

# STATES OF JERSEY



## **DRAFT AIR AND SEA PORTS (INCORPORATION) (JERSEY) LAW 201- (P.5/2015): COMMENTS**

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**Presented to the States on 26th May 2015  
by the Economic Affairs Scrutiny Panel**

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**STATES GREFFE**

## COMMENTS

### **Incorporation**

Proposals to change the way the Ports of Jersey (POJ) are run have developed over many years. The move towards incorporation gathered pace in 2010, when a ‘Shadow’ Board of Directors for Jersey Harbours and Jersey Airport was appointed; the principle of incorporation was eventually approved by the States in October 2012. The previous Economic Affairs Scrutiny Panel was asked to review proposals for incorporation, but chose to wait until the plans were finalised. By the time a White Paper consultation closed in August 2014, it was too late for a Scrutiny review to take place before the elections.

### **The review**

The current Panel was approached very soon after the 2014 elections to review the final Ports of Jersey Incorporation proposals. In view of the previous States decision approving the principle of incorporation, in preparing its terms of reference the Panel agreed not to revisit this. Site visits and briefings began in December. Given the need for the draft legislation not only to be approved by the States, but also to be passed by the Privy Council before it could come into effect, it quickly became apparent to members that allowing for a full review process to be completed from a standing start would make it difficult for Ports to meet their target date for incorporation to be in place by 1st July 2015.

### **Time pressure**

However, somewhat to the dismay of Panel members, the Council of Ministers pressed ahead and lodged the Draft Air and Sea Ports (Incorporation) (Jersey) Law 201- on 15th January 2015, for debate on 24th March. The Panel set about the task, whilst making it clear that it could not realistically expect to meet this deadline. A series of deferrals, first to 28th April, then 12th May, and finally to 2nd June suggest that it would have been more practical (and respectful of the role of Scrutiny) to have allowed an appropriate time-frame for Scrutiny to be carried out from the beginning, particularly as the date proposed for incorporation had been put back by 6 months on at least 2 previous occasions, without obvious ill-effect.

The need to co-operate with ever-shifting deadlines has resulted in the Panel presenting these comments, rather than a full Scrutiny Report on the proposals. The Panel is confident that with the help of its advisers it has carried out a thorough review, but preparing a full report would have required significantly more time. Transcripts, other evidence and the Panel’s terms of reference are all available from the Scrutiny website, [www.scrutiny.gov.je](http://www.scrutiny.gov.je).

### **Draft legislation**

During its review, the Panel and its advisers attended numerous briefings on all aspects of the proposals, including detailed discussion of the draft Law. Members believe that the objectives of Ports of Jersey Limited (POJL) have been clearly defined, and appropriate safeguards applied in the Law. However, the Panel did not carry out any technical legislative scrutiny. This is a complex piece of legislation, creating the company and making extensive changes to ensure that all necessary legal structures will still work once they are taken out of government. Detailed scrutiny of

the Law itself would have been a significant and specialised task and was not considered an appropriate use of the Panel's resources.

The Panel was assured that all necessary steps have been taken during the law drafting process to ensure that the draft Law will protect the States' interests in assets transferred to POJL, and that the operation of the new company will be subject to appropriate oversight, both by relevant Ministers and the Channel Islands Competition and Regulatory Authorities. The Panel's review has therefore primarily focused on important issues arising from other aspects of the incorporation process, which are discussed in more detail below.

### **Memorandum of Understanding**

Fundamental to the relationship between the Shareholder and the incorporated body (as represented by its Board of Directors) is the Memorandum of Understanding (MOU), which sets out the rights and responsibilities of both parties. The draft proposition before the Assembly is primarily concerned with the Law; however, the Panel considers that the MOU is an equally important document. The Panel was therefore surprised to find that the Memorandum of Understanding between Ports of Jersey Limited (POJL) and the Minister for Treasury and Resources, and the Memorandum and Articles of Association for POJL were not immediately available when requested. Although they were subsequently provided, it seems that these documents were still only in draft form when the Panel began its work. Subsequently it was found that many aspects of the MOU appeared little changed, or were identical to versions used for previous incorporations, notably that for Jersey Telecom. This caused members some concern, as the Comptroller and Auditor General's report on 'The States as Shareholder: Jersey Telecom' (R.109/2014, presented to the States on 24th July of that year) raised a number of criticisms and made recommendations for change which the Panel would have expected to see reflected in the POJL MOU.

The Panel met with the Comptroller and Auditor General to discuss her findings on Jersey Telecom, and also consulted its advisers regarding best practice elsewhere. Following detailed consideration of the Shareholder function, the Panel suggested a number of alterations to bring more clarity to the POJL MOU. These were discussed most recently at a meeting with the Minister for Treasury and Resources on 14th May. The Panel presented a paper to the Minister detailing a number of improvements to the latest draft of the MOU that it felt were essential. Topics covered included –

- the definition of materiality
- the role of the Ports Policy Group
- the appointment of directors
- the Strategic Business Plan and due diligence
- Corporate Social Responsibility and stewardship
- the presentation and transparency of accounts
- key performance indicators
- Important Management Decisions
- resources and support for the Shareholder function
- directors' remuneration and benchmarking.

The Panel also supplied the Minister with another paper suggesting draft amendments to the Memorandum and Articles of Association for consideration.

During the discussion, the Panel raised concerns about the amount of time individual directors can devote to serving on Boards, and particularly the ability of individuals to sit on a number of Boards at the same time, which could potentially result in an inappropriate concentration of influence in the hands of a small number of individuals. The Panel considers that this should be taken into account by the States and relevant bodies when selecting and appointing Board members for States-owned companies, both in this case and for future appointments.

Members believe that there is a strong case for additional guidelines to limit the number of directorships on States-owned companies that can be held by any individual at one time. Appointments would be expected to reflect ability and relevant experience, rather than reward reputation or past position. The Minister appeared to welcome the comments and indicated that he felt these matters should be followed up in a wider forum, while noting that there may be a limited number of suitably experienced individuals interested and available to take on such roles in a small island community.

A robust MOU is needed to protect the States' interests following incorporation, and the Panel was therefore pleased at the Minister's apparent willingness not only to accommodate the Panel's recommendations, but also to make the final MOU available to States Members before the debate on the current proposition.

The Panel was particularly pleased to hear that the Minister would be submitting a bid in the new Medium Term Financial Plan (MTFP) for additional resources to support the Shareholder function. The Panel believes that this will be crucial, as it was made clear in the Comptroller and Auditor General's report mentioned above that the current resources dedicated to this function are no longer adequate to manage the rapidly expanding number and complexity of States-owned incorporated bodies. Immense assets are now effectively being put into the hands of these bodies, yet currently the monitoring function is understood to be the responsibility of a single dedicated member of staff, an arrangement which can surely no longer be considered fit for purpose. An increased level of support for this function is clearly required.

### **The Panel's advisers and their report**

York Aviation, supported by MDS Transmodal for the harbours/marine aspects of the review, were engaged at very short notice by the Panel, owing to the time pressure noted above. The Panel asked them primarily to look at the business case and financial assumptions for incorporation, together with aspects of arrangements for States oversight and corporate governance. The Panel is grateful for their assistance, and considers that they fulfilled their task admirably, particularly in view of the time constraints. The full York Aviation report has been provided to States Members electronically as background and support for these comments, and is recommended to those who have an interest in the detail of financial assumptions and technical aspects of the Ports business case.

The benefits of expert advice for effective scrutiny were borne out when the Panel's advisers discovered some errors in the Financial Model underpinning the Case for Incorporation, despite this having been checked and validated previously by POJ's own consultants. While the errors were subsequently explained and put right, over the term of the plans they could have led to significant variations in the Financial Model.

Some of these problems arose during updates to earlier material, but it was still a concern to the Panel and its advisers that they were not picked up before being published. Some related to the ongoing Cargo Centre project, already approved and under construction. The Panel considers this as a useful reminder of the need for effective continuing oversight of financial decision-making and reporting for the incorporated body.

### **The Case for Incorporation**

An important early finding of the advisers, essential to a proper understanding of the POJ proposals, is that the Case for Incorporation document (including the Commercial Projects, which are relied upon in the Financial Model to turn a loss-making States organisation into a profitable entity under Incorporation) is essentially illustrative of what might be achieved under a more commercial culture to come. It is not a robust, detailed business plan, and has not been subjected to any rigorous scrutiny (internal or external).

Until replaced by a detailed, properly costed Strategic Business Plan, the Case for Incorporation is therefore a somewhat aspirational presentation of Ports of Jersey's ideal way forward, rather than a firm set of proposals that will be delivered in full by a certain date. The positive financial outcome presented in the Business Case Financial Model for the end of the plan in 2038 demonstrates the sort of financial recovery that POJ anticipate they will be able to achieve if they are given ownership of Ports' current assets, and the ability to manage their own finances on a commercial footing, outside the confines of the Financial Directions that apply to all States-run departments.

The Panel's adviser believes that projections for uplift in airline passenger levels by 300,000 per annum by 2038 seem potentially optimistic. However, this would apply whether or not incorporation took place (and could potentially be better managed by an incorporated POJ).

In terms of the robustness of the Financial Model, updating aeronautical revenue based on 2014 figures created a £27 million shortfall, although other items adjusted at the same time compensated for this, so the final position appears to indicate a £20 million improvement over the original Case for Incorporation. Again, this could potentially be even better managed by a more commercially-orientated, incorporated POJ, although to some extent this ability may be limited by decisions about regulation, which will be outside their control.

Some concerns over the actual revenues that can realistically be expected from the 9 'short-listed' Commercial Projects are exacerbated in the longer list seen by the Panel, which includes some distant possibilities and others involving significant costs – cruise-liner terminal, runway extension, new marina, etc.

However, as it makes no specific assumptions about the growth of non-aeronautical revenues (such as terminal retail and catering) other than growth in line with inflation, and makes no productivity assumptions in relation to operational expenditure (Opex) and assumes that this will also simply grow in line with inflation, the Financial Model may actually understate the income generating potential of the incorporated entity, and its ability to improve its overall financial performance.

Regarding the harbour, Ports' traffic forecasts in the 'likely case' in the Financial Model reflect relative stability in all sectors of port traffic, and no change in the number of ship arrivals (after adjustment to reflect recent changes in ferry services). This suggests there is no reason to expect any major shocks to port revenue because of market fluctuations during the period of the plan.

The extent of changes that appeared when the Financial Model was updated to 2014 shows how sensitive the model is, and highlights its vulnerability to changes in underlying assumptions which may be outside POJ control. The Panel's adviser does not believe that this concern is so great as to cast serious doubt on incorporation as the best way forward, but it puts an even greater emphasis on the need for careful appraisal of the business cases for every Commercial Project due to the risks to which the company (and ultimately the Shareholder) could be exposed, particularly if borrowing is involved. This should be a fundamental part of a robust Strategic Business Plan, subject to thorough scrutiny by the Board and Shareholder.

### **Commercial Projects**

As stated above, the Commercial Projects are the essential ingredient relied upon to 'turn around' what would otherwise be a profoundly negative long-term financial outlook for an unincorporated Ports of Jersey. However, as also indicated, at this stage these are not properly costed projects that are definitely going to happen. Rather, they are examples of commercial opportunities that POJ considers it may be able to follow up, either on their own, or as joint ventures with other parties.

The first list contains 9 Commercial Projects, which the Case for Incorporation maintains should be achievable in the early years of the plan to bring in £60 million of revenue. However, this caused the Panel some concern, as it includes at least one project that seems very questionable (the importation of Guernsey Waste) as well as some that appear relatively insignificant (such as the Atrium project).

The Panel considers that the Guernsey Waste project in particular must be considered doubtful, as its delivery depends on decisions outside not only POJ's control, but also that of the States. The Panel therefore asked why such an uncertain project was included in the first tranche underpinning the Case for Incorporation; the answer was that it formed part of the States' first Medium Term Financial Plan. This raises further questions about States-wide financial planning which are not relevant here.

Interestingly, some of the projects are already taking shape before incorporation, such as the new Cargo Centre mentioned above, already well advanced in construction. The Group Chief Executive Officer has indicated that lessons have been learned from this first commercial project.

The Panel accepts that there are likely to be ups and downs under incorporation, as with all business ventures. The Panel's adviser has described the plans at this stage as 'loose'; they present an optimistic (but not unreasonable) picture of returns that could be achieved if all goes well, but individual projects will require a much more detailed appraisal before they should receive the go-ahead.

During a public hearing on 22nd April, the Panel was told that La Folie area was cleared 'for imminent development' 10 years ago, and could therefore have been redeveloped and generating revenue for nearly a decade. This is a case of missed opportunity by the States that will hopefully not be repeated by a more commercially-

oriented, incorporated POJ. However, with the example of Port Galôts fresh in mind, the Panel strongly recommends that discussions with all relevant bodies (including the Planning Department) take place before any significant expenditure is incurred on new development plans.

### **Strategic Business Plan**

A detailed and fully costed Strategic Business Plan is required, which in the first iteration at least should be subject to appropriate and thorough due diligence, to ensure that Ports of Jersey (as a relatively inexperienced commercial entity) has solid foundations on which to build a sustainable future. How much scrutiny of future Strategic Business Plans is required could depend on how well the incorporated POJ performs in the first 3–5 years. In relation to the first SBP, the Panel was assured at the public hearing on 22nd April that this was in preparation. Members would have liked to see a finalised SBP before the States vote on the Ports of Jersey Incorporation, but accept that the details of the plan will need to be scrutinised thoroughly and subjected to independent due diligence to the satisfaction of the Minister for Treasury and Resources before it can be approved.

### **Staff**

The Panel followed up other aspects of the incorporation process in the Island. One of these was the position of staff as a result of the proposed changes. The Panel held a public hearing with the main unions representing POJ workers, JCSA/Prospect and Unite the Union, on 23rd March 2015. The full transcript is available on the Scrutiny website.

In discussions with the unions and POJ it was clear that no-one expects the incorporated POJ to offer a guaranteed ‘job for life’. Business demands will dictate if there is any need for changes in staffing (up or down), and normal employment rules would apply. The unions appear happy to accept this, so long as the process of incorporation itself does not result in any redundancies.

Changes post-incorporation would be expected to include initiatives involving productivity and efficiency; the Panel was told that this cultural shift has already begun with staff. Members were also assured that POJL will offer opportunities for employees to benefit from improved performance, although no details of any improved reward schemes have been seen.

However, following discussion at a public hearing on 22nd April 2015, the Group Chief Executive Officer agreed to offer staff transferring to POJL a one year guarantee of no detriment to employment terms and conditions, if the Panel requested it. The Panel considers that if POJ are confident of their ability to deliver the financial returns on which the plans are based, then they should be comfortable with offering this element of temporary security to reassure staff making the journey with them. The staff unions have been informed, although at the time of writing, the Panel has had no response to the offer.

The Panel notes Deputy G.P. Southern of St. Helier’s amendment to the proposition lodged on 12th May 2015, which calls for a 3 year window of opportunity for Ports staff to be redeployed into the Public Sector.

## **Clubs and associations**

The Panel also contacted clubs, associations and societies closely linked with POJ to obtain their views on incorporation. This led to a public hearing on 16th April 2015 with representatives of 8 of these groups.

The discussion revealed a rather mixed experience amongst clubs, with some apparently already paying rents at a commercial level, others on older agreements facing uplifts to rents, and a varying length of tenures. Discussions between POJ and some clubs had highlighted a way ahead whereby higher 'commercial' rents could be discounted in future to take into account benefits to the Public that either were already, or could in future, be delivered by the club, thus effectively preserving the status quo in terms of rent paid. Examples of such benefits could be the delivery of accredited training schemes, or enhancements to public safety standards. Elsewhere, POJ had acknowledged that clubs made a positive contribution to future business through introducing new generations to activities such as water sports that would continue to create customers for POJ services, so it was in their interests to continue to support them.

While there was some concern amongst clubs and associations that over time, POJ personnel and policies might change, leading to a less certain future, there seemed to be a general feeling that assurances received so far were broadly satisfactory, and indeed might lead to better things. The Panel would support a fair and consistent approach to all clubs and associations, which appears to be what Ports are aiming for, although they seem to have limited resources for dealing with the formal aspects of these matters, such as renewal of leases. The Group Chief Executive Officer admitted that they might be falling a little behind in this area.

The Panel has asked for recognition of the existing position of clubs, associations and societies to be included within the POJL MOU, and that any substantive change to the terms and conditions under which they occupy property, or carry out their activities should require Shareholder approval, to ensure that their interests are protected.

## **Public service obligations**

Public service obligations of POJL identified in the draft Law include requirements to maintain the Coastguard service and protect and maintain historic harbours. While broadly satisfied that these responsibilities have been appropriately acknowledged, the Panel would like to see more clarity over the nature of the commitment to maintaining historic harbours. For example, it would be useful to define the starting condition, whether the commitment is an agreement to ensure no detriment to the present state of historic harbours, or if it includes an obligation to address signs of a future need for maintenance or improvements, and who would pay for any such improvements. The Panel is of the opinion that overall it will be of benefit to the Island to transfer the responsibility for maintenance of the historic harbours to the incorporated body, due to their experience and expertise. However, members are aware of some concerns that should a major unforeseen incident, such as severe storm damage or structural failure occur in a historic harbour in future, depending on the circumstances POJL may still need to look to the States for some form of financial assistance.



## **Regulation**

The Panel also held a public hearing with the Chief Executive of the Channel Islands Competition and Regulatory Authorities (CICRA). This raised questions about what effect price control or capping might have on the operation of the Ports, depending on how this might be applied. The Panel was also made aware of a potential issue over CICRA's view of 'single till' operation, or how the regulator would respond to Ports' stated intention to subsidise airport operations from the running of the harbour. The meeting was ultimately somewhat inconclusive, on account of the fact that no actual decisions could be taken by the regulator prior to incorporation. It is assumed that Ports will already have taken steps to reassure themselves that CICRA will permit 'single till' operation, as otherwise this could prevent the cross-subsidy which will be vital to cost-effective operation of the incorporated body.

On the wider question of regulation, the Panel initially had some concerns about the role of the harbour master, who will retain overall authority and responsibility for the safety and smooth running of the harbour, including powers to direct and control use of the port facilities, whilst now becoming an employee of the commercially motivated POJL. The Panel queried whether this could potentially lead to some risk of a conflict of interests, and would have preferred a situation where the role of harbour master remained independent of the commercial entity. However, the Panel's advisers considered that there is adequate protection in law surrounding the duties of a harbour master to guard against a conflict of interests arising.

## **Findings and recommendations**

From their study of the Business Case and Financial Model for Incorporation, the Panel's advisers have confirmed that in their view, incorporation is on balance the best way forward for the Ports of Jersey. The Panel endorses that view, but would caution that the process needs to be approached with eyes wide open, as the results are not guaranteed. The following points are seen as particularly relevant –

1. The monopoly status of the Ports and their effective lifeline role in ensuring connectivity for passengers and freight between Jersey and the rest of the world places a special onus on the requirements for delivery. For this reason, incorporation needs to be accompanied by robust safeguards in terms of what the entity is empowered to do and the regulation of its activities.
2. The Panel has serious concerns over the level of resources currently available to the Minister for Treasury and Resources for the purposes of the Shareholder function. This has been stretched by successive incorporations and requires significant enhancement if the interests of the States are to be properly protected. It is understood the Treasury is submitting a bid for additional funding in the next MTFP to achieve this. The Panel considers this will be vital to enable the proper oversight of incorporated bodies.
3. The need to specify more objectives/conditions in the Memorandum of Understanding and/or the Memorandum and Articles of Association has been the subject of detailed discussion with the Minister for Treasury and Resources, and needs to be finalised before the debate.
4. Urgent assurance is needed that the Channel Islands Competition and Regulatory Authorities will permit 'single till' operation.

5. Consideration should be given to adding more specialist expertise in commercial airport management to the first Board of Directors.
6. The States should approve appointment of the first Board, including terms of office, etc. Subsequently, the Shareholder should formally agree the appointment of all directors, whether on a permanent or temporary basis.
7. More commercial expertise will also be required in senior management, particularly, but not solely, on the aviation side.
8. The Strategic Business Plan (SBP) will be a key document, and must contain detailed, properly costed project appraisals rather than high-level projections, or items taken from the MTFP without questioning their validity. Amongst other things, it should also include details of levels and types of borrowing anticipated. The SBP should be very clear about the risks and achievability of each project, and what contingency plans should be in place to overcome potential barriers to their realisation. The SBP should also take into account other responsibilities such as stewardship, Corporate Social Responsibility, environmental issues and Public Service Obligations.
9. The Shareholder should require the first SBP to be subjected to a high level of due diligence, to ensure that it does not contain errors that could undermine the 25 year plan from the outset. An effective framework should be established to ensure that further due diligence can be carried out on subsequent SBPs as required.
10. Internal processes for oversight and control of financial planning should be reviewed, and if necessary improved to ensure that they are robust.

## **Conclusion**

In the view of the Panel and its advisers, the financial position of the Ports of Jersey would almost certainly be significantly worse, and the same risks would still exist, if incorporation does not go ahead. The Panel recognises the importance of the flexibility that incorporation will bring to allow the Ports of Jersey to act with more agility and freedom in a commercial environment. However, it is also mindful of the need for this freedom to be balanced effectively with proper scrutiny and regulation, to protect the interests of customers and the Public of the Island.

Having taken into account all the evidence seen during its review, the Panel considers that changes agreed to the Memorandum of Understanding, improvements to the Shareholder function within the Treasury, and effective scrutiny of the Strategic Business Plan will be key to ensuring the success of the Ports of Jersey Incorporation. Subject to assurance that they will be delivered, the Panel supports the current proposition.