



Our ref: CC/CR

8 September 2011

Senator Alan Maclean  
EDD Minister  
c/o Liberation Place  
St Helier

Dear Alan

## **REQUEST FOR ADVICE: POTENTIAL FOR INCORPORATION**

Thank you for your letter of 24<sup>th</sup> March and the questions therein.

Following discussions with both Non Executive Directors and with the Executive, we are pleased to provide our preliminary advice on the questions you have raised. As you anticipated in your letter, these answers represent initial advice only, as the Shadow Board's investigations into several areas, such as the independent review of capital expenditure, are ongoing. However, in short, our firm belief is that incorporation of both the Harbours and the Airport will enable financial sustainability of these two trading operations.

As the issue of incorporation is relevant to several of the questions, I thought that it was worth defining what this meant. In essence, the Shadow Board sees it as the transfer of appropriate resources (e.g. physical assets, human resources and contractual rights and obligations) to an incorporated entity, presumed to be a Jersey limited liability company whose share capital is wholly-owned by a component of the States of Jersey (although other structures, such as a company limited by guarantee, might merit investigation, especially if they enhance access to capital markets), such that the company can effectively conduct the key elements of the businesses currently undertaken by Jersey Harbours and Jersey Airport.

The fundamental change arising as a consequence of incorporation is that the governance of the businesses becomes the responsibility of a Board of Directors whose conduct is governed by company law. Whilst the States of Jersey, as shareholder, can appoint and remove members of the Board of Directors, the extent of the States of Jersey's direct control over the businesses will reduce. Furthermore, the Board of Directors will have to take account of the interests of a range of stakeholders and, subject to any arrangements for public funding of non-commercial matters (e.g. the Coastguard) or guidance on, say, matters affecting Jersey's international relations, will have profit maximisation of the businesses as one of its key objectives.

I should emphasise at this point that the Shadow Board strongly supports the principle of incorporation as a way of improving the operating and financial performance of the Harbours and Airport, and to support long term sustainability.

Turning to the specific questions, I would answer as follows:

1. A 'going concern' is a business which is able to meet its liabilities as they fall due. This is an important test both for the Directors of that business, who may become personally liable for obligations incurred when knowingly trading whilst insolvent, and as a basis for drawing up accounts for the business. The 'going concern' basis of accounts preparation assumes the realisation of assets and settlement of liabilities in the normal course of business and attributes values and classifications accordingly. The alternative is to prepare accounts on a 'break-up' basis which can both materially reduce the value of assets and accelerate the payment of liabilities, thereby accentuating the problem. It is virtually impossible to incorporate a business which is not a going concern for the above reasons.

Based on recent projections it is clear that whilst Jersey Airport can reasonably expect to meet its immediate liabilities as they fall due, it is under-capitalised if it were allowed to continue on its current financial trajectory. This is evidenced both by the losses arising as a result of depreciation now being charged on GAAP compliant basis and the anticipated cash shortfall emerging as major assets have to be replaced. Whilst this cash shortfall is currently projected to be substantial, the current figures are very sensitive to the assumptions regarding the amount and timing of capital expenditure, which illustrates why the forthcoming independent review is so important. Notwithstanding the above, to the extent that the Shadow Board has the ability to exert control over the operations, particularly the staffing, there is scope for materially reducing any eventual cash deficit and we continue to support the Executive in reviewing the necessary changes to enable this to take place.

Consequently the Shadow Board believes that, given the opportunity to control the Airport, including the possibility of introducing some new revenue streams (e.g. "user pays" based charges) and undertaking property development, any residual financial burden on the States, could be reduced to a minimum. Nevertheless, it cannot be ruled out that some form of capital injection may be required.

Jersey Harbours, based on recent projections, is a going concern. However, whilst these projections make reasonable allowance for the obligations arising from the provision of the Coastguard service and the maintenance of the outlying heritage harbours, this latter responsibility could, in the exceptional circumstances of a major unexpected remediation project, jeopardise this.

2. To establish commercial sustainability, which is essentially the same as meeting the requirement of being a going concern, the Airport needs the realisation of the factors referred to in the previous section. The precise mix of revisions to capital expenditure, property development, revenue enhancement and operating expenditure reduction is difficult to define at this stage, but an injection of capital may well be necessary. The level of any capital injection will be minimised with commercial freedom to implement revenue enhancement and cost reduction programmes. The Shadow Board continues to work with the Airport Executive team to establish how any capital injection can be minimised through such commercial freedom.

With regard to the Harbours, the key action by the States of Jersey to maintain commercial sustainability is the clear definition of a Harbours Estate, which formalises the assumptions made in the financial projections about the ability to maintain operational capacity and develop marine leisure facilities.

It is the firm belief of the Shadow Board that, other things being equal, incorporation will be of net benefit to the businesses of the Harbours and Airport in delivering financial sustainability. Governance on a commercial basis by an appropriate Board of Directors will improve financial performance.

3. It is helpful to analyse some of the key steps to be achieved on a path to incorporation.

First and foremost is the need to win support amongst the main stakeholders, such as the States, the Unions who represent Harbours and Airport staff and the customers (both individuals and companies) who use the facilities. It is essential that there is a robust presentation of the case for incorporation and careful reassurance will need to be provided to counterparties to major commercial agreements such as France in relation to the Channel Islands Control Zone.

Secondly there will need to be negotiation of satisfactory treatment of the workforce transferred into the new company structure, including pension arrangements. The PECS Committee of Management would, we expect, insist (as it did with Jersey Telecom and Jersey Post) that the new entity or entities, as Admitted Bodies to the pension scheme, funded outstanding past service liabilities through a once off capital payment (which would, however, be offset by a corresponding reduction in the long-term States debt ditto, payment of which is linked to the overall cost of all 'States' salaries). It should be noted that this would be confined to the immediate restructuring and integration of the Jersey Airport and Jersey Harbours businesses.

Thirdly, the regulatory regime that will need to apply to the natural monopolies that the Harbours and Airport enjoy will need to be established to protect customer interests. In this regard the Shadow Board believes that, in early course, you should ask the Jersey Competition Regulatory Authority for a preliminary report on the approach that it would deem appropriate to apply to the Harbours and Airport.

If so directed, the Shadow Board would propose a Business Case for incorporation clearly identifying:

- Envisaged financial sustainability
- Costs and benefits of incorporation, including any remaining liabilities post integration of the business
- Viability of incorporating the two organisations together or separately
- Risk register identifying any social, economic or Island risks

4. There are numerous considerations to be developed and managed within a business case for incorporation. These will include:

a) On the basis of helpful precedents from the incorporation of Jersey Post and Jersey Telecom, a timely solution to the going concern issue and reasonable progress on the above key steps, the Shadow Board suggests the business case for incorporation could be delivered for the business plan debate in the spring of 2012, with implementation within the period of the next States. This estimate assumes that the model for incorporation and regulation includes a viable balance between the requirement of an incorporated entity to act commercially and the sometimes contradictory requirement to satisfy the obligation of the primary strategic transport assets to operate within States' procedures.

b) If we can satisfy our 'going concern' requirement, our current proposal would be to incorporate all operations of Jersey Airport and Jersey Harbours simultaneously into one structure in a single process and within the next States. Clearly law drafting time will need to be allocated in 2012 and 2013.

c) Where Jersey Airport and Jersey Harbours currently provide public services (e.g. Coastguard, historic harbours, medical flights and early morning mail flights) we must ensure this value to States of Jersey is reflected in the incorporation agreement.

d) Where Jersey Airport and Jersey Harbours currently administer businesses that provide depth, scale and potential for growth - it is imperative that the incorporated entity retains these businesses to ensure financial sustainability (e.g. Jersey Marinas).

I hope that these preliminary answers are helpful; the Shadow Board is available to meet with you and the Assistant Minister to progress towards making an announcement about incorporation. The Shadow Board believes it should adopt the lead responsibility for developing a high-level project plan that will represent a 'road map' to incorporation. This would include communication with bodies such as the JCRA, the States of Jersey Development Company and the Pensions Committee.

Overall, we believe the next step in the process should be that a Ministerial Decision is prepared instructing the Group Chief Executive, together with the Shadow Board, to:

1. Restructure the businesses into an integrated organisation to deliver immediate benefits and create the platform for incorporation
2. Prepare a Business Case for the incorporation of Jersey Harbours and Jersey Airport, reporting back in time for the next States Strategic Plan debate.
3. In the development of the Business Case, ensure a holistic plan is prepared, involving, for example, Human Resources, the States Employment Board, Law Draftsmen, Law Officers, States of Jersey Development Company, Treasury officials and the JCRA.

In the meantime we will continue to refine our analysis in order to provide further advice.

Yours sincerely



**CCG Clarke**

**Chairman, Harbours and Airport Shadow Board**