proposed by Municipal Ports Review).  |
| 2010       | Decision taken to merge some (back office) activities of Harbours and Airport, with new Group CEO.  |
| 2011       | Proposition for combined Shadow Board for Harbours and Airport debated in States, and new Group CEO appointed.  |

It is apparent that the States of Jersey has (just about) succeeded in making some positive change to governance of Jersey Harbours over the last 12 years.

During this time however, the complexion of the management has changed significantly, notably from having no senior manager for finance in the 90s, to having a Finance Director by the mid 2000s. Consultations with port users (in Guernsey, but common to both Islands) confirm that Jersey Harbours has become “more commercial” over the years.

It is worth noting that consultees regard the Port of Poole, a Trust Port that has just applied a significant redundancy programme to reduce costs to sustainable levels following loss of a key customer, as significantly more commercial in its outlook than either Guernsey or Jersey.

Jersey has also separated some regulatory roles from the commercial port, although the Coast Guard and lighthouse authority obligations remain an inherent component of Jersey Harbours activities. Realisation of the importance of these public services has arguably resulted in a slight pulling back from the doctrine of commercialisation of Jersey Harbours.

Fisher Associates conducted the original Service Review in 1999, as well as the review of 2008. Applying this perspective, it is notable that the States of Jersey had incorporated Post and Telecomms prior to 1999, but that the political implications of changing the business model of a **commercial port** proved a different matter.

Underlying this is the real importance of the port to the Island of Jersey. It is taken for granted that the port is there and working, but any threat (e.g. from industrial action), or perceived future potential threat (e.g. from losing control of assets), brings to the surface that the Island could survive for only a few days without its commercial port.

The key implication is that the level of unity and political commitment needed to incorporate Guernsey Harbours, let alone change it into a Trust Port, probably exceeds that for other services previously incorporated for similar reasons.

Specifically, the key lessons are that:

- ◆ Labour issues have a big impact on the reality of implementing such changes.
- ◆ Losing control of assets is a very difficult bridge to cross.
- ◆ Failure to implement change within a political cycle means that the impetus tends to fade away.

These lessons have a significant impact on our recommendations.

## 5 Conclusion

We recommend that Guernsey Harbours should be placed on a more commercial footing. This means that:

- ◆ The organisation as a whole will make decisions more quickly with a commercial rather than a political agenda.
- ◆ Management will be empowered but also accountable for implementing these.
- ◆ Profit will be improved by increasing efficiency and revenues (not just by putting up prices), including applying cost reflective tariffs, working with commercial customers to develop marginal revenue, policing income etc.
- ◆ The organisation will make commercial investments that enhance its financial self-sustainability.

In delivering this, the Trust Port model suffers from a number of drawbacks, notably the need to transfer ownership of assets, and (probably) to provide the new body with a dowry. Despite the advantages on paper, the Trust Port option is therefore discounted.

We consider that incorporating Guernsey Harbours by reconstituting it into “Guernsey Ports Ltd” has more merit overall, because it offers the chance to make real improvements, and is a more deliverable option. Turning Guernsey Harbours into Guernsey Ports Ltd would mean that:

- ◆ Land and assets would be vested in Guernsey Ports Ltd, and therefore still owned by the States but at arms length.
- ◆ The ports would be legally separated from the States’ general activities.
- ◆ The ports will be subject to the company tax regime.
- ◆ Governance would take the form of a new Board.
- ◆ Employees would no longer be direct employees of the States, but would be employed by the Company, at arms length to the States.
- ◆ Port development could be funded partly by borrowing – subject to the provisions of the company’s articles and shareholder’s policy.
- ◆ Public service functions currently undertaken by Guernsey Harbours (such as Guernsey Coast Guard), would need to be separated in principle, and either provided separately by an independent body or provided by Guernsey Ports Ltd under a public service contract.
- ◆ Services provided centrally by the States would be charged.

The six key steps for implementation of this option are:

1. Prepare a **business plan** incorporating a tariff review to provide a blueprint for how Guernsey Harbours can provide the improved level of profitability that is needed to enhance financial self-sustainability. This is a short to medium term plan, for implementation in 3 to 4 years (i.e. up to incorporation and the first year as Guernsey Ports Ltd).

2. Undertake a **review of assets** and propose and agree what constitutes the port estate. This activity needs to be undertaken in parallel with the business plan, which will demonstrate how exploiting harbour assets will contribute to financial self-sustainability.
3. Implement **ring fenced accounts** for Guernsey Harbours thus separating its funding from the general fund (and indeed the Airport), including preparation of GAAP compliant financial statements that give a proper commercial picture of the Port.
4. Set up a **Shadow Board** which with the aid of a memorandum of understanding will report to PSD against policy / terms of reference / budget on a quarterly basis. The recommended basic anatomy of the Board is nine Board Members including the Harbour Master, two States' appointees, and the remainder appointed by open advertisement and independent recruitment.
5. Prepare a **vision** for the harbour seafront (incorporating commercial port needs, but taking a wide strategic view on the economic potential that this might unlock), and develop a **port masterplan**. This can be undertaken in parallel with implementing the Shadow Board, and must set out a long term and timed physical strategy, considering associated funding needs.
6. Prepare a detailed **plan for incorporation**, setting out the key steps and milestones, with a view to taking this to the States for approval at a future date.

Steps 1 to 5 above are valuable contributions to commercialising Guernsey Harbours. In the event that the States does not incorporate Guernsey Harbours, it will have implemented these measures, and this means that Guernsey Harbours will then be much more consistent with best practice as identified in the Municipal Ports Review.

These six key steps will require considerable effort. They will need a coordinator and project manager within Guernsey Harbours, with the relevant governance, commercial and technical experience to support the management team.

The timing in terms of approvals for these activities is set out below:

- ◆ **Now:** Approval from PSD Board to progress:
  - Business plan
  - Review of / definition of Harbours' assets
- ◆ **January 2012:** Approval from States to:
  - Ring fence accounts / implement GAAP compliance
  - Set up Shadow Board
  - Progress preparation of master plan
  - Prepare detailed plan for incorporation
- ◆ **Later:** Report on progress and approval from States for incorporation plan.

**(NB While there are no significant immediate resource implications associated with this Report's recommendations, the Treasury and Resources Department is of the view that there will certainly be major financial and resource issues to be addressed as part of any move to put the Harbours into a 'States Trading Company' format. Based upon the evidence presented to date, the Treasury and Resources Department is far from convinced that such a move would be in the island's best interests and should the States decide to permit the Public Services Department to carry out further work on the feasibility of establishing a States Trading Company, that Department should not necessarily interpret such a decision as providing it with any form of 'agreement in principle' for the concept.)**

**(NB The Policy Council notes this Report and recommends, by a majority that it be presented to the States for debate.)**

The States are asked to decide:-

XIV.- Whether, after consideration of the Report dated 21<sup>st</sup> December 2011, of the Public Services Department, they are of the opinion:-

1. To note the reports prepared by Fisher Associates in Appendices 2 and 3 to that report.
2. To agree that the Public Services Department should undertake appropriate consultation prior to returning to the States with a report proposing clear objectives that should apply to the operation of the Harbours, regardless of any future commercial re-structuring.
3. To note the Public Services Department's current view that the establishment of a States Trading Company might present the most effective way forward for Guernsey Harbours.
4. To agree that the Public Services Department should conduct more detailed investigation into, and consultation concerning, the option of establishing a Guernsey Harbours States Trading Company, before reporting back to the States, such investigation and consultation to include (but not be limited to):
  - (a) financial issues (costs, savings etc);
  - (b) consultation with employees likely to be affected by any proposals to create a States Trading Company;
  - (c) consultation with service users;

- (d) potential for the shareholder role;
  - (e) potential regulation mechanism;
  - (f) legislative implications.
5. To note that the funds that will be required to progress this additional investigation and consultation, (provisionally estimated not to exceed £50,000) will be funded by Guernsey Harbours.
  6. To note that the Public Services Department is working to progress preparation of a Ports Master Plan, incorporating commercial port needs but also taking a wider strategic view on the economic potential that this might unlock.
  7. To note that the Public Services Department, working in conjunction with the Treasury and Resources Department, will be reviewing the current accounting and reporting arrangements for the Ports, including the mechanism of the Ports Holding Account.
  8. To note the intention of the Treasury and Resources Department to report, as part of the 2013 Budget Report, with an interim proposal for funding the Ports routine capital expenditure.



**COMMERCE AND EMPLOYMENT DEPARTMENT****FOUNDATIONS**

The Chief Minister  
Policy Council  
Sir Charles Frossard House  
La Charroterie  
St Peter Port

13<sup>th</sup> December 2011

Dear Sir

**1. Executive Summary**

1.1 In 2006, the States approved revisions to Guernsey's Trusts Laws.<sup>1</sup> In that Report the Commerce and Employment Department ("the Department") also recommended the introduction of foundations and the States made a decision "in principle" to introduce legislation to enable the formation of foundations in Guernsey. An extract of that report is included as Appendix One to this Report. The resolutions in that Report directed the Department to report back to the States setting out how the legislation would operate in practice.

1.2 This Report:

- (a) Provides a detailed outline on the proposed foundations legislation,
- (b) Outlines the consultation process which the Department has undertaken, and
- (c) Recommends that the States approves the recommendations for foundations legislation.

**2. Background – Key Concepts**

2.1 Civil law jurisdictions, such as countries in continental Europe, South America and the Far East do not generally recognise common law trusts. This lack of recognition means that the common law trust is unfamiliar and not well understood by civil law practitioners. This has hampered the ability of Guernsey's financial services sector to develop new business in civil law jurisdictions which include many emerging economies.

---

<sup>1</sup> See Billet D'Etat XXI of 2006

- 2.2 In order to provide a civil law alternative to the common law trust some civil law jurisdictions developed the concept of a “private foundation”. That provides a similar solution to the common law trust, although there are key differences between the two. The first country to introduce legislation enabling the formation of private foundations was Liechtenstein in 1926. Many other civil law jurisdictions have followed suit, for example private foundations may be formed in Switzerland, Austria, and Malta. Foundations are now a well established legal concept in many civil law jurisdictions.

***Patrimony (patrimoine)***

- 2.3 As foundations are a civil law concept it is important to understand the civil law concepts which underpin foundations and provide the basis for some of the policy recommendations set out in this Report. The primary reason for the establishment of foundations in civil law jurisdictions is to mitigate the effects of the civil law concept of patrimoine. In the civil law tradition (including Normandy customary law from which the customary law of Guernsey is largely derived) every individual has a patrimoine. A person’s patrimoine can most easily be described as an “empty bag” into which everything of economic value (including his debts, obligations and liabilities) is placed throughout that person’s life. On the death of the person the patrimoine is transferred intact to the person’s designated heir. A person may have only one patrimoine and may not separate or divide this patrimoine. If there were a purported assignment of part of the patrimoine it would not release the person’s heir from the debts and liabilities assigned, nor would it prevent the automatic transfer of the patrimoine to the heir on death. The inability for a person to divide his or her patrimoine led to the creation of civil law foundations (which are in part based upon common law trusts), as it was otherwise impossible to dedicate assets to further some other purpose.
- 2.4 Foundations divide the patrimoine, as assets are ‘dedicated’ to them by the founder, and the foundation is a legal person, which must be separate from, and independent of, the founder. This need for the foundation to be separate and independent from the founder means that the founder must have only limited powers over the fundamental existence and constitution of the foundation once formed. The rights of the founder to rewrite the constitution, terminate the foundation, or revoke the foundation must be limited in order to ensure the necessary separation and independence. If this is not done, it runs the risk of not being recognised as a civil law foundation and will fail in its aims, as it will be regarded as a sham. That is not to say the founder can have no rights, but rather that the rights of the founder to take such fundamental action must come to an end at some point and the foundation can then become completely independent of its founder. It is this key concept that is central to the Department’s proposed legislation, in order to ensure that Guernsey foundations will not be considered as sham arrangements in civil law jurisdictions.

### ***Common Law Evolution of Foundations***

- 2.5 Over the last 20 years a number of jurisdictions, including some common law jurisdictions, have introduced legislation permitting the formation of private foundations. Those jurisdictions include Panama in 1995, the Netherlands Antilles in 1998 and the Bahamas in 2004. Jersey introduced foundations legislation in 2009 and the Isle of Man's legislation was approved in November 2011.
- 2.6 The reason that common law jurisdictions have introduced foundations legislation are varied but can be summarised as follows:
- The rapid growth of emerging markets such as Russia, China, and Latin America has led to an increased demand for wealth management services.
  - Many of those emerging markets are civil law jurisdictions where trusts are poorly understood whilst foundations are more familiar.
  - By introducing foundations legislation these jurisdictions have been able to attract new business from the growing emerging markets as well as offering greater flexibility for clients from more traditional markets.
- 2.7 The common features of foundations include:
- Foundations have separate legal personality similar to a company but, unlike a company which is largely controlled by its shareholders, foundations are independent of their founder.
  - Foundations are formed by a founder who dedicates the initial assets of the foundation through an endowment.
  - Foundations hold their assets for the purposes set out in the constitutive documents and are administered according to the constitution rather than according to fiduciary principles which apply to trusts.
  - Foundations are administered by a council that performs functions similar to that performed by company directors. The councillors are appointed according to the constitution whilst in a company the directors are appointed by the shareholders.
  - Foundations may have specific beneficiaries who may be able to enforce their rights through the constitution.
  - Foundations may be formed for a specific purpose rather than to benefit beneficiaries.

- Foundations may also have an advisor or protector who ensures that the councillors comply with the constitution.

2.8 The Department has used these general indicia as the basis for developing the proposals outlined in this Report.

### **3. Market Demand and Economic Benefit**

3.1 The Department has researched the likely demand for foundations to determine the potential benefits to the Island. That research demonstrates that there is a clear market demand for Guernsey foundations.

3.2 Evidence provided to the Department indicates that clients from the following jurisdictions would potentially use Guernsey foundations once they are available: Continental Europe, the Middle East, the Russian Federation, and the Far East. There is a substantial international market for foundations. For example in the Netherlands there are more than 200,000 foundations registered, whilst Indonesia has more than 130,000.

3.3 The experience in Jersey has been that more than 100 foundations have been formed since the legislation was introduced in 2009. Approximately 1/3rd of those established have been traditional private foundations, 1/3rd have been charitable foundations and 1/3rd have been used in the funds industry where it is beneficial to have a stand alone entity for structuring purposes such as special purpose vehicles.

3.4 Of course the number of foundations formed is not the only measure of potential economic benefit. Attracting a small number of foundations which have significant assets would create significant economic benefit to the Island through the provision of administration services, legal and professional fees, investment advice and capital flows through the banking sector etc.

### **4. Reputational Issues**

4.1 A decision to introduce foundations in Guernsey has been criticised by some commentators. The concern is that there have been a number of scandals associated with a very small number of jurisdictions which have traditionally offered foundations.

4.2 Criticism of those jurisdictions was not the result of the structure itself but of a broader failure to meet relevant international standards on regulation and tax information exchange combined, usually, with strict banking secrecy laws. One of Guernsey's key attributes as a leading international finance centre is its reputation for being well regulated, transparent and co-operative. Guernsey's has a high level of compliance with international regulatory standards and in particular compliance with Anti-Money Laundering/Combating the Financing of Terrorism ("AML/CFT") standards as set by the Financial Action Task Force

(“FATF”). Those same high regulatory standards will be applied to foundations in the same manner as they apply to companies, partnerships, trusts and other legal entities and arrangements established in Guernsey.

- 4.3 The introduction of foundations will not have any detrimental effect on Guernsey’s international reputation. The Department has reached this conclusion following three years of detailed research and discussion with experts. That view is shared by the Guernsey Financial Services Commission which has confirmed that in their view offering foundations poses no significant reputational risk provided that they are administered appropriately and Guernsey’s commitment to robust Anti-Money Laundering policies remains high.
- 4.4 In addition in the civil law jurisdictions foundations are commonplace and largely non-controversial. A large number of civil law jurisdictions offer foundations including for example:
- Germany – which offers the *Stiftung*, or charitable foundation and the *Treuhand* a private foundation,
  - Belgium - which, since 1921 has offered charitable foundations and, since 1998 private foundations, the Channel Islands Brussels Office is a *fondation privee*
  - Norway - which offers foundations (*stiftelse*) to be formed for both commercial and non-commercial purposes,
  - Estonia - which offers both charitable and private foundations,
  - Italy – which offers non-profit foundations without a commercial purpose,
  - The Netherlands – which offers both private and charitable foundations and permits foundations to carry out commercial activities,
  - Japan – which offers incorporated foundations (*zaidan hojin*) which are ordinarily formed for charitable purposes but may be used for other purposes,
  - Switzerland – which offers both private (*Anstalt*) and public foundations
  - Indonesia – which offers foundations which are non-commercial to achieve a social purpose,
  - Austria – which offers foundations (*Stiftung*) which may be private or public in nature,
  - France – which offer non-profit public interest foundations.

- 4.5 All of these jurisdictions have been reviewed by the OECD Global Forum on tax transparency and information exchange and on no occasion were any of these jurisdictions criticised on the basis that they offered foundations. In civil law jurisdictions foundations are considered perfectly acceptable legal arrangements available for use by their citizens.
- 4.6 There is clearly a demand from high quality business which wishes to be located in a jurisdiction which has high quality regulation and service provision.

## **5. Formation and Administration of the Register of Foundations**

- 5.1 Guernsey foundations will only be formed once registered with the Company Registry. In some civil law jurisdictions private foundations are not obliged to be registered, however in accordance with Guernsey's legal tradition legal entities with limited liability require registration.
- 5.2 The formation of Guernsey foundations will be restricted to licensed fiduciaries ("Corporate Services Providers") regulated by the Guernsey Financial Services Commission ("the GFSC"). This will ensure compliance with AML/CFT obligations as well as regulatory oversight of the administrators of foundations.
- 5.3 The application will be made to the Registrar and must contain the following information:
- A copy of the Foundation's Charter. The Charter will contain the name of the foundation, set out the purpose for which the foundation has been established, and describe the initial endowment of the foundation. The charter may also contain any other matter that the founder thinks fit. Foundations will not be able to be used for carrying out a business undertaking which would ordinarily use a company but may carry out commercial activities where those activities are necessary to achieve the purpose.
  - The founder must subscribe to the Charter either personally or alternatively the Corporate Service Provider may sign the application on behalf of the founder.
  - The identity of the initial councillors must also be filed with the Registry.
  - The location of the foundation's registered office which must be situated in Guernsey.
- 5.4 The Register of Foundations will be divided into two parts. Part A will form part of the public records of the Island and be publicly accessible. Part B will be available to law enforcement, Income Tax and regulatory authorities but will not be otherwise publicly searchable.

- 5.5 There will be an obligation to file an annual validation with the Registry each year similar to that which applies to companies and limited partnerships. In addition the Law will provide for striking off foundations which are defunct or in default with a statutory power to restore foundations to the Register in certain defined circumstances. This will ensure that the Registrar will have the relevant powers to enforce compliance with statutory filing obligations. Consistent with other legislation, the property of a struck off foundation will become bona vacantia, belonging to the Crown.
- 5.6 All Guernsey foundations will be obliged to maintain documents at their registered office including, accounting records, documents filed with the Registrar, the charter of the foundation, and any other document required by law.
- 5.7 Guernsey foundations will also be obliged to ensure that they disclose their name, registered office, and registration number in all correspondence.

## **6. Governance of a Guernsey Foundation**

### ***The Constitution***

- 6.1 The Constitution of a foundation will comprise the Charter and the Rules, these are the documents which will determine how the foundation will be governed and administered. The Charter will set out the overriding purpose of the foundation, and will be filed with the Registrar. The Rules of the foundation set out how the foundation should be administered in order to achieve that purpose. The Rules shall: set out the functions of councillors; the procedures for appointment of councillors; resignation and removal of councillors; how the assets of the foundation are to be distributed in the event the foundation's purpose is achieved or defunct; the manner in which the property of the foundation may be distributed, accumulated or applied; how further endowments may be made; and provision for the addition, removal or change of status of beneficiaries as well as any other matter the founder requires.

### ***The Council***

- 6.2 The primary responsibility for administering the foundation rests with the foundation council (the "Council"). The default position in the Law will be that a foundation will require at least two councillors but the charter may specify a single councillor if the founder wishes. Councillors will owe a duty to act in good faith and in the best interests of the foundation in fulfilling their functions. In fulfilling their responsibilities the Council will of course act to further the purpose of the foundation.

### ***Balancing the Rights of the Beneficiaries***

- 6.3 Foundations differ from companies in a number of respects; however one of the major differences is that foundations do not have shareholders. In a traditional limited liability company the shareholders exercise rights to appoint the directors and to ensure that the company is being run in a prudent manner. The shareholders exercise the ultimate governance function and are able to dismiss directors and wind the company up if they so choose. A company is separate from, but not independent of, its members. As a foundation does not have shareholders it is important to ensure that there is some mechanism to hold the officers of the foundation to account. That involves considering how to protect the rights of any beneficiaries of the foundation.
- 6.4 The rights of any beneficiaries will be defined in the Constitution. That allows for a large degree in flexibility in setting out the rights, powers and duties of beneficiaries. Often beneficiaries of foundations are granted few rights and powers. In order to ensure that their rights are protected it is usual practice to require the appointment of a guardian or protector. In most jurisdictions it is obligatory to appoint a guardian or protector to ensure that the council fulfil their responsibilities and comply with the constitution of the foundation, but this can increase the administrative burden and costs. To limit this administrative burden it has been proposed that the appointment of a guardian should not be obligatory so long as the beneficiaries' rights are appropriately protected. To permit that flexibility the Department is proposing that there be two distinct types of beneficiaries: Enfranchised Beneficiaries and Disenfranchised Beneficiaries (The default position will be that all beneficiaries will be enfranchised unless the constitution provides otherwise).
- 6.5 Enfranchised beneficiaries will have full rights to information about the foundation and will have standing to apply to the Royal Court to enforce the terms of the constitution. Enfranchised beneficiaries will be able to protect their own interest thus removing the need for the appointment of a guardian.
- 6.6 Disenfranchised beneficiaries will have no rights to information about the foundation and may not even be aware that they are potential beneficiaries of that foundation. Disenfranchised beneficiaries will not be able to take action to enforce their rights before the Courts. Where a foundation has disenfranchised beneficiaries the foundation will be obliged to appoint a guardian whose role is to enforce the terms of the Constitution. By ensuring that the foundation is administered in accordance with the Constitution the rights of disenfranchised beneficiaries will be protected.

### ***The Guardian***

- 6.7 The Guardian will owe a duty to enforce the terms of the Constitution. The role of the Guardian will be to oversee the Council and ensure the Council is



complying with its obligations. The Guardian will also have standing to bring an action against the Council and the Foundation where satisfied that the Council is not fulfilling its responsibilities.

### ***The Rights and Powers of the Founder***

- 6.8 In some jurisdictions founders are given extensive powers. However the existence of extensive powers for the founder may call into question whether a foundation will be recognised as such in a civil law jurisdiction or instead treated as a sham due to the need to separate the founder from the foundation.
- 6.9 However, for Guernsey foundations to be competitive, the founder will need to be able to exercise some powers in respect of the foundation. Therefore, the Department has sought expert advice on this issue and considers that the appropriate balance will be struck by permitting the founder to exercise administrative powers in respect of a foundation, but that the founder should only have power to fundamentally amend the foundation (by revoking it or amending the Constitution) for a limited duration. This is consistent with practice in a number of civil law jurisdictions. Despite this important and necessary limitation the legislation will permit the founders to be given extensive rights to be involved in the ongoing administration of the foundation. Provided the rules make specific provision then the founder may exercise a range of administrative powers on an ongoing basis including:
- The ability to appoint or remove councillors and the guardian or protector.
  - The ability to prescribe the way the property of the foundation ought to be invested or applied. For example, it is common for a founder to wish to be involved in the ongoing investment decision relating to foundation property.
  - The addition or removal of persons (or classes of persons) as beneficiaries, including the ability to exclude a beneficiary from benefiting under the foundation.
  - The ability to impose conditions upon beneficiaries who may wish to benefit.
  - The alteration of the status of beneficiaries.
- 6.10 Those administrative powers will be able to be assignable and transferable as may be provided for in the constitution. Permitting the rules to specify the rights that the founder may exercise will allow advisors in Guernsey to tailor the terms of the constitution to meet the particular needs of their client. This will provide the necessary flexibility to allow foundations to be crafted in order to meet the needs of clients from a variety of jurisdictions.

## **7. Residual Legislative Issues**

7.1 In addition to the above matters the legislation will also make provision for the following:

- the capacity of the foundation to deal with third parties,
- powers for the Registrar to administer the register of foundations including the power to issue certificates of formation, for the creation of a register of foundations, to make disqualification orders against persons acting (or seeking to act) as foundation officials,
- the power to prescribe fees for registration or the Registrar's exercise of statutory powers under the Law,
- the appointment of a resident agent or resident councillor, for Guernsey foundations,
- the ability to migrate foundations to and from Guernsey,
- the names of foundations,
- the winding up, striking off and dissolution of foundations,
- the powers of the Royal Court in relation to foundations, and
- necessary and consequential amendments to other laws.

## **8. Implementation Costs**

8.1 In addition to a registration fee the Department is proposing that all foundations will be obliged to file an annual return and pay an annual fee which will be set at a level equivalent to that which applies to companies. This will avoid any arbitrage between companies and foundations on the basis of costs. The registration fee for companies is presently set at between £100 and £750 depending on the speed of incorporation. The annual validation fees for ordinary companies are currently set a maximum of £500 depending on the type of company. Therefore the Department is proposing a similar level of fees for foundations. That means over time the revenues generated by the foundations register will increase depending on the number of foundations formed. The Department will consult with the financial services industry and the Treasury and Resources Department when setting the fees under the legislation, but the key principle will be to ensure that the fees are similar to those which apply to companies.

- 8.2 This will result in a revenue stream for the States that will grow over time. If the register achieves similar number of foundations to that achieved in Jersey then revenue generated will be in the vicinity of £50,000 to £100,000 per annum. The Department has consulted with the Registrar of Companies on the costs of implementation of the legislation to ascertain whether there are any resource implications for the States of Guernsey. The Registrar has advised that the legislation can be administered within existing resources and no additional resources will be required unless and until a substantial number of foundations have been formed. Therefore, this annual revenue will increase the annual surplus of the Guernsey Registry and hence the transfer to General Revenue.
- 8.3 If the number of foundations grows substantially then the revenue generated may be significantly greater and additional investment may be justified given that revenue stream. In those circumstances the Registrar will work with the Treasury and Resources Department to develop and appropriate business case if further development of the Registry's IT system is required.

## **9. Consultation**

- 9.1 There has been some delay since the original resolution in 2006. That delay was due to competing legislative priorities including the need to finalise the review of Company Law and respond to the review by the International Monetary Fund. Nevertheless during that period the Department, in conjunction with the Law Officers has conducted detailed research on the subject as well as conducted an extensive consultation process.
- 9.2 During the development of the legislation the Department sought the advice of internationally recognised legal experts which specialise in both civil law foundations and common law trusts. That advice was instrumental in developing key attributes of the legislation.
- 9.3 The Department also conducted a public consultation exercise during 2011. There were 13 responses to that consultation including responses from practitioners throughout the Bailiwick and from the UK and Switzerland. Substantial responses were provided by the Society of Trust and Estate Practitioners and the Guernsey Association of Trustees. A full list of respondents is contained in Appendix Two.
- 9.4 The Law Officers have been consulted and raise no objection to the proposals. The Guernsey Financial Services Commission has been consulted on the proposals and their comments have been taken into account in preparing the legislation.

## **10. Corporate Governance**

- 10.1 The Department believes that it has complied fully with the six principles of corporate governance in the preparation of this States Report.
- 10.2 The States unanimously approved the introduction of foundations in 2006 in Billet D'Etat XXI of 2006.
- 10.3 Since then, the proposal to introduce foundations has formed part of the Department's Business Plan and more recently, the States Strategic Plan. In the most recent iteration of the SSP, at page 1950 of Billet D'Etat XVI of 2011 and approved at the October sitting of the States the SSP reiterated the overall the objective of maintaining a diversified, broadly balanced economy. In advising how the States would meet this objective the SSP commented at paragraph 13.24:

“Commerce & Employment has various projects under development to broaden the revenue streams of the finance sector including ... the proposals for development of Foundations legislation”.

## **11. Recommendation**

The States are recommended:-

- 1. To approve the proposals for the introduction of foundations as set out in this report, and
- 2. To direct the preparation of such legislation as may be necessary to give effect to the above decision.

Yours faithfully

C S McNulty Bauer  
Minister

M Lainé  
Deputy Minister

R Matthews  
A Brouard  
M Storey  
States Members

P Mills  
Non States Member

## **APPENDIX ONE – EXTRACT FROM BILLET D’ETAT XXI OF 2006**

- 6.1 It has been possible for foundations to be created under the laws of Liechtenstein since 1926, Panama since 1995, the Netherlands Antilles since 1998 and the Bahamas since 2004. Jersey is currently proposing to supplement its laws to permit the establishment of Jersey foundations.
- 6.2 There is no single definition of a foundation but some common features are as follows:
- Foundations have legal personality and are inscribed on a public register.
  - A foundation is formed by founder(s) who provide assets to it. Powers may be reserved to the founder(s), for example to revoke the foundation or add or remove beneficiaries.
  - A foundation holds assets for the purposes set out in its constitutive documents, and is administered according to contractual, rather than fiduciary, principles making it acceptable to people uneasy with trusts.
  - The constitutive document is a public document, but rules setting out the detailed internal operation of a foundation are contained in a private document.
  - A foundation is run by a council (or board) which is its executive arm and is responsible for fulfilling the foundation’s purpose.
  - A foundation has no shareholders and may or may not have beneficiaries depending on its purpose. For example, foundations may have a charitable purpose and no beneficiaries.
  - Beneficiaries have contractual rights to enforce a foundation’s operation in accordance with its constitutive document, rather than proprietary rights in its assets, or equitable rights such as are available to beneficiaries of trusts.
  - A foundation may have an adviser or protector if its rules so provide. If so, its rules will set out his role and powers, which may include the appointment or removal of council members, or beneficiaries, or the alteration of the foundation's constitution.

### ***Recommendations***

- 6.3 In order to provide choice and flexibility to the fiduciary sector, and therefore its clients, whilst allowing Guernsey to continue to meet international standards, the Department recommends that the States agree in principle to the introduction of foundations which will form the subject of a further detailed report. Such foundations to be introduced on the following lines:

- A foundation would come into existence on being entered on a public register. The essential elements of an application to enter would be copies of the foundation's charter, an application form and the prescribed fee. The register, which would be public, would show the names and addresses of the council members, the address of the registered office, and the purpose of the foundation.
- A foundation must have a registered office in Guernsey at which documents can be served.
- The mode of operation of a foundation's council would be governed by its rules and, in running the foundation, the council members should be subject to duties equivalent to those applicable to company directors. Council members who comply with those duties should not be liable for losses suffered by the foundation or third parties.
- Acting by way of business in connection with foundations should be a regulated fiduciary activity requiring licensing. This should include effecting or advising on the formation, management or administration of foundations, the provision of, or acting as, a council member, a founder, and providing a registered office.
- Foundations need to be brought within Guernsey's existing anti-money laundering regime so that obligations to verify identity are in line with those relating to trusts and companies. This would place obligations on the service provider.
- It should be possible for a Guernsey foundation to migrate to another Jurisdiction where it will be recognised, and for a foundation formed elsewhere to become a Guernsey foundation (subject to meeting the requirements applicable to Guernsey foundations).
- A Foundation's terms should be enforceable by its beneficiaries or, if there are none, by H.M. Procureur. It may be necessary for the legislation to give the Royal Court a specific power to order specific performance of the foundation's terms, as the usual remedy in contractual situations is an award of damages.
- The demand for foundations appears to arise primarily from a need for structures which can be used in similar circumstances to traditional family trusts, but are familiar to clients and intermediaries with a civil law background.
- The tax treatment of foundations would clearly be important and the Department recommends that they are, as far as possible, treated in the same way as trusts with Guernsey trustees.

- Legislation on foundations would need to state what are beneficiaries' rights to information.
- It is important that Guernsey foundations should not be attractive to potential founders whose aim in forming a foundation is to defraud their creditors and persons transferring assets to foundations should be in the same position, vis-à-vis creditors, as those transferring assets to a Guernsey trust.
- The Department recommends that foundations have 'open-ended' existence, subject to the ability to fix either a period or a mechanism for a foundation to come to an end. Given the separate legal personality of a foundation, it would need to be possible for it to be wound up and struck off the register, and insolvency aspects would involve consideration of whether it should be possible for a foundation to enter into administration.
- As foundations, unlike trusts, are legal entities and therefore should be entered on a public register, the costs of maintaining that register should be recovered through fees charged to the foundations.

**APPENDIX TWO – OUTLINE OF CONSULTATION PROCESS**

|     | Respondent  |
|-----|---|
| 1.  | The Guernsey Association of Trustees                            |
| 2.  | The Society of Trust and Estate Practitioners (Guernsey Branch) |
| 3.  | The Guernsey Society of Chartered and Certified Accountants     |
| 4.  | The Guernsey Financial Services Commission                      |
| 5.  | Carey Olsen (two responses)                                     |
| 6.  | Ogier   |
| 7.  | Carey Group (two responses)                                     |
| 8.  | S&J Associates - Sark   |
| 9.  | Lenz and Staehelin  |
| 10. | St Peters Trust Company   |
| 11. | Intertrust International Management Limited (Guernsey)          |
| 12. | Mr Michael McKean   |



**APPENDIX THREE****DRAFTING OF LEGISLATION – PRIORITY RATING SCHEME****STATES REPORT – FOUNDATIONS****Criterion 1 – Need for Legislation**

To comply with a Resolution of the States

**Criterion 2 - Funding**

There are no immediate funding requirements

**Criterion 3 – Risks and Benefits associated with enacting/not enacting the legislation**

There are economic benefits from introducing foundations to facilitate business flows into Guernsey's financial services sector. Given that competitor jurisdictions already have in place similar legislation there are risks to Guernsey's competitiveness as an international finance centre if legislation is not introduced.

**Criterion 4 – Estimated Drafting Time**

The foundations project has been ongoing for some time and much of the legislative drafting had been completed prior to the introduction of the legislative priority rating scheme. It is not anticipated that the remainder will take longer than a few weeks to finalise.

**(NB As there are no resource implications identified in this report, the Treasury and Resources Department has no comments to make.)**

**(NB By a majority, the Policy Council supports this report.)**

**The States are asked to decide:-**

XV.- Whether, after consideration of the Report dated 13<sup>th</sup> December 2011, of the Commerce and Employment Department, they are of the opinion:-

1. To approve the proposals for the introduction of foundations as set out in that report.
2. To direct the preparation of such legislation as may be necessary to give effect to their above decision.