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BILLET D'ÉTAT

WEDNESDAY, 28th JANUARY, 2009

POLICY COUNCIL - SECURITY OF FUEL SUPPLIES AND
PURCHASE OF TANKSHIPS

B I L L E T D ' É T A T

TO THE MEMBERS OF THE STATES OF THE ISLAND OF GUERNSEY

I have the honour to inform you that a Meeting of the States of Deliberation will be held at **THE ROYAL COURT HOUSE**, on **WEDNESDAY**, the **28th JANUARY, 2009**, immediately after the meetings already convened for that day, to consider the item contained in this Billet d'État which has been submitted for debate.

G. R. ROWLAND
Bailiff and Presiding Officer

The Royal Court House
Guernsey
9 January 2009

POLICY COUNCIL

SECURITY OF FUEL SUPPLIES AND PURCHASE OF TANKSHIPS

1. Executive Summary

- 1.1 The success of the Bailiwick both as a community and as an economy depends on securing a continuous supply of petroleum based products whether in the form of petrol for cars, diesel for commercial transport, kerosene for heating our homes, offices and institutions or aviation fuel. Supplies of petroleum products are as essential as supplies of water or electricity and are likely to remain so for many years to come.
- 1.2 Since the inception of the new Assembly in May 2008 the Emergency Powers Authority and, subsequently, the full Policy Council, working in close co-operation with the Commerce and Employment Department, has had cause to review a number of issues surrounding the security of fuel supplies.
- 1.3 It is evident from this review that since the beginning of 2008 and until recently stocks of petroleum products held locally have been well below those levels considered prudent from a strategic viewpoint. Furthermore, the Island has been vulnerable to disruption to supply due to a combination of the following factors:
- The significant limitations placed on delivery of stocks by the tidal nature of St Sampson's Harbour;
 - Ever more stringent industry regulations that now require the use of special double-hulled tankships, which in a form suitable for St Sampson's harbour, are in extremely short supply;
 - The availability during 2008 of only one suitable vessel to serve the Islands;
 - Delays in the process of approving the vessel for use by one of the two importing oil companies;
 - The consequent reduction in the number of visits by the vessel;
 - The use of just one of the two storage depots available thereby reducing on-Island stocks;
 - Challenges to regular deliveries during the limited tidal windows at St Sampson's by weather, technical and operational problems; and
 - The decision in October by the owners of the two vessels capable of serving Guernsey to apply for bankruptcy protection and the decision by

the Administrator to place the tankships on the market.

- 1.4 This report sets out to advise States Members of:
1. The circumstances that have lead to these challenges;
 2. Plans to secure storage of strategic supplies of fuel oil for the Bailiwick in future;
 3. The sequence of events that have led to the decision by the Policy Council to ensure continuity of supply by taking action to acquire two tankships on the States behalf; and
 4. The need to review the current rules surrounding strategic issues of this nature.
- 1.5 Although this report touches on the supplies of Heavy Fuel Oil (HFO) for Guernsey Electricity the combination of importation by a different, specially constructed vessel and separate storage arrangements means that such supplies are not subject to the challenges outlined for petroleum products generally within this report. Similarly, Liquefied Petroleum Gas (LPG) is brought in on specially constructed vessels of which there are sufficient numbers of suitable ships within the fleet used by Guernsey Gas. Once again the importation of LPG is unaffected by the issues outlined in this report.

Note: For the purposes of this report the term ‘fuel oils’ and ‘petroleum products’ should be regarded as interchangeable.

2. Guernsey’s Fuel Supply Chain

- 2.1 In order to understand the context within which the issues raised in this report are set it is necessary to appreciate how petroleum products are delivered to, and distributed within the Islands.
- 2.2 Guernsey imports finished petroleum products onto the Island to meet local demand. These imports are sourced from two international oil companies – Total and Shell – largely from some of the nine refineries based around the UK and, in relation to some grades of fuel, from Rotterdam.
- 2.3 Imports are by means of specially constructed tankships that are not owned by the importing companies. The vessels are leased from the owners by a shipping intermediary James Fisher Everard (JFE) on the basis of a “bare boat” charter (details of this arrangement appear later in the report).
- 2.4 Fuel is imported to one of the two terminals either side of St Sampson’s harbour – Total at North Side and Rubis [formerly Shell] at South Side. In the past ExxonMobil (retailing as Esso) had a separate Depot but following recent

investment and upgrading by Total, ExxonMobil has closed its facility and now draws down supplies from Total.

- 2.5 There are three marketing companies that distribute petroleum products locally:
- Fuel Supplies Channel Islands (FSCI) is a wholly owned subsidiary company of Rubis with day-to-day operations run autonomously by their Jersey based Managing Director.
 - Total Channel Island (TCI) is a wholly owned subsidiary of Total Oil the French multi-national oil company. Their Director and General Manager who is also responsible for Jersey is based in Guernsey.
 - Guernsey Petroleum Distributors (GPD) is an independent company.
- 2.6 There are two separate tanker berths for receiving vessels to discharge, the more southerly one used to be Exxon, but now just Rubis, who acquired the FSCI business from Shell earlier in 2008. The northern berth is used by Total. In “normal circumstances” both terminals receive a cargo of product about once a fortnight making a total of around fifty voyages per year.
- 2.7 FSCI has storage for about eight million litres of petroleum products within their terminal while Total has some seven million litres of storage. Together this is less than the equivalent capacity to that of the single tank farm on Jersey but the critical mass of operation, throughput, turnover, and stock losses are much diluted on Guernsey.
- 2.8 Total have invested substantially over the past few years in the upgrading of their terminal. In particular, loading onto road tankers is now bottom loading (i.e. drawing down from the pipework at ground level) providing a safer environment for their workforce. The Rubis terminal still retains gantry loading, involving working at heights, albeit with safety devices. Most large terminals in the UK are exclusively bottom loading.
- 2.9 The three distributors all have their own offices and truck parking compounds, carry out their own marketing programmes and establish brand loyalty through a number of marketing strategies. All three companies market the same range of products without geographical or demographical limitations (except for aviation fuels which have FSCI as the sole supplier). Deliveries to customers and garages are made in four and six wheeler rigid tankers with articulated vehicles only used by Rubis to transport aviation products to the airport.
- 2.10 For completeness it is appropriate to mention the supply of heavy fuel oil (HFO) and gas oil for the generating plants run by Guernsey Electricity Limited (GEL).
- 2.11 These supplies are sourced from the Esso refinery at Fawley and reach the Island on board the *Jayne W* a 2,000-dwt tankship on long-term charter. This is a

special double hulled tankship designed for Guernsey's unique harbour (this issue is addressed later) and is able to supply an average parcel of 2,000 tons of HFO on each voyage.

- 2.12 The fuel companies export small quantities of fuel to Sark in special containers and similar arrangements apply to Alderney although some fuel is imported directly to that Island by tankship from the UK.
- 2.13 Firstly, it is important to put Guernsey's use of petroleum products in context. Typically, 125 million litres of fuel oils are imported annually, which is higher pro rata by population than the UK due to the greater use of fuel oil for electricity generation on Guernsey. Local consumption of petrol and diesel represents the equivalent throughput of about three large supermarket petrol stations of the type operated in the UK by either Tesco or Sainsbury. Consequently there is little scope for economies of scale within Guernsey's petroleum distribution network and as such Guernsey is unlikely to be considered an attractive market for the major oil companies, on either growth or investment grounds. Indeed, during 2008 Shell divested its Channel Islands operations and sold FSCI not to one of the other major international oil companies but to Rubis. This point is relevant in terms of the choice by the oil companies not to invest in tankships explored later in this report.
- 2.14 A critical element in the supply of fuel to any Island are the seaborne links which, in the case of the Bailiwick have unique characteristics. The following sections address the nature of tankships capable of serving the Islands and the consequence of having a tidal harbour and a drying berth as the only discharge point.

3. Tankships

- 3.1 Oil industry practice is such that tankships tend not to be owned by either the oil producers or oil distributors. Rather, vessels tend to be owned by separate companies who either operate these themselves or charter them on "bare boat" charters or "time" charters to specialist chartering and shipping companies, who take responsibility for transportation risk.
- 3.2 An exception to this standard industry practice is BP which owns three vessels – the *Border Heather*, *Border Tartan* and *Border Thistle* which they operate to supply the Highlands and Islands in Scotland, some of which face similar problems to Guernsey. Prior to 2008 JFE – the tankship charterers used by both Total and Shell for petroleum product imports into the Channel Islands – used the *Alacrity* and the *Agility* from their fleet to deliver fuel to Guernsey. Both ships had double bottomed hulls, but with single skinned sides and as such did not meet the industry standard requirements for petroleum tankships operating in EC waters.
- 3.3 Furthermore, all petroleum tankships must have major oil company approvals

before being accepted onto a charter to carry the company's petroleum products. As these two vessels did not meet new EC standards the oil companies were no longer able to use the *Alacrity* and *Agility*, which in any event were over twenty years old.

3.4 Consequently, JFE entered into time charter arrangements with Svithoid Tankers for two tankships the *Vedrey Tora* and *Vedrey Thor* constructed in Russia and operating under the Gibraltar flag.

3.5 These tankships were built specifically to comply with the unusual requirements of the Channel Islands trade and especially Guernsey. Therefore, these double-hulled ships have been built within the Length Overall (LOA) restriction of 80 metres, a draft of 5.5 metres and the ability to safely settle on the bed of St Sampson's Harbour at low tide. In this respect the St Sampson's drying berths are classified as NAABSA berths, i.e. 'Not Always Afloat But Safely Aground'.

4. Characteristics of St Sampson's Harbour

4.1 St Sampson's harbour is tidal and dries out at low tide. It has two berths for the discharge of fuel:

- Number one berth North serves the fuel storage facilities to the north, i.e. Total and GEL;
- Number 2 berth South serves the storage facilities to the south, i.e. Rubis (FSCI).

4.2 The northern and southern facilities (berths and storage) are completely separate. There is no pipework between them that would enable the transfer of fuel (e.g. discharge from north berth into either or both north and south storage facilities).

4.3 Vessels discharging fuel at St Sampson's have to be of a size that can be accommodated at the berths and of a construction that enables safe operation at a dried out berth. Vessels can only gain access to the berths when the tide is such that there is sufficient water below the keel. The height of tide required is determined by the draught of the vessel, which in turn is determined by the total weight of the vessel and its cargo.

4.4 As a direct result of these limitations there are approximately between 24 and 27 tidal windows per year during which vessels can enter the berths either fully or part loaded. The sloping harbour bed also places some restrictions on the operation of the vessels.

4.5 Jersey has a larger deep water berth that does not dry out and can accommodate not only the vessels that serve Guernsey but also larger vessels, albeit that there are some constraints on its use due to the strength of the tidal flows across the mouth of the berth.

- 4.6 The States of Guernsey first considered the option of developing St Sampson's harbour and constructing a deep-water berth in 1968 and such an option is a potential project for the future. However, the considerable capital cost combined with the time it would take to plan and develop such a facility means that it cannot be regarded as a solution to the immediate challenges addressed by this report.

5. Implications for Fuel Companies

- 5.1 Guernsey Harbours impose certain design criteria to tankships entering St Sampson's harbour. These include bow and stern thrusters, high angle rudder and bridge control of main engines.
- 5.2 Upon entering the harbour, the vessel has to manoeuvre across a strong tidal flow and onto the berth. Tankships are always brought in on a rising tide. On departure the ship needs to leave the harbour mouth bows-first, and therefore must complete a 180-degree turn within the harbour to avoid a stern-first exit with potentially serious consequences into strong tidal flows between St Sampson's and Herm. In this case the critical restriction is a 350 feet (107 metres) clearance between the harbour mouth piers and Abraham's Bosom.
- 5.3 As described earlier, for a number of years Guernsey was served by a number of vessels, primarily the *Alacrity* and the *Agility*. These vessels previously met the requirements of the harbour authorities and the fuel supply companies.
- 5.4 These vessels were of single hull construction which, although compliant with maritime regulations for the carriage of petroleum products, gave no protection against leakage in case of damage, were old and becoming inefficient. They were therefore withdrawn from use at the end of 2007 and sold into less demanding trade because they no longer met the oil companies vetting requirements. They were replaced by two double-hulled vessels, the *Vedrey Tora* and the *Vedrey Thor* that can carry six different grades of cargo in separate tanks.
- 5.5 Over the last two or three years ship owners and operators have optimised their fleets resulting in a gradual elimination of the smaller (1,000 to 2,000 dwt) tankships that were suitable for Channel Island trade. Furthermore, because there are very few NAABSA berths in European waters there is little demand for specialist tankships to serve them.
- 5.6 As a consequence of these trends JFE have advised that there are just seven vessels known to them around the world that could meet Guernsey's specific requirements. They include the *Vedrey Tora* and the *Vedrey Thor*, three vessels operated by BP in the Scottish Islands and two vessels based in South America one of which is twenty years old. (This list does not include the specialist vessels that import heavy fuel oil for electricity generation and Liquefied

Petroleum Gas).

- 5.7 The *Border Heather* had been made available to Guernsey during 2008 when for a variety of reasons fuel supplies were running low but it is heavily committed to BP serving the Scottish Islands and would only be available occasionally and in very exceptional circumstances. Furthermore, in bad weather the Masters of the *Border Tartan* and *Border Thistle* have refused to enter St Sampson's Harbour on the grounds that the risks were unacceptable. The *Jayne W* uses number 1 berth to supply GEL with heavy fuel oil. As this has to be heated and is carried in a specially constructed vessel this ship cannot practically and economically be used for other grades of fuel.

6. Summary

- 6.1 The unusual characteristics of St Sampson's tidal harbour impose significant constraints on the number of vessels capable of delivering petroleum products to Guernsey. Vessels which served in the past (the *Alacrity* and the *Agility*) are now no longer in service in EU waters as they are not compliant with international oil company standards. In anticipation of the withdrawal of these vessels the *Vedrey Tora* and *Vedrey Thor* were commissioned by Svithoid Tankers to supply the Channel Islands. There are only five other vessels known to exist worldwide that could satisfy the peculiar characteristics of discharging petroleum products in Guernsey.

7. Alternative Options

- 7.1 Conscious of the vulnerability of the Islands to disruption of supply due to the restricted availability of suitable tankships, during the course of the Summer the Emergency Powers Advisory Group (EPAG) – an officer led group that supports the Emergency Powers Authority (EPA) and undertakes emergency planning and related functions - assisted by the Harbourmaster, the Commerce and Employment oil industry consultant and others examined whether there were viable alternative options for importing fuel in the short to medium term. It came to the conclusion that other than certain limited measures in an extreme emergency and where special arrangements would be acceptable for a short period only – there was no practical alternative to the current importation of fuel oils by specially constructed tankships that could meet appropriate safety standards.

- 7.2 Some of the options reviewed include the following:

Ship-to-Ship Transfer

- 7.2.1 The Harbourmaster advised “*the principle and concept of Ship to Ship Transfer of Petroleum is long established in the industry and its routine covered by Industry Guidelines and standards, but, in practice such transfers take place, to or from much larger ships than those which come*

into St Sampson's harbour. In the case of delivery of fuels to St Sampson's the "mother ship" being too large to enter the harbour would be required to anchor at a safe location, where there is little current and protected from the weather in order to transfer cargo to a smaller vessel alongside, which would then shuttle to and from the harbour as required. These conditions are not readily available in Guernsey and although possible on an ad hoc basis (subject to calm weather, currents etc) the amounts deliverable in comparison to Guernsey's demand for White Oils (petrol and diesel) would make this impractical in all but the most dire circumstances".

Use of Barges

- 7.2.2 Again the Harbourmaster has advised that because all vessels discharging into St Sampson's harbour have to be capable of satisfying NAABSA berth requirements i.e. have to be capable of discharging their cargo while laying on the dried out berth; barges are generally not designed with this in mind. Furthermore, the towing of a barge into the harbour is also problematic and for these reasons delivery in this way other than in extremis is considered to be neither a practical nor a commercial option.

Improvements to St Sampson's Harbour

- 7.2.3 In order to provide for more conventional vessels to serve the Island i.e. those that are not constructed to sit on the bed of the harbour, and to increase the range of tidal windows within which visits could be made would require extensive improvements to the harbour to provide sumps in which discharging tankers could sit at low tides. This would also require the dredging of the approach channel and would require the removal of some 6,000 cubic metres of stone from the Crabbriere rock outside the harbour mouth. This is an extremely costly option and certainly one that could not be delivered in the foreseeable future and therefore does not present a short-term solution.
- 7.2.4 Clearly, the establishment of a deep water berth for fuels and then – at marginal cost – other bulk cargoes and freight such as cement and gas imports would significantly increase the number of occasions on which vessels could discharge and also allow the use of conventional tankships. However, once again and for obvious reasons this is a major capital project for which could not be achieved in the near future.

Other Options

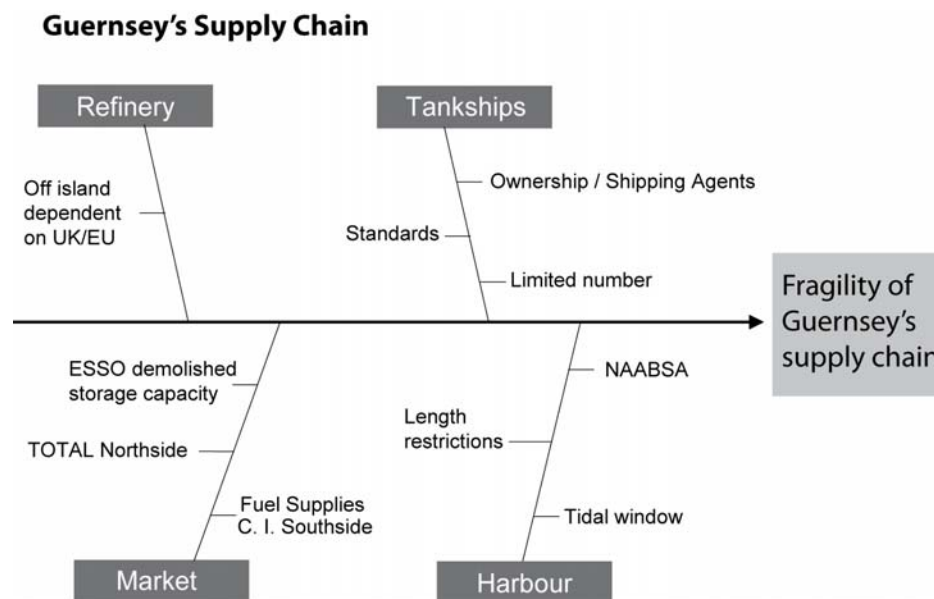
- 7.2.5 The use of St Peter Port harbour in its present form is also not a viable option as it is not configured for the discharge of flammable fuels and in any event the volume of oils discharged are such that it would be necessary to link the St Peter Port discharge point to the existing storage

terminals by inland pipeline - again a major capital project.

7.2.6 Finally, the importation of petroleum products by road tankers via the roll-on, roll-off ferries is not a viable option other than for limited grades of fuel such as kerosene in emergency situations. Setting aside Health and Safety considerations and the restrictions on the carriage of such cargoes in road tankers on these vessels, there is simply not the capacity to bring in the volume that the Island would need in this way.

8. Threats to Security of Supply

8.1 The potential weak points in Guernsey's fuel oil supply chain are summarised in the diagram below:



Developments during 2008

8.2 During the course of 2008, following the withdrawal of the *Alacrity* and the *Agility* from service a chain of events occurred which threatened the resilience of Guernsey's fuel supply chain.

8.3 Two new vessels had been ordered for construction that would be capable of supplying the Channel Islands and in particular discharging at St Sampson's Harbour. The *Vedrey Tora* was commissioned in 2007 but there were delays in the construction of its sister ship the *Vedrey Thor*, which was not delivered until April 2008. In anticipation of the replacement of the *Alacrity* and the *Agility* Shell and Total made arrangements for the two new vessels, to be inspected.

8.4 At the beginning of the year the *Vedrey Tora* was managed by V-Ships (part of the V Group, a company registered on the Isle of Man) and the *Vedrey Thor* by

Eskberge. At that time the vessels were operated by separate companies and were chartered by shipping agents on behalf of the fuel companies, as is industry practice. In accordance with standard oil industry practice, Total and Shell will only permit their cargos to be carried on vessels that have been positively vetted and which meet various requirements.

- 8.5 The *Vedrey Tora* was inspected and approved for use by Shell towards the end of 2007. The *Vedrey Tora* was also inspected by Total Activities Maritime (TAM) in November 2007 but at that time was not approved, primarily for operational reasons. TAM is the specialist company within the Total Group responsible for vetting vessels and storage terminals. As a result Total was unable to receive fuels to its depot on Northside and the stocks in its storage tanks were depleted over a series of weeks which meant that it was not able to replenish the terminal.
- 8.6 Consequently FSCI was the only oil company receiving supplies into the Island and agreed to assist Total, and additionally GPD, by supplying them petroleum products on a commercial basis. It was anticipated that these arrangements were on a short-term basis only, but the process undertaken by TAM to approve the *Vedrey Tora* did not conclude successfully until the Autumn of 2008.
- 8.7 When the States became aware of this situation in the spring of 2008 it immediately worked with the distributor companies to instigate a close monitoring system for shipping, supply, demand and remaining stocks. It also drew up contingency plans under Emergency Powers legislation, which, if necessary, would allow it to instigate a system for fuel rationing to ensure the essential services were kept supplied and to prevent panic buying.
- 8.8 Between January and October 2008, Total and GPD have been supplied by drawing the majority of their requirements from the Rubis terminal. Supplies of fuel in Guernsey ran low on occasions and informal demand calming measures were introduced by the distributor companies that prevented supplies running out completely. In the event the Island did not run out of fuel and consumers did not suffer inconvenience. In this respect, on one occasion supplies were made by the BP vessel *Border Heather* to alleviate a potential shortfall in the middle of June and it is only recently, following the approval of the *Vedrey Tora* by TAM, that Total's depot has now started to receive seaborne supplies again. On 4th December, Total informed the Commerce and Employment Department that stocks at Northside could now be considered fully restored.
- 8.9 Once the Commerce and Employment Department became aware of the problem it worked closely with the oil companies to manage the situation in the short term. Exposure to having only one vessel and in effect one depot on the Island supplying the market identified the need for a strategic solution in the medium term to ensure that Guernsey's resilience was not threatened in the future. Consequently the Department initiated a strategic assessment of the vulnerability of Guernsey to interruption of the supply of imported fuel and what immediate,

medium term and long term measures might need to be taken to mitigate or remove any such risks.

- 8.10 As a result of that review the Department started discussions with the oil companies to explore the introduction of minimum stock holding obligations in Guernsey.

9. The Concept of Minimum Stockholding Obligations

- 9.1 Recognising the critical part that petroleum products play in modern times and acknowledging that supplies of finished products can be subject to disruption the EU currently requires Member States to hold oil stocks of 90 days' worth of average daily national consumption based on the preceding year's figures. This is enshrined in Directive 2006/67/EC.

- 9.2 In addition, this requirement must also be met in each of three separate categories.

- (A) Motor spirit (petrol) and gasoline based aviation fuels (Avgas);
- (B) Gas and diesel oils, kerosene and kerosene based aviation fuels (Avtur); and
- (C) Fuel oils.

- 9.3 Member States, which are producers of oil, currently have a derogation that in the case of the UK is currently a 25% reduction in the stock holding requirements that reduces the UK obligation to 67.5 days worth of consumption. However, this derogation will decline over the next few years as UK North Sea crude oil production itself declines.

- 9.4 The European Commission has instigated an impact analysis on the reform and overhaul of the system and a formal consultation was launched earlier this year. The overall objective of the revision of the legislation is to strengthen further the current system for maintaining emergency stocks of oil.

- 9.5 While the stockholding obligations are uniform, the way in which Member States implement them is diverse i.e.:

- Some Member States have set up Government owned stocks or special agencies responsible for holding emergency stocks;
- Some Members rely entirely on stocks held by the oil companies;
- Others have opted for a mixed system; and
- In addition there are varying mechanisms for releasing capacity in times

of need.

- 9.6 Currently eight Member States rely entirely on mandatory industry stocks while for other Members all or part of the emergency stocks are held directly by the Government or an agency.
- 9.7 Furthermore, emergency oil stocks can be held on the territory of another Member State provided a bi-lateral inter-Governmental agreement exists between the Member States. There are currently about 40 bi-lateral agreements in force, with another ten or so under consideration. However, seven Member States have refrained from concluding such agreements and some of these expressly prescribe that all stocks are located on the national territory.
- 9.8 While most stocks are held in physical form, some emergency stock cover is provided by companies buying stock cover in “ticket” format. Such stocks are physically stored by another party but the holder of the “ticket” has an option to buy the stock in a crisis situation at an agreed price. “Ticket” agreements are usually concluded for a short period and this methodology is particularly adopted on cost grounds. In practice it is not always assured that all these stocks will be available as foreseen and can be adequately released in the event of a disruption. Public and commercial interests may not always coincide and may even become contradictory. In a rising market companies may hold onto stocks instead of alleviating the shortage by releasing them.
- 9.9 The EU proposed objectives also include introducing an improved effectiveness of stock system to ensure all of the key oil products are available in an emergency and moving away from the current system of aggregated product categories in order to improve transparency and to move closer to the approach favoured by the International Energy Authority (IEA).

Minimum Stockholding Obligations for Guernsey

- 9.10 Against the background set out above the Commerce and Employment Department has given consideration to the need to introduce arrangements to ensure that there are always sufficient stocks of fuel on the Island to cope with disruption in the supply chain. In this respect it has paid particular regard to the mandatory Compulsory Stockholding Obligations in other territories.
- 9.11 Currently, the concepts of either compulsory or minimum stock holding obligations do not apply in the Bailiwick. Indeed, in the past the States has not sought to intervene in this area given that oil supplies appeared to be plentiful, a larger tankship fleet than is currently available was able to serve St Sampson’s harbour and there was no evidence of a strategic threat. However, it is abundantly clear for the reasons set out in this report that a combination of:

- the peculiar circumstances that Guernsey finds itself in;

- global threats to disruption of supplies; and
- the knowledge that the local importing companies are driven by their commercial interests rather than any strategic obligation to the Island

has led both the Policy Council and the Commerce and Employment Department to the conclusion that some form of stockholding obligation for Guernsey should be adopted.

- 9.12 If all the primary storage on Guernsey were to be completely full then some 97 days of stock would be held. However, this is impossible to achieve on operational safety grounds, and in any event the overall picture is distorted by the large amount of heavy fuel oil storage owned by Guernsey Electricity. If HFO is excluded, then with all storage tanks completely full, there would be the equivalent of 57 days of stock.
- 9.13 The Commerce and Employment Department is in the process of engaging directly with the fuel companies and with the benefit of specialist advice, is seeking to establish the most appropriate strategic stockholding obligations for the Island and determine how this might be achieved.
- 9.14 It will be seeking to enter into a voluntary agreement with the local fuel companies as an immediate short-term measure but will give consideration to the merits or otherwise of Compulsory Stockholding Obligations supported by legislation. Other issues such as the current physical storage capacity on Island will also have to be evaluated.
- 9.15 It is proposed that the Commerce and Employment Department report back to the States on this matter together with appropriate recommendations no later than the January 2010 States Meeting.

10. Svithoid Tankships enters Administration

- 10.1 In early October 2008 Svithoid Tankers, the owners of the *Vedrey Tora* and *Vedrey Thor* announced that it was in talks to secure financing so that it could continue its operations. The group said that as a result of its immediate liquidity shortage, the company presently lacked the ability to perform under its undertakings. As a result the company was involved in negotiations with its creditors, bond holders, convertible bond holders and shareholders with the aim of finding a long term solution in order to secure the company's financing and the continued operations of the business.
- 10.2 Svithoid Tankers runs a fleet of 11 vessels and it has been reported in the trade press that the company was struggling to find a solution to both short and long term financing issues and with four new vessels under construction in Russia, as part of their fleet expansion programme, lengthy delays in deliveries had added to their problems.

- 10.3 On October 14th Svithoid Tankers reported that it had applied for bankruptcy protection and on the following day an Administrator was appointed. Svithoid announced that the Stockholm District Court granted an application of Svithoid Tankers AB for bankruptcy protection, and had appointed lawyer Einar Wanhainen at legal firm G Gronberg Advokatbyra to be the Administrator.
- 10.4 The States were unaware of these developments until the Commerce and Employment Department was informed of this event on 11th November by Total's Guernsey Director and General Manager. Immediately this information was obtained an EPAG meeting was convened at which it was established that the two ships capable and available of delivering petroleum supplies to Guernsey were now on the market by an Administrator who was anxious to sell. From contact made with JFE there appeared to be interested buyers.
- 10.5 Contact with JFE had also reinforced the fact that the local distributors followed the industry standard business risk management strategy whereby they did not seek to own vessels and therefore there was little expectation they would bid for them notwithstanding the fact that their lack of availability would cause considerable problems for local supplies. Against this background EPAG recommended the convening of a special EPA meeting which duly took place.
- 10.6 When the EPA (expanded to include the remaining Members of the Policy Council) was briefed on the developing situation it was able to set the current circumstances in the context of the challenges to the supply of fuel that had taken place over the previous seven months. As a result of its engagement on that issue it was fully aware that:
- The *Vedrey Tora* and the *Vedrey Thor* were the only vessels available to serve the Island.
 - There were no immediate, practical alternatives to using such vessels.
 - It was highly unlikely that either or both of the local oil companies would seek to address this issue.
 - On the advice of JFE who provided an initial estimate of the market value of these vessels it was clear that in all likelihood they could be acquired for substantially less than the cost of commissioning and building replacement vessels.
 - In any event it could take up to two years to commission and take delivery of new vessels.
- 10.7 It was also advised that the Administrator was seeking bids for the vessels and had already rejected a serious bid for the *Vedrey Tora*.

- 10.8 The Policy Council decided that in order to secure continued essential supplies of fuel oil to the Bailiwick it was in the States best interests to seek to acquire the ownership of these vessels. It therefore instituted a process whereby, using JFE as an intermediary and engaging specialist maritime lawyers from the Norton Rose Group¹, a bid for the vessel was placed with the Administrator.
- 10.9 During the course of a number of meetings on this issue, some specially convened for the purpose, the Policy Council was advised by Richard Burmeister, the MD of JFE (who visited the Island), by St James Chambers and by James Milne, the oil industry consultant retained by the Commerce and Employment Department. A conscious decision was made in the initial stages not to reveal that the States was an interested party as in the Policy Council's judgement and that of its advisers to do so could well have increased the price at which the vessels could be obtained.
- 10.10 Consideration was given to purchasing just one of the vessels, the *Tora*, as it was known that the sister ship the *Thor* required remedial work on the ballast tanks which were not properly coated against corrosion when the vessel was constructed. However, the Policy Council decided that the Island's strategic needs were best served by the acquisition of the two vessels, given the fact that sooner or later the *Tora* would need to be taken out of service for regular maintenance or could break down or be unable to deliver for other operational reasons. In due course when the *Thor* had been repaired it was intended to arrange the charters in such a way as it could act as a second vessel on the service if required but in the meantime could provide an income stream for the States as owners.
- 10.11 While the States would acquire the vessels the intention was, and indeed it has been agreed, that JFE would "bare boat" charter both vessels from the States of Guernsey. A bare boat charter means the owner (in this case the States of Guernsey) delivers the vessel to the charterer (i.e. JFE), with no crew, stores, moveable equipment etc. The owner then charges a daily bare boat rate that covers their capital and gives an appropriate return. All of the operating costs for the vessel are then picked up by the charterer. These include crewing, wear and tear, stores, insurance, dry-docking and refit costs, port costs and bunker costs depending on usage. JFE would be able to take over the bare boat charter for the *Vedrey Tora* at the earliest opportunity and use it within its existing fleet however it did not have any immediate planned need for the *Vedrey Thor* until October 2010 unless it was able to withdraw from an existing bare boat charter in respect of one of its older vessels. JFE are working towards achieving this but in the meantime the States of Guernsey will receive a bare boat chartering income for the *Vedrey Tora* and if not immediately from the *Vedrey Thor*, then that will commence in October 2010. In the interim the *Vedrey Thor* will earn

¹ The Norton Rose Group is a leading international legal practice. It offers a full business law service from offices across Europe, the Middle East and Asia. Its focus and key areas of expertise are in corporate finance; financial institutions; energy and infrastructure; transport; and technology

income through spot rates or time charters until the bare boat charter with JFE commences.

- 10.12 The Policy Council was presented with an initial business case based on the available information which demonstrated that over a twenty-year time horizon and using a cost of capital of 5% the purchase of both vessels could result in a positive return for the States. While this was regarded as a bonus, and the basis of a sound commercial venture, nevertheless the overriding reasons for the purchase remain strategic.
- 10.13 The Policy Council unanimously authorised the Chief Minister to lead negotiations on the States behalf with the discretion to either conclude the deal or refer back to the Policy Council as necessary.
- 10.14 Following negotiations the Administrator accepted an offer of €16.9m on 18 December 2008, a bid that took into account the cost of refurbishing the ballast tanks of the *Vedrey Thor*. In this respect the specialist advisers indicated that it was unlikely that it would be possible to persuade the Russian shipyard, which built the vessel to make good the deficient work themselves or to recover the cost from them. The bid was subject to completion of satisfactory surveys and due diligence.
- 10.15 Norton Rose negotiated and assisted in agreeing the Memorandum of Agreement with the Swedish Administrator and drafted the necessary corporate authorisations of the Buyer for the purchase and advised on Swedish bankruptcy protection arrangements.
- 10.16 The Policy Council also commissioned specialists London Offshore Consultants (LOC) to carry out pre-purchase condition surveys on the two vessels.
- 10.17 A Guernsey company, Jamesco 750 Limited was incorporated on 30th October (No 49631) as a general-purpose vehicle initially with a single nominee director. The Treasury and Resources Department is the sole shareholder with two shares in the company. The Treasury and Resources Department will be nominating Board Directors for the Company in due course and these will be appointed contemporaneously with, or before, the completion of the purchase of the vessels. The Company has received a commercial loan from the Treasury and Resources Department to fund the purchase of the vessels and meet associated costs.

11. Reviewing the Rules Governing Strategic Purchases

- 11.1 It has become clear during this process that the rules drawn up to allow States Departments in conjunction with the Treasury and Resources Department to make purchases which are in the strategic interest of the Island did not envisage the circumstances explained in this report.

- 11.2 The Treasury and Resources Department is able to agree to purchase land and property without immediate reference to the States where it is considered to be in the Island's strategic interests to do so and the relevant Department has the necessary capital funds available. By way of example the recent purchase of land surrounding the Airport to provide for runway improvements falls into this category. However, the rules do not immediately provide for purchases of assets such as tankships because they are neither buildings nor land.
- 11.3 In the fast moving scenario that developed from the middle of November 2008 when the States was first alerted to Svithoid applying for bankruptcy protection, reliance on following the "established procedure" carried a high risk of failing to secure a critical part of the fuel oil infrastructure on which the Bailiwick depends. To have prepared a report for the States (even on an emergency basis) and then held a debate, which would have been reported by the media and then, subject to States approval, entered into a negotiation for these vessels, would have had a number of potential consequences. Given the existence of a number of competing parties for the vessels and the desire of the Administrator to act swiftly, decisions needed to be made in days and in some cases hours rather than weeks. Furthermore, revealing the States hand and thereby alerting the Administrator to the strategic value of the vessels to the Island would have impacted on the price to the detriment of the States. Public exposure of the States interest would also have alerted other parties, which could have affected their bidding behaviour. Concerns such as these were the reason for the rules concerning land and property purchases outlined above.
- 11.4 The Policy Council, working through the EPA could not rely on the legislation that enables an "emergency" to be declared and thereafter exceptional steps to be taken - because the Law is drawn up in such a way as to focus on the response to an obvious (and largely physical) emergency or incident rather than providing powers permitting the taking of pre-emptive action to avoid a situation that might arise in future.
- 11.5 Given the absence of any practical alternative and the timescale for commissioning and building new replacement vessels the Policy Council, Commerce and Employment Department and Treasury and Resources Department agreed that, regardless of States procedures, to have failed to initiate the action would be grossly irresponsible and a failure in the States duty to this community.
- 11.6 The Policy Council therefore fully acknowledges that it has taken steps to acquire these assets on behalf of the States in a manner that is not covered by the existing rules but in all the circumstances;
- seeks endorsement of its actions by the States; and
 - seeks agreement that these rules should be reviewed.

- 11.7 To this end it is proposing that the Treasury and Resources Department should review the existing financial rules in the light of this experience. It is also recommending that the States Assembly and Constitution Committee, in consultation with the Policy Council and other Departments should review the rules relating to the constitution and operation of States Departments and Committees to address unplanned or unforeseen circumstances which require immediate action.

12. Consultation

- 12.1 Given the speed with which this issue has moved, particularly the purchase of the tankships and given the need for absolute confidentiality, conscious efforts have been made to reduce the number of informed individuals, whether Politicians or staff, involved in this process. Therefore, the depth of consultation that would normally take place has been more restricted. However, through the EPAG the Policy Council had access to a number of specialists including James Fisher Everard, Commerce and Employment's retained oil industry consultant, the Norton Rose Group, 'London Offshore Consultants' (LOC), shipping valuers, commercial contracts expertise within St James Chambers and the Harbourmaster (who has extensive experience in the oil shipping business). Furthermore, the Policy Council has taken the unusual step of ensuring that all Members of the Policy Council took an oath of secrecy under the Emergency Powers legislation to enable the full Council to address the issue.
- 12.2 There has been extensive consultation and close working with the Commerce and Employment Department whose mandate extends to strategic supplies to the Island and more recently with the Treasury and Resources Department. Alderney and Sark have been made aware of the recent purchases.
- 12.3 The Law Officers have been fully consulted and their assistance in the process of acquiring the vessels and in particular the management of specialist legal advisers has been greatly appreciated.

13. Resource Implications

- 13.1 As has been explained by entering into a "bare boat" charter with JFE there will be no day to day operational responsibilities for the States of Guernsey and therefore beyond the creation of a company, which will operate on commercial lines and of which the Treasury and Resources Department will be shareholders, there will be no need for additional staff resources for the States.
- 13.2 Monitoring of fuel supplies and continued engagement with the oil companies on strategic issues will be undertaken by existing staff of the Commerce and Employment Department.

14. Conclusion

14.1 The events of the last year have exposed the current vulnerability of the Bailiwick in respect of imports of essential fuel oils for the reasons outlined in this Report.

14.2 The resulting evaluation of the fuel supply chain has led Policy Council and the Commerce and Employment Department to the conclusion that: -

1. The States needs to take a greater role in the monitoring of fuel supplies on the Island and the operational arrangements for its importation.
2. There is a need to introduce some form of stock holding obligation whether by agreement with the importing companies or by means of legislation.
3. The peculiar nature of St Sampson's tidal harbour, Guernsey's only fuel oil discharge point means only seven ships worldwide have been identified as being capable of delivering fuel oils in this manner and only two are currently available.
4. When the owners of these two vessels were put into administration in October 2008 the subsequent offer on the shipping market represented a serious threat to the Bailiwick in that the vessels could well have been sold to other parties who would relocate them elsewhere in the world. There would be no immediate alternative practical means of importing fuel to the Island on any scale.
5. It was necessary for the States to take action to safeguard the long-term interests of the Bailiwick by purchasing the two available vessels.
6. In taking this action, the Policy Council and the other Departments involved have been forced by circumstances to act outside of the rules governing these matters and this indicates that those rules need to be the subject of urgent revision.

15. Recommendation

15.1 The States, having considered this Report, is recommended:-

1. To direct the Commerce and Employment Department in consultation with local oil importers and distributors to establish agreement on a voluntary minimum stockholding of petroleum products and then to examine the case for Compulsory Stockholding Obligations supported by legislation if deemed necessary and report back to the States no later than January 2010.

2. To approve the decision by the Policy Council to secure the supply of fuel oils to the Bailiwick through the purchase of the tank ships *Vedrey Tora* and *Vedrey Thor* in the manner set out in this Report.
3. To approve the actions of the Treasury and Resources Department on behalf of the States in issuing a loan and to authorise that Department to enter into any commercial guarantees or underwriting arrangements that it may consider appropriate in respect of these vessels.
4. To direct the Treasury and Resources Department to review the existing financial rules to address unplanned or unforeseen circumstances which require immediate action and to recommend changes as appropriate.
5. To direct the States Assembly and Constitution Committee in consultation with the Policy Council and other Departments to review the rules governing the constitution and operation of States Departments and Committees (and their respective mandates) to address unplanned or unforeseen circumstances which require immediate action and to recommend changes as appropriate.

L S Trott
Chief Minister

24th December 2008

(NB The Treasury and Resources Department supports the proposals.)

The States are asked to decide:-

Whether, after consideration of the Report dated 24th December, 2008, of the Policy Council, they are of the opinion:-

1. To direct the Commerce and Employment Department in consultation with local oil importers and distributors to establish agreement on a voluntary minimum stockholding of petroleum products and then to examine the case for Compulsory Stockholding Obligations supported by legislation if deemed necessary and report back to the States no later than January 2010.
2. To approve the decision by the Policy Council to secure the supply of fuel oils to the Bailiwick through the purchase of the tank ships *Vedrey Tora* and *Vedrey Thor* in the manner set out in that Report.
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IN THE STATES OF THE ISLAND OF GUERNSEY ON THE 29th DAY OF JANUARY, 2009

The States resolved as follows concerning Billet d'État No IV
dated 9th January 2009

POLICY COUNCIL

SECURITY OF FUEL SUPPLIES AND PURCHASE OF TANKSHIPS

After consideration of the Report dated 24th December, 2008, of the Policy Council: -

1. To direct the Commerce and Employment Department in consultation with local oil importers and distributors to establish agreement on a voluntary minimum stockholding of petroleum products and then to examine the case for Compulsory Stockholding Obligations supported by legislation if deemed necessary and report back to the States no later than January 2010.
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K H TOUGH
HER MAJESTY'S GREFFIER