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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 SEPTEMBER, 2011** at 9.30am, to consider the items contained in this Billet d'État which have been submitted for debate.

G. R. ROWLAND
Bailiff and Presiding Officer

The Royal Court House
Guernsey
19 August 2011

PROJET DE LOI

entitled

THE CUSTOMS AND EXCISE (GENERAL PROVISIONS) (BAILIWICK OF GUERNSEY) (AMENDMENT) LAW, 2011

The States are asked to decide:-

I .- Whether they are of the opinion to approve the Projet de Loi entitled "The Customs and Excise (General Provisions) (Bailiwick of Guernsey) (Amendment) Law, 2011" and to authorise the Bailiff to present a most humble petition to Her Majesty in Council praying for Her Royal Sanction thereto.

PROJET DE LOI

entitled

THE CRIMINAL JUSTICE (MINIMUM TERMS FOR SENTENCES OF LIFE IMPRISONMENT) (BAILIWICK OF GUERNSEY) LAW, 2011

The States are asked to decide:-

II.- Whether they are of the opinion to approve the Projet de Loi entitled "The Criminal Justice (Minimum Terms for Sentences of Life Imprisonment) (Bailiwick of Guernsey) Law, 2011" and to authorise the Bailiff to present a most humble petition to Her Majesty in Council praying for Her Royal Sanction thereto.

THE INCOME TAX (GUERNSEY) (APPROVAL OF AGREEMENTS WITH INDONESIA AND MEXICO) ORDINANCE, 2011

The States are asked to decide:-

III. - Whether they are of the opinion to approve the draft Ordinance entitled "The Income Tax (Guernsey) (Approval of Agreements with Indonesia and Mexico) Ordinance, 2011" and to direct that the same shall have effect as an Ordinance of the States.

THE MISUSE OF DRUGS (BAILIWICK OF GUERNSEY) LAW, 1974 (AMENDMENT) ORDINANCE, 2011

The States are asked to decide:-

IV. - Whether they are of the opinion to approve the draft Ordinance entitled "The Misuse of Drugs (Bailiwick of Guernsey) Law, 1974 (Amendment) Ordinance, 2011" and to direct that the same shall have effect as an Ordinance of the States.

THE LAND PLANNING AND DEVELOPMENT (PLANNING COVENANTS) ORDINANCE, 2011

The States are asked to decide:-

V. - Whether they are of the opinion to approve the draft Ordinance entitled "The Land Planning and Development (Planning Covenants) Ordinance, 2011" and to direct that the same shall have effect as an Ordinance of the States.

THE DOG TAX (AMENDMENT) (GUERNSEY) ORDINANCE, 2011

VI. - Whether they are of the opinion to approve the draft Ordinance entitled "The Dog Tax (Amendment) (Guernsey) Ordinance, 2011" and to direct that the same shall have effect as an Ordinance of the States.

THE PAROCHIAL TAXATION (RESERVE FUNDS) (AMENDMENT) ORDINANCE, 2011

VII. - Whether they are of the opinion to approve the draft Ordinance entitled "The Parochial Taxation (Reserve Funds) (Amendment) Ordinance, 2011" and to direct that the same shall have effect as an Ordinance of the States.

POLICY COUNCIL

FINANCIAL TRANSFORMATION PROGRAMME – REVIEW OF COLLEGES GRANT AID AND SUBSIDIES

1. Executive Summary

1.1 This report arises from the States Financial Transformation Programme (FTP). Its purpose is to identify and recommend the size of any reduction in revenue grants and subsidies provided by the States to the three Colleges (Elizabeth College, The Ladies' College and Blanchelande College) when the current seven year grant agreement expires in August 2012. It is not a report on secondary education policy.

1.2 Following a detailed examination of the current level of the grant and subsidies in the context of each of the Colleges, the FTP developed a number of options for future grant aid ranging from a continuation of the status quo to complete abolition, with several variants between these two extremes.

1.3 The Policy Council has considered the results of this work, and is recommending a preferred solution to the States. The Council has undertaken formal consultation with the Treasury & Resources and Education Departments, as well as the Board of Governors of each of the three Colleges. **Very significantly all of these bodies endorse and support this report's recommendations. Letters from each body are appended.**

1.4 This report recommends that upon expiry of the current seven year agreement of Grant Aid to the Colleges in August 2012, a new seven year agreement is put in place whereby the Colleges continue to receive grant aid in two forms. Firstly full fees payment for the same agreed numbers of Special Place Holders at each of the Colleges (23 annually at each of Elizabeth College and The Ladies' College, and up to six annually at Blanchelande College), and secondly a General Grant paid on a per capita basis to each College to help cover running costs and contribute towards capital costs at the Colleges.

1.5 The current grant (2011 values) is £4.88 million, which is made up roughly equally between the General Grant and the costs of the Special Place Holder fees. The combined grant represents a large proportion of the income of the Colleges ranging from 55% at The Ladies' College, to 46% at Elizabeth College and 42% at Blanchelande College.

1.6 It is recommended that the size of the combined grant be reduced incrementally over the seven years to result in a net saving to the States budget (at 2011 values) of £1.11 million. The year by year reductions are shown in the report. While all figures in this report are shown for clarity and simplicity without inflation, an inflation uplift linked to RPIX will be applied annually to the General and Special Place Holder Grants and the net saving to the States budget.

While the figures shown in this report relate to 2011, the base year for calculations will move to 2012 to coincide with the expiry of the current agreement and the commencement of a new one.

1.7 The Policy Council is mindful of the fact that the Colleges are an established part of the Island's education system, which have a long history of support from the States. The funding proposals in this report have therefore been developed so as not to expose the Colleges to high risks of damaging their economic or academic viability and sustainability. Similar thought has also been given to ensure that a reduction in the States grant aid to the Colleges can be achieved without demonstrable detriment to the Island's education system or a net increase in its overall cost to the States.

1.8 This work stream was identified by the original FTP as a saving under the Education Department budget. However, as the Policy Council is responsible and accountable for policy proposals contained within the FTP, the Department's contribution to the Report has been limited only to representation on the States Working Party, although the Education Board has kindly provided the Review with as much staff assistance as has been requested.

2. Introduction

2.1 This report arises from the **States Fundamental Spending Review**, not from a review of education policy. The driver behind this work is therefore identifying and recommending to the States the maximum potential savings to the States budget without compromising the integrity of the States primary and secondary schools infrastructure or resulting in overall increased costs to the States education sector, while also being careful not to expose the three Colleges (Elizabeth College, The Ladies' College and Blanchelande College) to unacceptable risks in relation to their economic or academic viability.

2.2 The Fundamental Spending Review identified two options to reduce States expenditure on the Colleges. The first was to reduce/cease subsidies paid to the Colleges (known as the General Grant), while the second was to reduce the number of special places at the Colleges, which are funded by the States (the Special Place Holder (SPH) fees).

2.3 Although the two projects cover two distinct elements of money from the States, they were combined for the purposes of the Financial Transformation Programme (FTP) to enable a single recommendation to be put forward for a new grant aid settlement for the Colleges to take effect from September 2012, when the existing seven year agreement expires.

2.4 This report sets out the background to the project, and contains a summary of the options examined for changing the grant aid to the Colleges from September 2012. It also contains the recommendations of the Policy Council, which are

supported by the Education Department, the Treasury & Resources Department and the Boards of Governors of the three Colleges.

3. Methodology and Activities

3.1 This FTP work stream commenced in May 2010 with an initial meeting between representatives of the Colleges and the States. A project plan was developed, key stakeholders identified and data collection began in July and August 2010, while the impact analysis got underway, alongside a value for money assessment, in the autumn of that year.

3.2 By the end of 2010 the options were being defined and stakeholder meetings were underway. This continued with further stakeholder engagement and more detailed analysis and data verification early in 2011. The Full Business Case for the Review was prepared and finalised in March/April 2011, and it was submitted to the Transformation Executive in April. This is in line with the States agreed procedures for dealing with the Financial Transformation Programme.

3.3 The business case was developed with stakeholder input from all three Colleges and the States, with all parties being involved in the assessment of options. However, while taking on board comments from both the Colleges Working Party (comprising the Principals and one member of each of the three College Boards) and a States Working Party (comprising the Minister, Education Department and Deputy M Dorey as the other Policy Council representative assisted by staff from the Education Department), it is the Policy Council that is submitting these proposals to the States for consideration. The States will therefore debate this matter and take the final decisions.

4. The Context

4.1 The Grant Aid given by the States to the Colleges each year comprises two parts:-

a) A General Grant paid per capita for each pupil (including Special Place Holders) attending the Colleges. In addition to contributing to the running costs of the Colleges, the intention of the grant is to "provide the basis, in part, of a fund to meet capital requirements" at the Colleges. In 2011 the General Grant was paid at £2,179 per pupil; and

b) Special Place Holder (SPH) Fees for pupils who qualify under the 11+ examination criteria. The States currently pays for 23 SPH annually at each of Elizabeth College and The Ladies' College, and up to six SPH annually at Blanchelande College. However, for various reasons it is rare for all such places to be filled throughout the Colleges.

4.2 The States have, historically, shown a willingness to support the Colleges financially. It is important to bear in mind, however, how different the history of States assistance has been with each of the Colleges.

4.3 In the case of Elizabeth College, funding statutes date back as far as 1826, with grant funding being in place since 1965. The aim of the States grant since 1998 has been to make a significant contribution to running costs and also deliver a surplus of around £100,000 each year to meet (in part) capital needs. However, significant capital is required to upgrade and maintain its existing buildings – which include an historic building. Ownership of the building is presumed to vest with the College, but this is not entirely clear.

4.4 There have been places reserved for States funded pupils at The Ladies' College since 1907, with grant funding from 1962. There are historic issues with capital funding. The site is States-owned. Prior to 2005 the College was maintained on a deficit funding model, which gave no ability to accrue any capital fund.

4.5 By comparison with the other two Colleges, Blanchelande College has a much shorter history of grant funding from the States. It was provided in 2001/02, however before that the States granted a lease for the school to use a former site at Rosaire Avenue. It has been funded since 2005 under a similar model as the other Colleges. The current College site is owned by the Catholic Church, and if any surplus is generated it is used for the upkeep and repair of the existing buildings.

4.6 The subsidy to the Colleges (£4.88 million in 2011) is currently split approximately equally between the General Grant and the Special Place Holder Fees, with a slight weighting towards the General Grant. The General Grant in 2011 was £2.45 million, compared to the SPH fees of £2.43 million. The subsidy by College in 2011 was Elizabeth College £2.38 million (49%), The Ladies' College £1.87 million (38%) and Blanchelande £0.64 million (13%).

4.7 The SPH fees part of the subsidy has risen at a compound annual growth rate (CAGR) of 5.5% since 2007, compared to a 2.4% CAGR in the General Grant. The primary driver of this has been the increases in College fees over the same period, as was recommended as part of the 2005 agreement on States grant aid for the Colleges. As SPH fees are paid by the States at the level of College fees each year, the States payments for SPH have risen in real terms. If fees continue to rise, SPH fees will overtake the General Grant as the majority part of the annual States subsidy.

4.8 Total grant aid makes up a very significant proportion of each College's total annual revenue, (42% at Blanchelande College, 46% at Elizabeth College and 55% at The Ladies' College). As the grant aid to the Colleges forms such a significant part of the Colleges' revenues, a sudden removal or dramatic decrease in States funding could result in a very significant increase in fees at

the Colleges to compensate. Such large increases in fees may lead to much greater parental sensitivity to fee increase than has been the case to date.

4.9 Changes to fees since 2006 do not appear to have significantly affected pupil numbers at the Colleges, and while Blanchelande College has seen a small reduction in pupils since 2006, this is proportionate to a general decline in the numbers of secondary school pupils in the States sector. In addition to the above, Year 7 (i.e. first year of Secondary School) capture rates at the Colleges have remained stable, while sixth form retention has been more variable across the Colleges but appears to have grown since 2008.

4.10 Based on the latest Education Department forecasts, around 300 places at States schools are projected to be spare in 2012. This figure represents 29% of the Colleges' pupils in 2010/11. Data have not been available as to in which school years capacity is available, although initial analysis indicates capacity across Years 7-11, but with much more limited places at the Sixth Form Centre. Were a significant number of pupils to leave or not join the Colleges within the year groups where capacity in the States sector was limited, or where catchment area schools were full, this would create a risk as to whether the States sector could effectively accommodate all the secondary school pupils on the island.

4.11 While accepting the limitations of off island comparisons, the FTP compared data on fees levels between the Colleges and UK independent day schools. The data were drawn from the Independent Day Schools Commission and the Charity Commission. Two types of comparison were made, against the UK independent schools average and against a bespoke comparator group of 28 single-sex schools.

4.12 Broadly such comparisons showed that College fee levels appear lower than those of the day schools average. However, it should be noted that UK independent day schools do not receive a subsidy per pupil to supplement fee levels. Based on rates for 2009, if the subsidy of £2,179 per pupil is added to the Guernsey College figures the levels get nearer to the UK Days Schools Average of £10,095 per pupil (Elizabeth College = £9,112, Ladies' College £7,568 and Blanchelande College £7,429). The fee ranges of the schools in the bespoke comparator group range from a minimum of £7,820 at the Newcastle School for Boys to £21,500 at St. George's School, Ascot. It should be noted that the independent schools in the UK operate in much larger markets, where many parents try to avoid a State education offer that is perceived to be inferior, whereas in Guernsey the States education system has a very high reputation.

4.13 The Colleges' relative spending levels per pupil appear to be at the lower end of the spectrum when compared to all independent day schools and a bespoke comparator group. All three Guernsey Colleges appear to have a spending level slightly below the median of the group, which is £9,732. The Ladies' College and Blanchelande College both appear to be lower spending than the lowest

spending school from the comparator group (St. Catherine's School, Twickenham).

4.14 Comparative costs comparisons between the Colleges and the States schools are fraught with difficulty. Nevertheless, the FTP did make a comparison of the relative gross spending per pupil between each of the Colleges and the States secondary schools. This gives an *indication* of the relative value for money of the Colleges within the secondary education system in Guernsey. Comparisons were made using 2009 data.

4.15 Direct like-for-like comparisons are very difficult for a number of reasons, for example back office support is an essential resource within the Education Department across all States primary and secondary schools, whereas the Colleges each have to provide their own administrative offices.

4.16 The FTP therefore looked at a number of views of the analysis to try to account for the variables and show the impact they appear to have on the final numbers. Such comparisons included:-

1. Gross revenue spend per pupil only;

2. Gross revenue spend per pupil + apportioned additional revenue costs on a per pupil basis; and

3. Gross revenue spending per pupil + apportioned revenue costs + apportioned net routine capital expenditure on a per pupil basis. For the avoidance of doubt this does not include the capital costs of the recent developments of St Sampson's High and Les Beaucamps High schools.

4.17 Taking into account schools expenditure only, States schools appear to have a lower cost per pupil than any of the Colleges. However, when apportioned administrative costs and routine capital allocations are accounted for, unit costs rise to between £5,914 (St Sampson's High) and £7,829 (Grammar School) – compared to £6,804 for The Ladies' College, £7,081 for Blanchelande College and £8,496 for Elizabeth College (2009 data).

4.18 A higher unit cost is not necessarily an indicator of low value for money, as it can be strongly influenced by factors such as the age of the school and the scope of the curricular and extra-curricular activities.

5. Conclusions from the Context

5.1 The States have clearly recognised over a long period of time that the Colleges play a valuable part in the educational infrastructure of Guernsey. The States have historically shown a willingness to support the Colleges financially, particularly in the provision of special places, which forms a fundamental part of

the academic selection and secondary school attendance at both the Grammar School and the three Colleges.

5.2 However, despite an investment of £12.9 million across the Colleges since 2005/06 through the General Grant, College capital building has not generally kept pace with that of the States sector. It should be acknowledged, however, that the period used for comparison covers the Education Department's Educational Development Plan (EDP), which involves a significant catch-up process to rectify long-term under-investment in an earlier period. In recent times Elizabeth College has been able to put a total of just over £¾ million towards capital reserves in 2007/8 and 2008/09, while The Ladies' College put aside c£980,000 over a similar period. The Colleges have historically benefited too from legacies and bequests and other sponsorships.

5.3 Both College fee levels and spending levels appear to be at the lower end of the spectrum when compared to a select group of UK comparators and a UK national independent day school average. However, although this appears to indicate scope for further increases in fees this must be weighed in the context of the broader level of social accessibility to fee-paying education in Guernsey.

5.4 Changes to fees over time with the current grant framework do not appear to have significantly affected pupil numbers at the Colleges to date, but changes to the grant formula that prompt the Colleges to raise substantially their fees are likely to result in fewer fee-paying enrolments and more fee-paying pupils leaving to join other schools than has been seen before.

5.5 A modest number of pupils leaving or choosing not to join the Colleges could be accommodated with the States sector across most (but possibly not all) year groups, although there would be a serious risk to secondary education capacity in the island were a college to close.

6. Options Appraisal

6.1 Against the above contextual background, the FTP work stream looked at a number of options for changing the grant aid provided by the States to the Colleges from 2012 onwards.

6.2 The options were developed in consultation with both the Colleges and the States Working Parties, both of whom had the opportunity to comment on earlier drafts of the five options and provided feedback which has been incorporated wherever relevant and possible.

6.3 A model was used to illustrate the likely scenario that may occur according to a set of changes in the grant aid. As such it was built using either data supplied directly by stakeholders or informed assumptions made by the FTP. The model does not attempt to provide a definitive case for what *will* happen were changes to the grant aid to occur. Rather it has been built to illustrate the *potential*

changes that *may* happen based on likely scenarios for fee increases, customer sensitivity and incurred costs to the States.

6.4 Revenue costs incurred by the States Education Department as a result of changes to the Colleges' grant aid are difficult to predict. Whether or not the States need to hire a new teacher, purchase additional supplies, or even build a new school to accommodate pupil numbers can change according to:-

a) The number of pupils that leave or choose not to join the Colleges;

b) The year groups these pupils are in;

c) The States schools they join; and

d) Whether classroom sizes exceed current standards of 24 pupils per class.

Details of the five options are given in Appendix One.

7. Development of a Sixth Option

7.1 As each of the options that were assessed have issues which affect their financial or operational viability, it was concluded that a recommended option would need to **blend elements of some of these options** based on the **greatest potential for savings** with the **least threat to the education system**. A sixth option was therefore developed, which is based on the following:-

1. A reduction in the overall level of grant funding paid to the Colleges;

2. No change to the number of special places per College; and

3. Any changes to be phased in over seven years from 2012.

7.2 It was also resolved that any option must be supported by a set of Key Performance Indicators designed to ensure that the impact of the changes on a range of indicators could be monitored, and remain within agreed tolerances, so that if there was a change in circumstances which took the indicators outside these tolerances, it would trigger a further financial review of the grant funding arrangements.

8. Conclusions and Recommendation

8.1 The Policy Council concluded inter alia:-

a. That the General Grant does not appear fully effective in giving the Colleges a fund to meet their long-term capital requirements, as College capital building has recently fallen behind that of the States sector. However, it does make a major contribution to the running costs of the

colleges; while at the same time enabling some contribution to capital reserves.

b. Special place holder fees rise in line with fees; as a result SPH fees paid by the States have risen by a compound annual growth rate of 7% since 2007. This needs to be taken into account in any new agreement otherwise savings to the States via reductions in the General Grant could be eroded by increases in Special Place Holder Fees;

c. Changes to the SPH scheme would potentially require changes to how both primary and secondary education in Guernsey operates, this is outside the scope of the FTP;

d. Pupils leaving or choosing not to enter the Colleges could be accommodated within the States sector, but there is only projected spare capacity around 300 pupils across secondary education and this provision is not spread evenly between schools or years;

e. Changes to fees over time within the grant framework do not appear to have significantly affected pupil numbers at the Colleges to date, but significant changes to the grant formula that are passed on to parents may result in fewer fee-paying enrolments and more fee-paying pupils leaving to join other schools than has been seen to date;

f. A recommended option needs to help realise the maximum possible realistic saving for the States without affecting College pupil numbers such that the States sector capacity is threatened or exhausted;

g. A continuation of the current grant formula should not be proposed, as it is likely that the General Grant would continue to be less than fully effective and SPH fees would continue to rise;

h. Any changes to the system of SPH would be high risk, as it would require a new model for access to the Grammar School/Sixth Form Centre and open up wider political ideological debates than the pure financial matter of grant aid, which is the focus of the FTP work stream;

i. As a consequence of the above, the recommended option should not propose changes to the number of SPH at the Colleges; and

j. The General Grant offers the most realistic opportunity to make savings on the grant aid given to the Colleges with the least threat to the infrastructure of secondary education in Guernsey.

Policy Council's recommendation

8.2 Given the above, the Policy Council believes that the optimum way forward is to retain the principles of the current grant and subsidies approach, but to reduce the General Grant over a seven year phased period as follows:-

General Grant

The percentage reduction to the General Grant (or any other arrangements for grant aid beyond August 2012) needs to be agreed by the States of Deliberation. However, based on the FTP work, the Policy Council believes that it is possible to reduce the overall grant by £1.11 million phased in over seven years without threatening the economic or academic viability of the Colleges.

Special Place Holders Fees

a. No change is recommended to the number of SPH each year at the Colleges. This means that the Colleges would continue to receive provision for 23 special places per school year at Elizabeth College and The Ladies' College, and up to six places per school year at Blanchelande College; and

b. While SPH fees may increase in line with increases for fees generally, any net increases beyond those linked to the relevant RPIX uplifts would need to result in a corresponding further decrease in the amount of the General Grant. Without this condition savings for the States by reducing the General Grant could be negated by increases in SPH fees.

8.3 The Financial Appraisal of the FTP work stream based on the above changes forecast **additional expenditure** for the States of **£114,000 by 2018**, to be set against a **gross saving** of **£1.22 million**, resulting in a **net saving to the States budget of £1.11 million by 2018**.

9. Summary of Findings

9.1 The Transformation Executive (TE) considered the Full Business Case for this work stream at two meetings in April 2011, one of which was attended in part by representatives of the Colleges Working Party.

9.2 Following the above meetings, the TE reached the following common understanding with the College representatives:-

- the FTP project has led to welcome recognition that the Colleges are an integral part of the excellent Guernsey education system which should not be put at risk by any changes;

- a proposed reduction (subject to Policy Council and States of Deliberation endorsement) in annual funding received by the Colleges of **£1.11 million**

per annum could be reached on a **seven year phased basis from September 2012** (i.e. the level of reduction recommended by the FTP work stream). This sum would be built incrementally over the seven years as follows:-

2012	£157,000
2013	£332,000
2014	£459,000
2015	£634,000
2016	£809,000
2017	£937,000
2018	£1,112,000

- these figures are to be net of any additional costs incurred by the States that are shown to have been a direct result of pupil emigration from the Colleges to the States sector;

- the original FTP Savings Opportunity Report (SOR) for this work stream indicated a potential saving of £650,000 to be achieved by 2014. The above recommendation does not provide for around this level of saving until 2015. However, it then goes on to build the saving further to reach almost double the original SOR value;

- grant funding will be calculated in **2012** real terms and while all figures in this report are shown for clarity and simplicity without inflation an inflation uplift having regard to RPIX will be applied annually to both the General and Special Place Holder Grants and the net saving to the States budget;

- in order to avoid a dramatic financial challenge at the end of the seven year period an annual reporting and review cycle should be introduced, including monitoring against agreed Key Performance Indicators and open inspection of the Colleges' accounts. This process to be undertaken by the Treasury & Resources Department, in collaboration with the Colleges and the Education Department. These reviews are to be submitted to the Education Department for consideration and appropriate action under the terms of that Department's mandate;

- the way future funding support is expressed should acknowledge that **the States are paying full fees for SPH** and the **balance of funding contributes to capital sustainability** apportioned between the Colleges proportionately by the total number of pupils;

- the proposed funding level does not solve the capital expenditure issues faced by the Colleges, but they will continue to make plans for appropriate development funded from other sources; and

- the process of moving the Colleges towards more equality in fee structures, which began under the previous grant funding agreement, should continue while recognising that total equality may not be achievable.

10. Recommendations:

The Policy Council therefore recommends the States:

1. to approve the continuation of States funding for Elizabeth College, The Ladies' College and Blanchelande College through a General Grant and full fees payment for Special Placeholders for a further seven years from 01 September 2012 as set out in this Report;

2. to approve the continuation of the existing provision in the funding formula for 23 special places per school year for both Elizabeth College and The Ladies' College, and up to six special places per school year for Blanchelande College, subject to existing qualifying criteria;

3. to approve the principle that, adopting a phased approach over seven years along the lines set out in this Report, the amount of the States funding for the Colleges will reduce by £1.11 million/annum (2011 values) by year seven of the agreement (i.e. 2018);

4. to approve that the base figures to be used to achieve this level of saving will be 2012 (real term) figures, and that all amounts involved over the lifetime of the arrangements (both in terms of the grants and fees paid by the States and the savings to be accrued by the States) will be adjusted annually in line with any standard percentage budget increase or decrease awarded to the Education Department;

5. to approve that the Colleges' Budget continues to be a separate Education Department Cash Limit and remains separate from the Education General Budget;

6. to direct the Treasury & Resources Department to take into account these proposals when recommending to the States revenue allocations for 2012 and subsequent years; and

7. to approve the introduction of an annual reporting and review cycle as described in this Report, including monitoring against a set of agreed Key Performance Indicators and open inspection of the Colleges' accounts, to be undertaken by the Treasury & Resources Department (in collaboration with the Education Department and the three Colleges); such work to be submitted to the Education Department for consideration and appropriate action under the terms of that Department's mandate.

L S Trott
Chief Minister
11 July 2011

B M Flouquet, Deputy Minister
G H Mahy
C N K Parkinson
D B Jones
C S McNulty Bauer
A H Adam
M H Dorey
P.R Sirett (Absent)
C A Steere
M.G O'Hara

Alternate Member present when this report was considered by the Policy Council:
J M Le Sauvage

Appendix One

The Options Appraisals

1. The Options

Note:- All options were modelled using latest available data – i.e. 2011 budget figures. However, the current grant arrangements do not end until August 2012, so any new agreement (to take effect from September 2012) would need to be based on 2012 budget figures (when available).

While all figures in this report are shown for clarity and simplicity without inflation, an inflation uplift linked to RPIX will be applied annually to the General and Special Place Holder Grants and the net saving to the States budget.

The model was used to illustrate the likely scenario that may occur according to a set of changes in the grant aid. The model does not attempt to provide a definitive case for what *will* happen were changes to the grant to occur. Rather it has been built to illustrate the *potential changes* that *may* happen.

1.1 Five Options were modelled as follows:-

a. Continue current grant aid formula;

b. Cease all grant aid arrangements;

c. Proportional reductions in current grant aid;

d. Cease the General Grant; and

e. Fundamental changes to funding formula.

Summary of Option One – Continue Current Grant Aid Formula

1.2 This would mean that from August 2012 the current grant aid arrangements would be continued for a further seven years. From 2012, the Colleges would receive a General Grant per pupil of £2,179 for each pupil attending each College, including special place holders. In addition to this there would be provision for 23 special places each school year at Elizabeth College and The Ladies' College (with funding guaranteed), and up to six places per school year at Blanchelande College where fees are fully paid by the States, subject to the existing qualifying criteria. The General Grant element of the formula would increase annually in line with any standard percentage increase awarded to States Departments through the States Budgetary process. SPH fees paid by the

States would increase in line with any fees increases implemented by the Colleges.

1.3 The rationale **for** this option includes:-

a. Acknowledgment of the belief amongst some stakeholders that "the current system is not broken so does not require fixing";

b. The Colleges continuing to receive States funding and be financially and educationally viable; and

c. It is unlikely that significant changes to fees outside the rate of existing planned increases would be required.

1.4 The rationale **against** this option includes:

a. Very unlikely to result in a reduction in States revenue expenditure as identified as an opportunity in the Fundamental Spending Review;

b. Expenditure on grant aid could be expected to increase as College fees increase;

c. A continuation of the General Grant may not address the current situation of recent capital building not appearing to keep pace with the States sector. However, this option would continue to provide the Colleges with an annual surplus more than the options which remove or reduce grant funding; and

d. A continuation of the current arrangements would likely postpone rather than solve the long term capital expenditure difficulties and the uncertainties that the Colleges face.

1.5 The model forecasts that this option would result in a net **cost to the States** of **£816,000 per annum** by the end of the seven years (2018).

Summary of Option Two – Cease all Grant Aid Arrangements

1.6 The current grant aid to the Colleges (both General Grant and SPH fees) would cease w.e.f August 2012, and would not be replaced. There would no longer be special places at the Colleges from 2012 onwards, although changes would not be back-dated. This means that the States would continue to support **existing** SPH through their 11-18 education. The Colleges would be required to generate all of their income through school fees and other sundry charges. The States would no longer provide the Colleges with the basis of a fund to meet capital requirements in place of the General Grant.

1.7 The rationale **for** this option includes:-

a. The costs of the current funding formula are increasing for the States at a time when it needs to reduce its baseline operating budget;

b. The General Grant per capita does not provide the Colleges with sufficient base for all of their capital funds to maintain and develop their existing sites, although it is noted that the cessation of grant aid will remove the current annual surpluses of the Colleges;

c. The SPH system is unfair on parents as it is not means tested alongside attainment through the 11+ examinations. This results in differences between what parents pay relative to their means; and

d. Neither aspect of the grant is arguably an efficient or an effective use of taxpayers' money as it does not fully benefit the States, the Colleges or parents.

1.8 The rationale **against** this option includes:-

a. A significant increase in fees is likely to lead to greater parental sensitivity to rises than has been the case to date, with numbers of pupils across all year groups having to leave (or not join) the Colleges;

b. Depending on the scale of the migration, the States are likely to be unable to accommodate a large shift in pupil numbers away from the Colleges;

c. The Colleges would likely have to rationalise their current curricular and extra-curricular offerings, as well as staff, to reduce operating costs. This may result in a drop in both academic standards and a desire from parents to send their children to the Colleges;

d. The financial operating models of the Colleges would be significantly challenged. Were a College to close, the States may have to "nationalise" the school at a significant cost to cover capacity; and

e. This option would seriously question current educational policy regarding selection to the Grammar School and Colleges.

1.9 The model forecasts that after deducting costs of £720,000, the States net cashable **revenue saving** under this option could be expected to be **£4.16 million** per year by 2018. However, this gain is likely to be **offset** by the need to build a new school at a capital cost of around **£37 million**, or by lower but still significant costs of either having to "nationalise" one of the existing Colleges, or extend other schools in the Education Development Plan Phase 1.

Summary of Option Three – Proportional Reductions in Current Grant Aid

1.10 The principles of the current grant funding would be continued from August 2012 onwards, but with a reduction in the grant aid based on a percentage agreed by the States. For this option the FTP modelled a scenario based on the following assumptions:-

> the Colleges would be provided with an annual General Grant per capita to form the basis of a fund to meet, in part, capital requirements. This would however be at a reduced rate of **25%** from the projected 2012 level (at 2011 levels this would be a reduction from £2,179 to £1,634 per pupil);
>
> the Colleges would also receive in addition to this funding for special place holders per school year, subject to existing qualifying criteria. However, the number of special places available at each school would be reduced from current levels by **25%**. As with other options, it is assumed that changes would not be back-dated, but would be phased in on an annual basis. In line with existing arrangements fees for SPH paid by the States would increase in line with any fee increases implemented by the Colleges.

1.11 The rationale **for** this option includes:

a. Simple reductions in grant aid would deliver a saving for the States, notwithstanding any cost increases to the Education Department to accommodate large numbers of pupils moving from or not joining the Colleges;

b. Unlike more radical removals of funding, the Colleges would be less likely to increase fees at percentages that will cause a significantly greater level of sensitivity than experienced to date;

c. The Colleges would continue to get a grant each year from the States to form the basis, in part, of a fund to meet capital requirements; and

d. Significant changes to the SPH scheme may not necessarily be required, which would have fewer implications for the current system of selection at age 11.

1.12 The rationale **against** this option includes:

a. This model would not protect the States from future rises in SPH fees, as the Colleges increase fees in future;

b. As this amount would lower the amount given to the Colleges for capital compared to current levels, it would be unlikely to allow the Colleges to build the capital funding needed to maintain and develop their sites;

c. Even smaller changes to funding may affect the financial and educational viability of one of the Colleges, meaning that excessive strain may be placed on States school capacity which may not be able to accommodate the number of pupils involved;

d. Increases in fees may limit the number of parents who could afford to send children to the Colleges and result in them becoming more "elitist" institutions (something which is not favoured by any of the stakeholders); and

e. Reducing the number of special places at the Colleges each year will create admission issues at the Grammar School Sixth Form Centre and the States Secondary Schools, which may cause consequences that are hard to predict.

1.13 Allowing for forecasted **costs** to the States of **£240,000** per annum relating to the increase in pupils moving from the Colleges to the States sector, reducing the General Grant by 25% and cutting the SPH by 25% could realise a total **net annual saving for the States** of around **£2.9 million** by 2018.

Summary of Option Four – Ceasing the General Grant

1.14 The current General Grant, which provides a grant of £2,179 per pupil for each pupil attending each College (including SPH) would cease after August 2012. This effectively removes the principle of providing the Colleges with a surplus each year that would contribute in part to capital requirements. It would also remove significant funding which helps to cover running costs.

1.15 The Colleges would continue to receive funding for 23 special places per school year at both Elizabeth College and The Ladies' College, and up to six SPH per school year at Blanchelande College – where fees are fully paid for by the States, subject to existing qualification criteria. SPH fees paid by the States would increase in line with any fee increases implemented at the Colleges. As with other options, the changes would not be back-dated, but would be phased in on an annual basis.

1.16 The rationale **for** this option includes:

1. The General Grant per capita does not provide the Colleges with a sufficient base capital fund to maintain and develop their sites. There may be other, more effective, ways to do this;

2. If the States were to support College capital needs in another way, it would reinforce a more strategic approach to managing the educational system on

Guernsey, as well as providing the flexibility the Colleges require to meet their own specific individual needs; and

3. This option appears (in theory at least) to be the most realistic solution for providing the Colleges with the level of capital funding they require, bringing them into the strategic management of the island's education system and reducing the current grant aid levels.

1.17 The rationale **against** this option includes:-

1. The General Grant acts as a "top-up" to the Colleges' operating deficits as well as providing a surplus on top of their operating expenses. Blanchelande College does not make a surplus;

2. As a result, this option would be very likely to result in increases to fees beyond the current growth rates experienced over the last few years; and

3. There would need to be some other system for the States to contribute towards the capital needs of the Colleges.

1.18 The model forecasts that total additional costs to the States are **£1.1 million** by 2018, set against gross financial savings of **£2.4 million**, thus delivering a net saving to the States by 2018 of **£1.3** million per annum. This excludes any contribution by the States towards the Colleges capital needs.

Summary of Option 5 – Fundamental Changes to Funding Formula

1.19 Under this option the current arrangements of a split grant (General Grant plus SPH scheme) would cease w.e.f. August 2012, and be replaced by a new system. Under this new system grant aid would be paid to the Colleges as a single sum paid (at a 25% reduction in current levels) each year to each of the three Colleges. The Colleges would be free to distribute this to pupils as a "bursary" or "scholarship", subject to award criteria set by the Education Department.

1.20 The bursary could be distributed in stepped levels, with awards of £2,000, £4,000, £6,000 or full fee support. The number of pupils given funding at each level would be capped at an agreed maximum level, with the specific number each year decided by the Colleges each year based on their understanding of the likely pupil profile. The award would be granted according to a weighted set of criteria based on academic attainment through the 11+ examination system, and the ability to pay assessed via a means test. The administration of this award assessment would be borne by the Education Department.

1.21 The rationale **for** the option includes:-

1. By giving greater control over how the Colleges assist pupils financially, the Colleges could raise a greater proportion of their revenues overall from fees

as opposed to States funding. In time this may lead to a further reduction in States funding;

2. Introducing ability to pay criteria for States support would bring a social mobility aspect into the use of taxpayers' money and allow parents to pay according to their means. This would be likely to increase accessibility to the Colleges; and

3. Introducing ability to pay into the award of a grant would arguably be fairer to parents and allow for more flexible fees.

1.22 The rationale **against** this option includes:-

1. To administer an entirely new system would require a new administrative set-up that would carry out awards assessments. The colleges would be unwilling to take this on, and it would represent a new cost to the Education Department;

2. The costs of creating an administrative system to distribute small sums of financial support may outweigh the benefits;

3. The States could only save money through this option if the grant given to each College were lower than the current level, and a cap was in place to avoid increases due to fee increases;

4. Removing the special places within the Colleges would carry a significant political risk, questioning the purpose of the 11+ selection system which in itself could hinder decision making on this work stream in the States. It would also remove a system which has been in place for over 100 years;

5. There is a perception that parents may be unwilling to submit to an award assessment owing to social stigmas and would therefore not take advantage of the new arrangements; and

6. There would need to be some other system for the States to contribute towards the capital needs of the Colleges.

1.23 Under this option the model forecasts that there would be additional costs for the States of **£192,000 per annum**, to be set against a gross saving to the States of **£1.2 million**, giving a net saving by 2018 of **£1.0 million** per annum.

Elizabeth College

The Ladies' College Guernsey

Blanchelande Girls' College

28th June 2011

Deputy L S Trott
Chief Minister
Policy Council
States of Guernsey
Sir Charles Frossard House
St Peter Port
Guernsey
GY1 1FH

Dear Deputy Trott

STATES FINANCIAL TRANSFORMATION PROGRAMME (FTP) – REVIEW OF COLLEGES GRANT AND SUBSIDIES

We write in response to your letter dated 14 June 2011 and the associated Policy Council report which will form the basis of a States Report. The three Colleges are grateful for the opportunity to comment on the Policy Council proposed recommendations especially in view of the importance for each school of finding a sustainable financial model and continuing to provide excellent value for money as an integral and pivotal component of the Guernsey education system. This response represents the combined views of Elizabeth College, Ladies' College and Blanchelande College and follows cooperative work between the schools during the review process.

We are particularly pleased that the consultation with Colleges and the Education Department during the review has resulted in confirmation that the Colleges are an integral and important part of a very successful education system. We believe that the Colleges make a valuable contribution to the quality of educational opportunity and social mobility as required in the Education Law and reinforced by the high level strategic objectives of the Education Department in the SSP. Consequently, the Colleges are particularly mindful of risks involved in any changes to the current financial model. However, we are also aware of the current pressures on States finances and therefore the potential for incremental savings in States expenditure from a gradual transition in the Grants and Subsidies budget. The Colleges are committed to playing their part in reduction of States expenditure.

Working Party
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However, the current success of the integrated education system is the result of a proper sharing of responsibility through funding. This is the mechanism that allows full support for special placeholders and a degree of recognition for the contribution made by fee payers through the general grant system. For this reason, any dramatic change would involve significant risk to Guernsey's education system across both the grant-aided and State sectors. We therefore welcome the long-term staging of the proposed changes and, in particular, recognition that the financial situation must be monitored regularly rather than being set for a seven-year period without any regard for changing conditions.

The Policy Council proposals in our view set the seven-year horizon at the absolute limits of what is viable given current medium term forecasts. Indeed, given the choice we believe that the overall balance and security of the Guernsey education system would be more secure if the seven-year reduction plans involved less change. The inclusion of an annual review process to monitor financial balances in the system is very welcome. We believe that this recommendation will provide recognition of the pressures faced in each of the three Colleges' business models as unforeseen changes in the educational and economic environments have to be managed.

There is some ongoing concern expressed in the report about long-term provision for real estate capital expenditure by the Colleges. We share those concerns but the situation is different for each school. In the past the Colleges have been encouraged to retain reasonable revenue surpluses in order to plan for capital expenditure requirements. The proposed reduction in grants and subsidies does not help this objective. Nevertheless, each school still needs to be able to generate sufficient revenue surplus to make longer-term provision for maintaining and developing the buildings that they use and we believe this must be noted and recognised in the ongoing regular review processes.

In conclusion, therefore, the three Colleges are willing to endorse and support Policy Council recommendations whilst still harbouring some concerns about the long-term effects of the changes. We trust that the proposed regular review of the financial model will mitigate the risks and provide an appropriate mechanism to safeguard the long-term security and success of an excellent Island-wide education system.

Yours sincerely

K. Paul Mellor

Rev K P Mellor
Elizabeth College

Deputy P L Gillson
Ladies' College

N. Paluch

Dr N Paluch
Blanchelande College

TREASURY AND RESOURCES
A STATES OF GUERNSEY GOVERNMENT DEPARTMENT

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The Chief Minister
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5 July 2011

Dear Deputy ~~Trott~~ Lyndon

States Financial Transformation Programme (FTP) – Review of Colleges' Grants and Subsidies

I refer to a letter dated 14 June 2011 from the Policy Council, concerning the above mentioned FTP workstream, with which was enclosed a copy of a report dated 5 June 2011.

My Board has recently given consideration to the report and I am pleased to be able to confirm that Members unanimously support the recommendations. We were particularly pleased to note that the proposals will, if approved, eventually lead to a reduction in States expenditure in this area of £1.1 million pounds per annum. This will represent a significant contribution towards the States agreed target of driving out £31 million of efficiency savings through the Financial Transformation Programme.

With regard to the annual reporting and review cycle, which it is intended to put in place in order to avoid the possibility of a major financial problem arising at the end of or during the implementation period, my Department is content to lead this process in consultation with the colleges and the Education Department.

Yours sincerely

C N K Parkinson
Minister

POLITICAL RESPONSIBILITIES
Client Services (including Cadastre), Corporate Procurement Services, Income Tax, Information and Communication Technology, States Property Services, Treasury (including Risk Management, Internal Audit and Investments).

EDUCATION
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Our ref: 391/6b/FF/CAS/KL

14th July 2011

Deputy P R Sirett,
Member of the Policy Council,
Policy Council,
PO Box 43, la Charroterie,
St Peter Port, Guernsey
GY1 1FH

Dear Deputy Sirett,

States Financial Transformation Programme-Review of Colleges Grant & Subsidies

Thank you for your letter of 14 June 2011, which also enclosed a copy of Policy Council's Report on College funding. You asked for comments from my Board on the Report by no later than Friday 1st July.

The Education Board very much hopes that the Policy Council will afford it the courtesy of having this letter of comment attached to the States Report published in the Billet d'Etat. The Board looks forward to receiving the Council's confirmation that this letter will be published in that way.

As the Department has only been afforded two weeks between receipt of the draft Report and the deadline for any comments thereon to be submitted to Policy Council, there has not been sufficient time for the Board of the Education Department to consider the Report in any depth and, as a consequence, it is not in a position to comment extensively on the content or recommendations thereof.

Notwithstanding these comments, however, and to the extent that the Board has been able to consider the Report, it is of the opinion that the proposals contained therein appear to provide a viable basis for the future funding of the grant-aided colleges. The Board is unable to give a view on the financial recommendations, as it has not seen the supporting data.

The Board would also wish to take the opportunity to revise the current Conditions of Grant Aid to the Colleges, in particular to include in the Conditions some key dates by which the Colleges would be required to supply information concerning their activities. The Board is happy to discuss these with the Council, with a view possibly to reaching agreement with the Colleges ahead of the Report on any proposed changes or alternatively including them in this States Report.

Finally, I should like to take this opportunity on behalf of the Education Board to thank the Council for inviting the Board to submit a letter of comment to its States Report. The Board looks forward to debating the proposals later in 2011.

Yours sincerely,

Deputy C A Steere,
Minister,
Education Department

The States are asked to decide:-

VIII.- Whether, after consideration of the Report dated 11th July, 2011, of the Policy Council, they are of the opinion:-

1. To approve the continuation of States funding for Elizabeth College, The Ladies' College and Blanchelande College through a General Grant and full fees payment for Special Placeholders for a further seven years from 01 September 2012 as set out in this Report.

2. To approve the continuation of the existing provision in the funding formula for 23 special places per school year for both Elizabeth College and The Ladies' College, and up to six special places per school year for Blanchelande College, subject to existing qualifying criteria.

3. To approve the principle that, adopting a phased approach over seven years along the lines set out in this Report, the amount of the States funding for the Colleges will reduce by £1.11 million/annum (2011 values) by year seven of the agreement (i.e. 2018).

4. To approve that the base figures to be used to achieve this level of saving will be 2012 (real term) figures, and that all amounts involved over the lifetime of the arrangements (both in terms of the grants and fees paid by the States and the savings to be accrued by the States) will be adjusted annually in line with any standard percentage budget increase or decrease awarded to the Education Department.

5. To approve that the Colleges' Budget continues to be a separate Education Department Cash Limit and remains separate from the Education General Budget.

6. To direct the Treasury & Resources Department to take into account these proposals when recommending to the States revenue allocations for 2012 and subsequent years.

7. To approve the introduction of an annual reporting and review cycle as described in this Report, including monitoring against a set of agreed Key Performance Indicators and open inspection of the Colleges' accounts, to be undertaken by the Treasury & Resources Department (in collaboration with the Education Department and the three Colleges); such work to be submitted to the Education Department for consideration and appropriate action under the terms of that Department's mandate.

POLICY COUNCIL

PROGRESS ON FULFILLING RECOMMENDATIONS MADE BY THE TRIBUNAL OF INQUIRY INTO INDUSTRIAL ACTION BY AIRPORT FIRE FIGHTERS AT GUERNSEY AIRPORT

Executive Summary

1. The comprehensive review undertaken by the Tribunal of Inquiry into the facts and circumstances leading up to and surrounding the industrial action taken by Airport Firefighters in May 2009, resulted in some fourteen recommendations for improvement in the way in which the States manages it affairs.

2. This Report documents the progress made on responding to each of those recommendations. It details various initiatives that are in hand to address improvements suggested by the Tribunal on the way in which the States engages with employee groups, it describes how the Commerce and Employment Department are consulting on improvements to the Industrial Relations Law identified by the Tribunal and it advises the States that within this Term of Government the Policy Council plans to submit three separate reports to the States dealing with:

   - Public Sector Pay Determination
   - Transparency of Government (Freedom of Information)
   - Civil Contingencies Law (which should address the issues raised in respect of crisis management).

Background

3. On the 16th July 2009 the States resolved to establish a Tribunal under the Tribunals of Inquiry (Evidence) (Guernsey) Law, 1949 as amended to inquire into the facts and circumstances leading up to and surrounding the industrial action taken by the Airport Firefighters at Guernsey Airport in May 2009, including the circumstances in which the dispute was resolved.

4. A Tribunal was appointed by the Royal Court on the 2nd October 2009 and concluded its work with a presentation of a Report which was published as Appendix III to Billet d'Etat IX for the States meeting on the 28th April 2010. In a subsequent Report published in Billet XV in June 2010 the Policy Council advised the States of a number of workstreams that had either commenced or were due to be commissioned in order to respond to the fourteen recommendations made by the Tribunal.

5. The States accepted the report and resolved:

"To endorse the proposed workstreams to be taken on the recommendations of the Tribunal, as set out in that report, and to direct the Policy Council to report back to the States by no later than June 2011 outlining the progress made against each of the workstreams".

6. The Policy Council is fully aware that it has not complied with the June 2011 deadline as set out in the Resolution but, conscious of a number of developments in relation to the workstreams under the fourteen headings, felt that it would be more productive to delay the presentation of the Progress Report for three months thereby enabling it to be in a position to provide a more comprehensive response.

7. The format of this report repeats that of the June 2010 report by considering progress on each of the workstreams under the headings which summarised the Tribunal's recommendations.

Progress on responding to the Tribunal's recommendations

Public Sector Pay Determination

8. The Tribunal had acknowledged that, following receipt of the "Report of a Review of the Role of the States of Guernsey as an Employer, Mechanisms for Determining Public Sector Pay in Guernsey" by Dr Graham Robinson in February 2008, the Policy Council was exploring the concept of a States Employment Board. This would see political accountability, currently split between the PSRC in respect of pay determination and related matters and the wider employer and HR responsibilities that sit within the Policy Council's mandate combined into one new political body.

9. In Section 8.4 of its Report, the Tribunal had observed amongst other things that:

" • *We do not consider that the creation of a States Employment Board would be beneficial".*

" • *We consider that responsibility for pay determination should rest with the Policy Council."*

" • *Operational responsibility for negotiations within the remit should rest exclusively with professional negotiators".*

As indicated in the June 2010 Policy Council Report the Policy Council has indeed revisited the concept of a States Employment Board and as a first step consulted with the Public Sector Remuneration Committee.

10. The Committee responded to the Policy Council in the following terms:

1. The current Political split in employer functions between the Public Sector Remuneration Committee, Policy Council and, to some extent, Departments is not the most effective way to discharge the role of employer in an organisation of this size. Rather, there should be one body accountable for the entire employment remit and this should be explicit in the mandate of that body. At Staff level this is how the overall HR function is organised.

2. The appropriate body for this role should be the Policy Council with a revised and more explicit mandate executing the role of employer of all States employees rather than only Civil Servants and should embrace the current mandate of the PSRC.

3. The PSRC is keen to ensure that any new approach builds on the progress made in the past eighteen months specifically:

   - Reducing the presence of Politicians at the negotiation table;

   - Ensuring Departmental engagement for negotiating positions;

   - Achieving a wider perspective by appointing two non-States Members to the PSRC.

4. It is considered unwieldy that the eleven members of the Policy Council should deal with the detail of pay and conditions of service.

5. Accordingly, the Policy Council should delegate the remit of determining pay and conditions of service of all States employees to a Sub-Committee.

6. The Sub-Committee should be made up of a minimum of five politicians, at least one of whom should be a Minister to ensure linkage to the Policy Council. All politicians have voting rights, supported by the Head of HR & OD acting as lead officer on behalf of the Chief Executive. Two non-States Members should be appointed in an advisory capacity to provide independent and preferably professional private sector input. The Committee is of the view that ideally the Head of HR & OD would also have voting rights. The membership should represent the major 'employing' Departments, namely Health & Social Services, Public Services, Home and Education along with Treasury and Resources.

7. Politicians and Members of the Sub-Committee would not take part in negotiations. This would be delegated to the professional negotiating staff (currently employed by the Policy Council on behalf of the PSRC) together with officer representatives from the relevant Departments. Negotiations will adhere to policies established by the Sub-Committee. This will require negotiating changes to some agreements in place with staff groups.

11. The PSRC believe that the suggested approach:

- addresses the key concerns of previous observers including Robinson and the Fire-fighters Tribunal;

- provides for evolutionary rather than revolutionary change;

- maximises the use of the Civil Service resources available to best effect; and

- recognises the importance of remuneration and benefits from a Political perspective.

12. The Committee also offered to engage with the four major 'employing' departments to gather their views and to report back to the Policy Council with its recommendations for the future.

13. This engagement process is now in progress and is expected to conclude by the end of the Summer of 2011, the Policy Council will prepare a specific report on this subject to be presented to the States later in the year.

A partnership approach to industrial relations

"We recommend the adoption of a "partnership" approach to industrial relations under principles to be developed by the Head of Human Resources and Organisational Development".

14. A partnership approach to industrial relations has been adopted by an increasing number of large employers in the UK. Notably the NHS and local government have moved toward this model of industrial relations and away from the more traditional adversarial approach that characterised relationships between employers and trade unions in the 1970's and 1980's. It should be noted that there are still spectacular failures in the UK and anecdotal evidence is that in one case local government have taken over 15 years to achieve partnership working with one particular Union.

15. Key principles that underpin partnership agreements are a shared and stated commitment to;

- High quality services
- Value for money
- Continuous improvement

The employer needs to commit to good practice in all areas of management, e.g.

- Fairness
- Development of employees
- Commitment to security of employment
- Opportunity

If partnership agreements are to be effective both parties must ensure that they;

- Build trust and mutual respect
- Develop open and honest communications
- Ensure absolute commitment from the highest level in the organisation
- Maintain a positive and constructive approach
- Engage in early discussion on emerging issues
- Maintain a dialogue
- Ensure a "no surprise" culture.

While the seven elements above are essential for effective partnership arrangements, there are three fundamental criteria that must be in place before this approach could be considered and they are;

- Competence (Skills)
- Maturity
- Capacity (Resources)

16. The States of Guernsey needs to be confident not only in the commitment of staff and trade unions but also in the competence, capability and maturity of all parties to the agreement. While the Policy Council has no doubt that these elements can be more than satisfied by the employer's side it is not in a position to say with confidence all of the trade unions that currently represent the various employee groups would be in a position to embrace this approach.

17. The employer would need to be convinced that the potential trade union partners would have the necessary commitment and resources to properly engage in this process, fully understand their changed role and contribute in a positive manner that adds value to the development of HR policy and strategy for the organisation.

18. All the evidence suggests that not all of the existing trade unions are yet able to operate in this manner nevertheless some are making considerable progress.

19. The Policy Council has adopted the following approach:

The States is committed to a partnership approach (both between employer and trade Union and PSRC and department) and the current methodology of working towards partnership will continue however this will be an evolution and not a revolution. There is therefore no timeline for completing this task.

Structured collective bargaining

"We recommend that collective bargaining should be conducted on the basis of procedural agreements".

20. Against the background of a move towards the adoption of a "partnership approach" and the review of the method of public sector pay determination adopted by the States, the Policy Council has invited the PSRC, working with the Head of HR and OD to follow through this recommendation by:

    - Reviewing the appropriateness of those formal procedures that are currently in place and,

    - Establishing a need for appropriate procedures where they do not exist.

21. In reporting to the States in June 2010 the Policy Council made the point that if some procedures do merit improvement but were currently the subject of a contract between groups of employees and the States then these would need to be changed through negotiation.

22. Against this background, the Policy Council has agreed that officers of its Human Resources Unit and those supporting the PSRC will:

    1. Develop a proposal for the future structure of collective bargaining.

    2. Test this approach with targeted trade unions, initially with the AGCS, with a view to changing existing agreements.

23. Both the Policy Council and the PSRC recognise that this is a resource intensive activity given the plethora of unions that the employer needs to work with – for example there are six unions representing the teachers and lecturers alone. Currently the resources within the HR team are inadequate to deliver this in a short timeframe (both in terms of skills and numbers of people). In these circumstances it is anticipated that it may well take two to three pay cycles to finalise the arrangements.

Evidence based pay determination

"We recommend that economic and labour market data should be routinely compiled and circulated by an independent body which has the confidence of all parties".

24. In 2010 the Policy Council made a New Service Development bid within the SSP for funds which would have allowed a review of terms and conditions and which would have identified, amongst other things:

    - What the right comparators were for all pay groups

    - What data needs to be collected.

    - How that data should be collected.

- How best to implement the data collection.

The bid was not one of those accepted by the States.

25. Without the funding for the review of terms and conditions this major piece of work will have to be executed once the HR Unit has the right in-house capacity in terms of staff and skills to do so.

26. This may well be possible as an outcome of the FTP HR workstream but it will not deliver the skills until the middle of 2012 at the earliest. In the meantime, the PSRC in its negotiations will continue to use the data it has and consult with the unions on what data it is that both sides should be seeking.

Job Evaluation

"We recommend that public sector jobs should be weighted according to an objective, gender – neutral system of job evaluation".

27. In its 2010 Report the Policy Council indicated that while it had commissioned a review of this option it recognised at the outset that the magnitude and impact of such a task should not be underestimated.

28. The issue of job evaluation and pay equality in the context of equal value legislation has preoccupied much of the public sector in England and Wales for the last ten years.

29. The introduction by local authorities in the UK of a single job evaluation covering two 'types' of staff highlighted a number of issues; that some jobs of one 'type' were overpaid in relation to their counterparts and; that traditional male employment, e.g. refuse collection, construction, was better paid (when the value of total remuneration was calculated) than jobs typically undertaken by female staff. The latter problem was primarily due to the payment to male manual workers of a range of bonuses in addition to basic salary that had no clear link to productivity or performance. As a consequence while male manual worker jobs scored less under job evaluation than some female roles, e.g. care assistant, and were paid a lower basic grade their actual gross earnings were significantly higher.

30. The analysis of job content using a systematic Job evaluation scheme highlighted this discrepancy and local authorities have been forced to either increase pay for large groups of female employees or reduce pay for large groups of male employees. Typical costs for an all purpose unitary local authority of carrying out a comprehensive job evaluation exercise and pay review have been in the region of 5-7% of total salary bill.

31. Despite the pressure generated by equal value legislation local authorities have continued to exclude groups such as teachers from these reviews, on the basis that their terms and conditions and pattern of employment are significantly different for mainstream staff.

32. The States of Guernsey is even more diverse than an all purpose local authority. In this context it would be difficult to design a scheme that was capable of making consistent judgements on job size between the full range of different employment groups. Attempts to design and implement such a scheme would undoubtedly be criticised by some employee groups who felt that their key skills or unique operating context was not being properly valued. In addition it would highlight pay discrepancies across the public sector that would be expensive to rectify with no tangible benefit.

33. Almost all employee groups in the States of Guernsey have in some way an appropriate evaluation scheme that are relevant to the specific staff group. For instance the Civil Service uses HAY, the PSEs use another system more suited to their type of work, Nurses and some medical professionals use Guernsey Agenda for Change, Guernsey Fire and Rescue Service are within a structure that replicates that in the UK as are Police and Prison Officers.

34. The Policy Council concluded that it was not minded to pursue this recommendation further at this stage and that the States should continue to operate different job evaluation schemes for different employee groups eg. teachers, civil servants, nurses and so on.

New arrangements for public sector pay determination

"We recommend that the current institutional arrangements for public sector pay determination should be replaced".

35. This recommendation is linked firmly with Recommendation 1, Public sector pay determination and the Policy Council response is set out earlier in this report.

Changes to the Industrial Disputes and Conditions of Employment (Guernsey) Law, 1993 as amended

"There are specific aspects of the 1993 Law which we recommend should form part of any review".

36. The Commerce and Employment Department will be issuing a consultation paper on the reform of the 1993 Law later in 2011 at which point it has confirmed that it will invite comment on the six areas identified by the Tribunal amongst other issues and will reflect on them in considering any changes to the legislation.

Legal regulation of industrial action

"We recommend that consideration be given to legislation to clarify the scope of lawful industrial action and the conditions under which it may be taken. Such legislation should have regard to the restrictions which may be legitimate and proportionate in essential services and to appropriate guarantees to safeguard the terms and conditions of workers in such services".

37. By way of clarification of the current position in Guernsey,

- there are no criminal or civil sanctions against employees or their unions in the event of their taking industrial action;

but

- there is no protection against dismissal for employees who take industrial action;

and

- employees and their unions may be subject to claims for damages in the event of losses arising due to industrial action.

In other words, what is known in the UK as the "right to strike" does not exist in Guernsey.

However, in order to provide a "balance of power" between employer and employees (in the absence of the latter's "right to strike") there is provision for a legally binding award through the Industrial Disputes Law. Employers' wishes cannot simply be imposed.

38. The Commerce and Employment Department has advised that it has concluded a stand alone consultation on the scope of lawful industrial action and the conditions under which it may be taken. This consultation drew a mixed response but on balance there was no strong appetite for change and in these circumstances although the matter will be the subject of a review in future, it has not been accorded priority by the Department.

Commitment to good governance

"We recommend that the States of Guernsey should confirm its commitment to these principles and should institute an education training programme relating to these principles".

39. The principles referred to are the six principles of good governance established by the UK Independent Commission on Good Governance in Public Services which have now been adopted by the States following consideration of the report on governance from the Public Accounts Committee.

40. The Policy Council now awaits with interest the outcome of the work of the Joint Committee examining how best to apply the principles in practical terms in respect of which a report is due to the States no later than March 2012.

Relationships between Departments and Committees

"We recommend that there should be greater inter-Departmental co-operation and collaboration, with the Policy Council resolving difficulties where the priorities of Departments differ. Specifically, we recommend that:

(a) cross-Departmental working should be part of the initial and ongoing training of officials;

(b) where cross-Departmental projects have been identified, a cross-Departmental Board should meet at regular intervals (for example, every quarter or six months as appropriate) to monitor progress and identify any gaps or conflicts in approach;

(c) any unresolved operational difficulties should be reported immediately to the Chief Officer Group;

(d) the Chair of the Chief Officer Group should ensure that any policy issues requiring resolution are presented speedily to the Policy Council".

41. At the time of its 2010 report, the Policy Council expressed its belief that:

"Any conclusions drawn by the Tribunal on corporate working will be based on evidence submitted in respect of the events surrounding the Airport Firefighters dispute. However, the Tribunal will not have been exposed to the wider experience of increasing co-ordination and co-operation between Departments at corporate level across the States. And assumes therefore that the comments relate to the co-ordination of cross- Departmental issues in an industrial relations context".

42. Notwithstanding the Policy Council's view of the narrow focus of the Tribunal on the question of cross-Departmental working, nevertheless it recognises that there is considerable scope for improving corporate working and over the last year significant steps have been made in this direction.

43. Specifically, at the beginning of 2011 the Policy Council, acting in its capacity as "States Employer", agreed with the Chief Executive to take certain steps to strengthen the authority that the Chief Executive was able to exercise over Chief Officers in order to deliver better performance and corporate working. Specifically, Chief Officer job descriptions were changed to establish a clear line management responsibility between Chief Officers and the Chief Executive. Chief Officers remain responsible to their Boards for delivery of matters which fall within Departmental mandates but they are accountable to the Chief Executive for their performance both in respect of Departmental goals and corporate objectives.

44. The Policy Council believe this is an important step towards corporate working.

45. As a consequence of these changes, the format of the Chief Officer Group has also changed such that it now meets on a quarterly (rather than a monthly) basis for a more formal business meeting at which the focus is on reporting progress against targets rather than the previous more informal consideration of a range of issues. This approach also gives the opportunity to address any difficulties that might arise in working across the Department as envisaged by the Tribunal.

46. Given the frequency and make up of the Chief Officer Group and its size, the Chief Executive has formed a smaller Executive Leadership Team to support him particularly in the area of driving through change. The team consists of the Chief Executive as Chairman, the Deputy Chief Executive, Chief Officer of T&R, Head of HR and OD, Chief Accountant and Head of Policy and Research.

47. Further significant steps towards more corporate working have been taken as a result of a number of initiatives under the banner of the Financial Transformation Programme and in particular an initiative to develop an integrated approach within HSSD, Education and Home Department to deliver cost saving projects that support the development of strategic objectives.

48. Included in the States Strategic Plan report to be debated by the States in October 2011 will be further details of how the FTP project management framework is delivering joined up working in a cross cutting manner.

49. The Policy Council is satisfied that the points raised by the Tribunal under this heading are being properly progressed albeit by a different mechanism to that envisaged by the Tribunal.

Adherence to process

"We recommend that there should be clear mandates and procedures for dealing with incipient emergencies and the procedure relied upon should be appropriately designated and understood".

and,

Crisis Management

"We recommend that there should be an identifiable body with a mandate to deal with crises falling short of an emergency".

50. In its June report 2010, the Policy Council reported on the establishment of a Strategic Threats Group (Billet XV, 2010, pages 807 to 809) as a response to the shortcomings of the current arrangements for dealing with a crisis that fell short of an emergency.

51. As described in the Policy Council's report, the focus of the Group is to provide political and practical input to a situation where one or more strategic threats are emerging and where the options for remedial action requires co-ordinated efforts of a number of Departments and agencies. The Policy Council is pleased to report that to date there has been no requirement for the Group to meet.

52. The Policy Council has always seen the Strategic Threats Group as a temporary measure pending a complete review of the Emergency Powers (Bailiwick of Guernsey) Law, 1965 as amended and working with the Home Department and the Emergency Powers Advisory Group (EPAG) is in the process of finalising a report to the States to give life to the Resolution of 30th March 2005;

"To direct the Emergency Powers Authority to bring forward proposals to replace the Emergency Powers (Bailiwick of Guernsey) Law, 1965 as amended with new legislation on the lines of the UK Civil Contingencies Act 2004".

53. A report on this subject will be presented to the States later this year and the proposals, if accepted, will address all of the points raised by the Tribunal in relation to crisis management and adherence to process.

Risk Management

"We recommend that every Department should conduct a risk assessment in relation to the activities for which it is responsible and should subject the risk assessment to regular review".

54. As the Policy Council has previously pointed out to the States, risk management is embedded within every Department and at corporate level the Policy Council has approved and published an Island Risk Register which identifies potential threats to the well being of our community and in respect of which response plans exist. However, the Policy Council acknowledges that there has not been in the past a consistent, centrally co-ordinated corporate approach to risk assessment along the lines suggested by the Tribunal.

55. Since June 2010 members of the Chief Officer Group have been developing a corporate risk management framework for the States of Guernsey. This has enjoyed added impetus by the decision of the Chief Officer of HSSD to make available his Department's Health and Safety Management (who brings considerable experience in this field from his previous career) to assist in this task. The project has also benefited from input from Marsh, States Risk Managers.

56. It is envisaged that by the end of 2011 key risks for all Departments will have been recorded and mitigating action identified in a consistent manner. The new approach will also ensure that the framework and its associated registers will be constantly refreshed and that a culture of risk awareness and management will be established within all Departments.

Openness and transparency

"We recommend that there should be a presumption that reports commissioned from the public service will be made publicly available unless there are specific grounds for doing otherwise".

57. In the June 2010 Report the Policy Council referred to its commitment made publicly on a number of occasions to the principles of open Government and in the light of the Tribunal's conclusions, it stated that it would be giving further consideration to the development of guidelines covering the publication of reports commissioned by the States.

58. This subject also falls within the Policy Council's commitment to consider whether to recommend to the States legislation along the lines of the UK Freedom of Information Act. With this in mind, early in 2011 the Policy Council arranged a presentation on the subject to States Members, Senior Officers and the media by Ms Jane Sigley, Head of FOI Policy and Strategy, Ministry of Justice.

59. The presentations which were well attended provided the opportunity for Ms Sigley to explain the workings of the Freedom of Information Act, its scope in terms of providing public access to Government information (which in a number of areas is less extensive than some media reports would suggest) and the cost and challenges arising from the UK arrangements. In this respect it was indicated that the UK Act was about to be subject to a major review.

60. It was clear from the presentation to States Members which was attended by the majority of Members that a number of Deputies who had hitherto been broadly in favour of introducing local legislation to mirror the UK Act adopted a very different view after appreciating the likely impact on the States of such a move, particularly in terms of cost and bureaucracy.

61. It was against this background the Policy Council decided to undertake an informal e-mail survey of States Members as to whether they believed Guernsey should press ahead with UK style legislation at this time. The majority of respondents indicated that while some form of pragmatic move towards more open Government and greater public access to information was desirable, embracing the UK Act at this time was a step too far and there was a need for some form of evolution and "Guernsey solution".

62. With this in mind the Policy Council commissioned Ms Belinda Crowe to review this matter and assist the Policy Council in developing an Information Strategy to further its aim of increasing transparency and openness and inform its thinking on possible access to information legislation.

63. Ms Crowe was, until earlier this year, the Information Director at the Ministry of Justice administering a thirty two million pound budget and a two hundred strong multi function team located across the UK responsible for leading delivery of all MOJ's information responsibilities from development of Government policy on Data Protection to Freedom of Information and Data Protection/Sharing. Prior to this Ms Crowe was a senior member of the MOJ team who was responsible for engagement with the Crown Dependencies and therefore has some insight into how the States of Guernsey operates.

64. The aim of the Report is "to develop a high level of information strategy for the States of Guernsey, recommendations for increasing openness and the systems, processes and culture to support the Strategy".

65. Ms Crowe visited the Island in May 2011 and interviewed a wide range of people as part of her research and the Policy Council expects to receive her report by the end of July 2011. It then expects that a report on the subject is submitted to the States in this Term.

Conclusion

66. The Policy Council is confident that steps have already been taken, or are in progress, to properly address the recommendations made by the Tribunal and that, where appropriate, separate reports to the States will be submitted in due course on specific issues. This Report has not raised specific funding or resourcing issues on the basis that initiatives that are already in hand will be undertaken without the need for additional resource or because there will be a subsequent States Report on this subject which will contain such assessments.

67. The Policy Council is also confident that this Report complies with the six principles of good governance.

Recommendations

68. The Policy Council recommends the States to note the actions which have been taken in response to recommendations made in the Report of the Tribunal of Inquiry into Industrial Action by Airport Firefighters at Guernsey Airport a number of which will be the subject of separate reports to the States in future.

L.S. Trott
Chief Minister

15 July 2011

B M Flouquet, Deputy Minister
G H Mahy
C N K Parkinson
D B Jones
C S McNulty Bauer
A H Adam
M H Dorey
P.R Sirett (Absent)
C A Steere
M.G O'Hara

Alternate Member present when this report was considered by the Policy Council:
J M Le Sauvage

(NB The Treasury and Resources Department: There are no resource implications associated with this Report.)

The States are asked to decide:-

IX. - Whether, after consideration of the Report dated 15th July, 2011, of the Policy Council, they are of the opinion:-

To note the actions which have been taken in response to recommendations made in the Report of the Tribunal of Inquiry into Industrial Action by Airport Firefighters at Guernsey Airport, a number of which will be the subject of separate reports to the States in future.

POLICY COUNCIL

PLANNING PANEL MEMBERSHIP

1. Executive Summary

1.1 The purpose of this States Report is threefold, namely to ask the States to appoint:

(a) Mr. Patrick Russell, who is currently the Chairman of the Planning Panel, as a Professional Member to replace Mr. William Bowen who has resigned from this position.

(b) Mr. Stuart Fell, who is currently a Professional Member of the Planning Panel, as the Panel's Deputy Chairman to replace Mr. William Bowen who has resigned from this position.

(c) Miss Julia White, who is currently a "reserve member" of the Planning Panel, as an Ordinary Member.

2. Background

2.1 The introduction of the Land Planning and Development (Guernsey) Law, 2005 on 6 April 2009 established an independent panel, the Planning Panel ("the Panel"), to hear appeals against decisions on planning applications.

2.2 On 25 March 2009, the States appointed Mr. Stuart Fell and Mr. William Bowen as the Panel's two Professional Members to chair these appeal hearings and to sit as a Single Professional Member.

2.3 On 3 June 2011, Mr. Bowen tendered his resignation for personal reasons.

2.4 The Policy Council wishes to record its appreciation to Mr. Bowen for his work with the Panel and notes that the Chairman has spoken of Mr. Bowen's limitless enthusiasm for his work with the Panel and his ability to put appellants at their ease when presenting their appeals.

3. Appointment of New Professional Members

3.1 Prior to Mr. Bowen's resignation, the Policy Council had agreed to a request from the Panel for a third Professional Member to be appointed as the Panel's workload was steadily increasing. As a result, the Panel was concerned that if either of the two Professional Members was unable to sit for a protracted period (e.g. because of illness) the remaining Professional Member would, undoubtedly, find it difficult to hear all appeals in a timely manner and also there would be no provision for dealing with conflicts of interest.

3.2 Following Mr. Bowen's resignation, the Policy Council has, in close consultation with the Panel, commenced the recruitment of two new Professional Members. In addition to advertising locally, an advertisement has been placed in "Planning", a fortnightly journal published by the Royal Town Planning Institute.

3.3 The Policy Council hopes that it will be possible to recruit two suitable qualified and experienced people to work alongside the existing members of the Panel.

3.4 In the interim, the volume of work before the Panel is such that it will not be possible for Mr. Fell to hear all appeals in a timely manner, nor is there any provision for hearing appeals where Mr. Fell may have a personal or professional conflict of interest.

4. Interim Arrangements

4.1 This recruitment process, including the need for a further States Report recommending the appointment of the successful candidates, and the time that may be needed for training means that it is unlikely that the two new Professional Members will be able to commence their duties until early 2012.

4.2 However, given the volume of work already before the Panel, Mr. Fell's other professional commitments and that there is already one appeal which Mr. Bowen was due to hear because Mr. Fell has a professional conflict of interest in the case, the Policy Council is asking the States to appoint the Panel's Chairman, Mr. Patrick Russell, as a Professional Member on an interim basis.

4.3 Section 86(3)(b) defines Professional Members as being persons:

> "*... with such qualifications and experience in planning matters as in the opinion of the States is necessary for the hearing and determination of appeals to the Planning Tribunal*."

4.4 Although Mr. Russell does not have any formal qualifications in planning he is an experienced solicitor and, in addition to his work with the Panel, is currently a part-time Tribunal Judge of the First-Tier Tribunal, Health, Education and Social Care Chamber. He has wide experience of sitting as a Tribunal Chairman and being responsible for the conduct of the proceedings and preparing the written judgement of the Tribunal and undertakes regular training in the practice and procedure of tribunals. Mr. Russell has sat regularly as an Ordinary Member of the Panel since it started hearing appeals in October 2009 and so has a sound understanding of local planning laws and policies, their application and the work of the Panel.

4.5 The Policy Council believes that Mr. Russell's appointment will ensure that the Panel is able to continue to carry out its responsibilities in a professional, timely

and efficient manner until the two new Professional Members have been appointed.

4.6 Mr. Russell has indicated that he is willing to sit as a Professional Member on this basis and that he would revert to sitting as an Ordinary Member once the two new Professional Members are appointed.

5. Appointment of a Deputy Chairman

5.1 In addition to his role as a Professional Member, the States had appointed Mr. William Bowen as the Panel's Deputy Chairman.

5.2 Following Mr. Bowen's resignation the Policy Council asked the Panel's Chairman to recommend a member of the Panel to be appointed as the Deputy Chairman. The Chairman has recommended Mr. Stuart Fell who is currently a Professional Member on the Panel.

5.3 Mr. Fell is currently employed as a consultant with a planning and architectural design practice based in Jersey. Prior to moving into private practice Mr. Fell was employed by the States of Jersey Planning Service as a conservation architect and urban designer and before moving to Jersey he had worked for a number of Local Authority Planning Departments and for the UK Planning Inspectorate as a planning inspector.

5.4 Mr. Fell has indicated that he is willing to take on this additional role and the Policy Council believes that his wide experience of planning matters will enable him to support and deputise for the Chairman and assist the Panel in developing its role.

6. Appointment of New Ordinary Member

6.1 The Panel currently has four Ordinary Members, including the Chairman, and two sit with a Professional Member to hear all appeals except those which are determined by a Single Professional Member. The majority of appeals heard by the Panel involve a Planning Tribunal.

6.2 The Chairman has advised the Policy Council that the appointment of an additional Ordinary Member is necessary to ensure that there are sufficient members to hear all appeals, especially should an individual make more than one appeal in relation to a particular development or site. For example, an appeal may be lodged where the Environment Department refuses permission for a retrospective application. If the appellant then fails to reinstate something he has demolished or to take down something he has built and the Department issues a Compliance Notice the appellant then has a right to appeal the Notice. In such circumstances the members of the Planning Tribunal appointed to hear the original appeal would be unable to hear any subsequent appeal.

6.3 In its March 2009 States Report seeking the appointment of the members of the Planning Panel, the Policy Council advised the States that three of the unsuccessful candidates interviewed had been asked to train as informal "reserve members" to be available should the workload require that the number of Panel members be increased. The Chairman, at the request of the Policy Council, has consulted with each of the "reserve members" to see whether they wished to be considered for appointment to the Panel and he has spoken with Mr. Fell regarding which of the three should be recommended to the Policy Council for appointment.

6.4 The Chairman has recommended the appointment of Miss Julia White. Miss White is an Advocate of the Royal Court and is currently employed as an Associate with Carey Olsen. Miss White undertakes a wide range of civil litigation, particularly relating to land and property disputes, and specialises in advising on planning, housing and other administrative law matters. The Chairman believes that Miss White's legal background will be of great assistance to the Panel. Miss White has also recently been appointed as a member of the Guernsey Tax Tribunal.

6.5 Miss White has indicated that she is willing to be appointed as an Ordinary Member of the Planning Panel.

Recommendations

7.1 In accordance with the provisions of the Land Planning and Development (Guernsey) Law, 2005, the Policy Council recommends that the States appoint:

(a) Mr. Patrick Russell to sit as a Professional Member of the Planning Panel until 5 April 2013.

(b) Mr. Stuart Fell to serve as the Deputy Chairman of the Planning Panel.

(c) Miss Julia White to sit as an Ordinary Member of the Planning Panel until 5 April 2013.

L S Trott
Chief Minister

25th July 2011

B M Flouquet, Deputy Minister
G H Mahy
C N K Parkinson
D B Jones
C S McNulty Bauer
A H Adam
P.R Sirett (Abstained)

M H Dorey
C A Steere
M.G O'Hara (Absent)

Alternate Members present when this report was considered by the Policy Council:
M.G Garrett

(NB The Treasury and Resources Department: There are no resource implications associated with this Report.)

The States are asked to decide:-

X. - Whether, after consideration of the Report dated 25th July, 2011, of the Policy Council, they are of the opinion:-

1. To appoint Mr. Patrick Russell to sit as a Professional Member of the Planning Panel until 5 April 2013, in accordance with the provisions of the Land Planning and Development (Guernsey) Law, 2005.

2. To appoint Mr. Stuart Fell to serve as the Deputy Chairman of the Planning Panel, in accordance with the provisions of the Land Planning and Development (Guernsey) Law, 2005.

3. To appoint Miss Julia White to sit as an Ordinary Member of the Planning Panel until 5 April 2013, in accordance with the provisions of the Land Planning and Development (Guernsey) Law, 2005.

TREASURY & RESOURCES DEPARTMENT

PROPOSED REVISIONS TO INCOME TAX LEGISLATION

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

13th July 2011

Dear Sir

1. **Executive Summary**

This Report contains proposals for:

1.1 the clarification of the income tax rules for the taxation of non-resident entertainers who carry out activities in Guernsey, to ensure that tax is still payable, in Guernsey, notwithstanding that the payment made in respect of the provision of those services may be routed through a third party, or a series of third parties;

1.2 the amendment of the Income Tax (Guernsey) Law, 1975, as amended ("the Income Tax Law") to provide for the appointment of more than one Deputy Director of Income Tax;

1.3 amendment of the Income Tax (Exempt Bodies) (Guernsey) Ordinance, 1989 ("the 1989 Ordinance") to modernise the definitions of which bodies can be granted exemption, and the conditions applying to such exemption;

1.4 amendment of the Income Tax Law regarding the powers available to the Director of Income Tax ("the Director") to enforce completion of tax returns;

1.5 the repeal of legislation which requires the Director to obtain the approval of an independent person before exercising his information gathering powers in respect of a request received from another jurisdiction under a Tax Information Exchange Agreement or other relevant international tax agreement ("TIEA");

1. 6 the clarification of the legislation which enables the Director to obtain information from taxpayers and third parties, in order to make it clear that

such information can be obtained for the purposes of collection, recovery and enforcement of a tax liability.

2. **The taxation of non-resident entertainers**

2.1 A self-employed non-resident entertainer (such as a singer, musician, comedian, actor, etc) is taxable, in Guernsey, on any income derived from Guernsey, as a consequence of him carrying on his business in the island.

2.2 Although Guernsey has Double Taxation Arrangements with the United Kingdom and Jersey, which contain special provisions exempting earnings where employees are in Guernsey for relatively limited periods of time (in order to prevent onerous double taxation of employees who move between the jurisdictions) those Agreements specifically exclude, from the exemption, "the profits or remuneration of public entertainers such as stage, motion picture or radio artists, musicians and athletes", meaning that they are liable to tax in respect of services performed in Guernsey, no matter how long they spend here.

2.3 This would also be the position for any entertainers who come to Guernsey from countries other than the United Kingdom and Jersey, in the absence of a Double Tax Arrangement providing otherwise.

2.4 Section 48 of the Income Tax Law provides that "… where a non-resident person is liable to tax in respect of any income and has an agent in Guernsey the agent shall be chargeable on his behalf with tax in respect of any such income which arises whether directly or indirectly from or through his agency".

2.5 Such a provision is important to ensure there is an effective mechanism for collecting tax in relation to non-resident entertainers because, by their nature, non-resident entertainers are only in the island for relatively short periods of time.

2.6 Where an entertainer contracts with a Guernsey promoter directly, therefore, section 48 will clearly apply and the Guernsey based promoter (the "agent") has to account to the Director for the tax liability of the non-resident (and will, generally, then pay on to the non-resident entertainer the net amount after deduction of the appropriate tax).

2.7 There can, however, be an issue where the entertainer contracts with an agency outside of Guernsey which then, in turn, contracts with a Guernsey based promoter. Increasingly, it is unusual for entertainers to contract with the promoter directly in their own names. In this day and age, most promoters contract their services through an agency, possibly using an interposed company. In the latter case, the entertainer would be an employee

of the company, which then would have a contract with an agency, which in turn contracts with the Guernsey promoter.

2.8 A question may then arise as to whether the Guernsey promoter has a responsibility, under the provisions of section 48 of the Income Tax Law, as "agent" for the non-resident performer. If they do not then section 48 would not apply and there is no effective mechanism for the Director to collect tax on the Guernsey income of the non-resident entertainer.

2.9 The Department considers it desirable for the Income Tax Law to be revised to make it clear that, in the circumstances outlined in 2.5 and 2.6. above, the Guernsey based person making a payment to a third party would remain liable as agent for the non-resident entertainer, under section 48 of the Income Tax Law, notwithstanding that the payment may be "routed" through a third party or, indeed, a series of third parties.

2.10 It could be envisaged that similar situations could arise outside of the entertainment world (such as when groups of employees are brought to Guernsey to work for a Guernsey based business, the provision of their services having been arranged through a non-Guernsey resident employment agency). It is proposed that the rules set out at 2.1 above would cover such situations also, unless the payment is otherwise exempted under the Income Tax Law.

3. Deputy Director of Income Tax

3.1 Under section 205(1) of the Income Tax Law, income tax is under the care and management of the Director:

"… to assist whom there may be appointed a Deputy Director of Income Tax."

3.2 Whilst section 1(b) of the Interpretation (Guernsey) Law, 1948 provides the general rule that, in the interpretation of legislation, the singular includes the plural, HM Procureur has advised the Director that as, under the Income Tax Law, the Deputy Director of Income Tax may, potentially, exercise any of the statutory functions of the Director, should it be considered appropriate to appoint more than one Deputy Director of Income Tax it would be advisable for the Income Tax Law to be revised to put beyond doubt the propriety, under the Income Tax Law, of any function carried out by any of the Deputy Directors.

4. Amendments to Exempt Bodies Ordinance

4.1 The Income Tax Law contains provisions which allow certain bodies to claim exemption from income tax, and the 1989 Ordinance sets out details of

the types of bodies which qualify for exemption and the conditions attached to it.

4.2 Since 2008, exemption has only been available to what are, in effect, collective investment schemes (funds). The rationale for granting such exemption is to facilitate the establishment of such schemes in Guernsey and to ensure that the ultimate investors pay tax only once on income received by them ultimately, according to their personal circumstances. If it were not for the income tax exemption, tax could be suffered on the investments of the scheme at various stages, thus creating double, or multiple, taxation.

4.3 Since the 1989 Ordinance was made, there have been developments in the way such schemes have been structured. This, together with the withdrawal of exemption from certain other categories of companies over the years, means it is now appropriate to update the Ordinance.

4.4 The Department therefore proposes that the 1989 Ordinance be amended so that any qualifying body, irrespective of its legal form or structure, is able to qualify for exemption. The main qualification would be that the body should be established for the purpose of collective investment, broadly the pooling of investments by a means available to the public.

4.5 Moreover, exemption should be extended to any body forming part of the structure under which the scheme, as a whole, operates. The reason for this is because many schemes establish a number of separate underlying bodies to deal with various aspects of the fund's investments and its administration. It seems appropriate, therefore, for exemption to be available to such bodies on the basis that exemption would have been available if all functions were carried out by the scheme itself.

4.6 For the avoidance of doubt, it would not, however, be the intention to allow exemption for those bodies which manage a range of unconnected schemes, and are independent of those schemes legally and economically.

4.7 Furthermore, it will continue to be a condition of exemption that the scheme should contract with a third party, licensed under the Protection of Investors or Regulation of Fiduciaries Law, established in Guernsey to provide administration, management, corporate secretarial and, where appropriate, custodial services.

5. Enforcing completion of tax returns

5.1 The Income Tax Office issues approximately 40,000 income tax returns in January each year and, unsurprisingly, not all of those are returned in the time allowed, which is currently 180 days. As a result, the Director has several methods available to him to encourage completion of the returns in those cases:

(a) In most cases where taxpayers do not pay the bulk of their income tax through the ETI Scheme, an assessment will be issued using estimated figures. Normally the taxpayer will appeal against such assessments and ultimately will provide the tax return, enabling the assessment to be revised to the correct figures. There is a process which prevents appeals remaining open indefinitely and which enables the appeal to be dismissed if the return is not submitted.

(b) The Director is able to impose a penalty administratively, such penalty not to exceed £300 for the initial offence, with a maximum continuing daily penalty of £50 for each day that the return remains outstanding after the imposition of the initial penalty.

(c) Finally, with effect from this year, the Director now has the ability to request prosecution of a person who does not complete a tax return within the time allowed, and the legislation allows for the court to impose a penalty and/or a term of imprisonment.

5.2 Following the introduction of a 0% standard rate of income tax for companies, estimated assessments, as described above, are no longer issued to most companies because no tax would be payable and, therefore, even if they were issued, there would be no encouragement for the company to appeal. These returns are still required, however, to ensure proper compliance with the Income Tax Law (e.g. correct operation of the ETI Scheme; complete return of distributions of profits and loans to participators, etc). As a result, it became clear that the only alternative method available to the Director, to enforce the delivery of returns in such cases effectively, was to make wider use of the imposition of administrative penalties. He also felt it appropriate to consider issues surrounding the enforcement of tax returns from all taxpayers at the same time.

5.3 As outlined above, the imposition of an administrative penalty is a process which requires manual identification of relevant cases by the officer working the case, followed by a referral to the Director for the instigation of the process enabling the penalty to be imposed. Before a penalty can be imposed, the Director must notify the taxpayer of his intentions to do so, and give them a reasonable opportunity to state their case. It is, therefore, a somewhat arbitrary process, which is fairly resource intensive. There may be the perception that there is a degree of inequity in this process, with some taxpayers being treated differently to others. The Department therefore proposes that:

(a) Where a tax return had not been submitted by the relevant deadline (see below), a penalty would be imposed automatically.

(b) By way of an administrative procedure, 30 days prior to the deadline, a letter would be sent to all persons who had not completed their tax returns, warning them of the imminent potential imposition of the penalty and encouraging them to file their return before then.

(c) At present, the Income Tax Law allows the Director to specify the period within which a return should be submitted, not being less than 21 days, and currently 180 days is allowed. It is envisaged that in view of the proposed wider application of the penalties system, he will extend the time ordinarily allowed for completion to 30 November in the year in which they are issued (i.e. 5 months longer than at present).

(d) The level of penalty to be imposed under (a) above would be as at present, that is an initial penalty not exceeding £300 and further daily penalties not exceeding £50.

(e) If the penalty had been correctly imposed in Law, it would not be rescinded, even once the return was completed, except in very exceptional circumstances, such as if serious ill health or other reasonable cause had prevented completion of the return within the statutory time period. However, where the taxpayer can prove that no tax would be due if a return were made, the penalty would be limited to £50, reflecting the existing position.

(f) The rights of appeal against the imposition of a penalty, contained at section 76 of the Income Tax Law, would still be available.

(g) The ability for the Director to refer a person for prosecution if the return is not submitted would remain as an alternative sanction.

6. Repeal of section 75CA

6.1 In 2008, the States approved changes to the information gathering powers of the Director where those powers were used to meet Guernsey's obligations under a TIEA. The changes introduced a procedure whereby TIEA requests were subject to additional scrutiny. In the Report to the States, the detailed proposals were:

"*The Administrator [now the Director] should only be able to obtain information for, and provide information to, another country pursuant to a request made under a TIEA following a process of verification by a person independent of the Administrator, that the request to the Administrator has complied in its formal and procedural aspects with the terms of the relevant TIEA. It will not be for that person to enquire into the substantive issues raised in and by the request, or into the factual background.*"

6.2 Following the approval of the Report, legislation was drafted which inserted section 75CA into the Income Tax Law. Those provisions permitted the President of the Guernsey Tax Tribunal to appoint a person to review all requests for information and verify that the request had been made in accordance with the formal and procedural requirements. Without the approval of that appointed person, the Director would not be able to exercise his powers.

6.3 Although approved by the States in 2008, the legislation has only recently received Royal Assent, and has not yet taken effect. In the meantime, the Director has received requests for assistance under TIEAs and has, therefore, continued to exercise his powers to obtain and exchange information under Guernsey's TIEA network in the manner provided for by the existing legislation.

6.4 Guernsey has recently undergone an assessment by the Global Forum on Transparency and Exchange of Information for Tax Purposes. This was a Phase 1 Review and considered only the legal framework for information exchange. Guernsey received an excellent report, with only minor deficiencies identified in the legislative framework. In 2012, however, Guernsey will undergo the second Phase of the Review, which will be an examination of the practical effects of the application of the legislative framework. One aspect to be examined will be the timeliness of responses by the Guernsey authorities to requests for information from its TIEA partners. The global standard generally requires requests to be dealt with within 90 days.

6.5 During the Phase 1 assessment, and anticipating the Phase 2 Review, the following concerns were raised by the Global Forum Assessment Team regarding section 75CA of the Law:

"The forthcoming amendment to the Income Tax Law does not provide any specific timeline and it is unclear from this Phase 1 assessment whether the additional safeguards described above will result in an unduly restrictive condition which may prevent Guernsey from fully complying with its obligations under the TIEAs …."

6.6 To that extent, therefore, it is possible that the existence of section 75CA may lead to difficulties in Guernsey achieving the required standards to fulfil the Phase 2 assessment process, in 2012.

6.7 Whilst Guernsey is currently "white listed" by the Global Forum, having made strenuous efforts to achieve the required standards, it is likely that those standards will evolve over time, particularly in the light of the current Peer Reviews being undertaken.

6.8 It is important that Guernsey takes care to ensure that it has in place the relevant mechanisms to ensure it meets its obligations under the TIEAs into which it has entered in a timely manner, and the existence of the additional scrutiny process described above (the absence of which, to date, has caused no significant concerns) can only add to the time it takes for Guernsey to do so. It may also be perceived by the Global Forum that Guernsey is introducing unnecessary barriers to information exchange, which may have the potential to detract from Guernsey's deserved reputation as a co-operative, transparent and well-regulated jurisdiction.

6.9 As mentioned earlier, whilst Royal Assent was awaited for section 75CA, the Director has continued to exercise the information gathering powers in respect of any TIEA requests received without the oversight described above. So far as the Department is aware, this has not created any difficulties or undue concerns. Furthermore, the non-application of section 75CA would in no way extend the type, or amount, of information that the Director is authorised to exchange under the terms of each TIEA.

6.10 Apart from the fact that this provision might impact adversely on Guernsey's international profile, it is also the case that implementation of section 75CA will create additional administrative costs. In the light of the current efforts being made by the States to reduce expenditure, the Department considers such additional costs to be unnecessary and unjustifiable.

6.11 In the light of the above, the Department believes that section 75CA should be repealed as soon as possible. In reaching this decision, the Department has consulted with, and has taken account of the views of, the Guernsey International Business Association and the Financial Sector Group.

7. Clarification of Part VIA regarding collection, enforcement and recovery action

7.1 Part VIA of the Income Tax Law was introduced in 2005 in order to enable the Director to obtain information from both taxpayers themselves and from third parties in respect of that taxpayer, in order to assist the Director in establishing a taxpayer's liability.

7.2 Clearly the collection of that tax, having established the amount of the liability, is an integral part of the Director's functions under the Income Tax Law, and there are occasions when it will be helpful for the Director to be able to obtain information to assist in the collection process, on the same basis as he is able to obtain it in order to establish the liability initially.

7.3 The Department therefore proposes that the Income Tax Law be clarified in order to put it beyond doubt that the powers contained in Part VIA of the Income Tax Law may be used for the purposes of obtaining information not

only in connection with establishing the amount of the tax liability, but also in connection with the collection, recovery and enforcement of that liability.

8. Principles of Good Governance

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

9. Legislation

9.1 Following Royal Assent to the Income Tax (Zero 10) (Guernsey) Law 2007, the Income Tax Law was amended to introduce section 208C, which permits the States to amend the Income Tax Law by Ordinance. This is the process which will be used to effect the amendments proposed in this Report.

9.2 The Law Officers have been consulted about these proposals.

10. Recommendations

The Department recommends the States to agree that:

1. section 48 of the Income Tax Law be revised to make it clear that where a person in Guernsey makes a payment in connection with the provision, in Guernsey, of services by a non-resident who is liable to tax in respect of that payment then that person would be treated as "agent" for the non-resident for the purposes of section 48, notwithstanding that the payment was paid through a third party, or a series of third parties, unless the payment is otherwise exempted under the Income Tax Law;

2. The 1989 Ordinance should be amended to ensure that any entity or legal arrangement which is a body for the purposes of the Income Tax Law and which is, or which is concerned with, a collective investment scheme be capable of gaining exemption from income tax, irrespective of its legal form, provided it is established for the purposes of undertaking collective investment, or is in the beneficial ownership of such a body, or has some other prescribed legal or economic connection with such a body (for example, the management of its assets).

3. the Income Tax Law be revised to make it clear that more than one Deputy Director of Income Tax may be appointed to assist the Director in carrying out his statutory functions, and that any reference in the Income Tax Law to "the Deputy Director of Income Tax" would include any such Deputy Director, so appointed;

4. the Income Tax Law be amended in order to provide for the automatic imposition of a penalty, in the circumstances described in paragraph 5.3 above;

5. section 75CA of the Income Tax Law be repealed and consequential amendments be made;

6. Part VIA of the Income Tax Law be amended in order to make it clear that the provisions therein relating to the obtaining of information apply to collection, recovery and enforcement action taken by the Director.

Yours faithfully

C N K Parkinson
Minister

Deputy J Honeybill (Deputy Minister)
Deputy R Domaille
Deputy A Langlois
Deputy S Langlois

ANNEX

Proposed revisions to income tax legislation

This Annex sets out information which:

1. contains information justifying the need for legislation;

2. confirms how funding will be provided to carry out functions required by the new legislation;

3. explains the risks and benefits associated with enacting/not enacting the legislation;

4. provides an estimated drafting time required to draw up the legislation.

1. The need for legislation

Each of the proposals contained in the Report will either result in additional tax revenues (sections B and E), facilitate or enhance the administration of the income tax system (sections C, E, F and G), or provide support to Guernsey's financial services sector (section D).

2. Funding

Only sections C and E will require additional funding. In both cases, any additional salary or computer program costs will be accommodated within normal departmental budgetary allocations, as appropriate.

3. Risk and benefits

If the legislation to implement the proposals is not enacted, it is likely that tax revenues will not increase (sections B and E), the administration of income tax could be less efficient than might otherwise be the case (sections C, E, F and G), or the ability of Guernsey's financial services sector to expand might be inhibited (section D).

4. Drafting time

Required drafting time for legislation is estimated to be one week.

(NB The Policy Council supports this Report.)

The States are asked to decide:-

XI.- Whether, after consideration of the Report dated 13th July, 2011, of the Treasury and Resources Department , they are of the opinion:-

1. To revise section 48 of the Income Tax Law to make it clear that where a person in Guernsey makes a payment in connection with the provision, in Guernsey, of services by a non-resident who is liable to tax in respect of that payment then that person would be treated as "agent" for the non-resident for the purposes of section 48, notwithstanding that the payment was paid through a third party, or a series of third parties, unless the payment is otherwise exempted under the Income Tax Law;

2. To amend the 1989 Ordinance to ensure that any entity or legal arrangement which is a body for the purposes of the Income Tax Law and which is, or which is concerned with, a collective investment scheme be capable of gaining exemption from income tax, irrespective of its legal form, provided it is established for the purposes of undertaking collective investment, or is in the beneficial ownership of such a body, or has some other prescribed legal or economic connection with such a body (for example, the management of its assets).

3. To revise the Income Tax Law be revised to make it clear that more than one Deputy Director of Income Tax may be appointed to assist the Director in carrying out his statutory functions, and that any reference in the Income Tax Law to "the Deputy Director of Income Tax" would include any such Deputy Director, so appointed.

4. To amend the Income Tax Law in order to provide for the automatic imposition of a penalty, in the circumstances described in paragraph 5.3 above.

5. To repeal section 75CA of the Income Tax Law and make consequential amendments.

6. To amend Part VIA of the Income Tax Law in order to make it clear that the provisions therein relating to the obtaining of information apply to collection, recovery and enforcement action taken by the Director.

TREASURY AND RESOURCES DEPARTMENT

APPOINTMENT OF NON-EXECUTIVE DIRECTORS
GUERNSEY ELECTRICITY LIMITED

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

13th July 2011

Dear Sir

1. Under the States Trading Companies (Bailiwick of Guernsey) Ordinance 2001, non-executive directors of a States Trading Company shall be appointed by the States on the nomination of the Treasury and Resources Department.

2. The Treasury and Resources Department is recommending the appointment of two new non-executive directors of Guernsey Electricity Limited; Mr Robert Lawrence and Mr Ian Hardman, who have both agreed that their names can be put forward.

3. The company has recently decided to increase its number of executive directors to four but, under its Articles of Association, the number of non-executive directors must exceed the number of executive directors. Following the recent and untimely death of Mr Ken Gregson, who had diligently and very ably led the Board since it was commercialised in 2002, the number of non-executive directors of the company has been reduced to three and it is therefore necessary for the States to approve the appointment of two new non-executive directors of Guernsey Electricity Limited.

4. It is essential for the good corporate governance of the States Trading Companies that the non-executive directors on the Board have, between them, appropriate and wide experience which is relevant to the Company's business. The two nominees, Mr Robert Lawrence and Mr Ian Hardman, have extensive experience and it is considered that their appointment will complement and enhance the skill set of the Board.

5. Mr Lawrence started as a telecoms technical engineer in Jersey. He held various posts in Jersey Telecoms rising to be Chief Executive Officer of the group, a position he held from 1991 until January 2010. He therefore has extensive experience of working within a utility based organisation.

6. Mr Hardman is an Associate of the Chartered Institute of Secretaries and Administrators and has been employed within the Guernsey Finance industry since leaving school in 1973. He is currently the Senior Island Manager of Lloyds TSB Offshore Limited.

7. **Recommendation**

7.1 The Treasury and Resources Department recommends the States, in accordance with section 3 (1) of the States Trading Companies (Bailiwick of Guernsey) Ordinance, 2001, to:

(a) Appoint Robert Lawrence as a non-executive director of Guernsey Electricity Limited.

(b) Appoint Ian Hardman as a non-executive director of Guernsey Electricity Limited.

Yours faithfully

C N K Parkinson
Minister

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

(NB The Policy Council supports this Report.)

The States are asked to decide:-

XII.- Whether, after consideration of the Report dated 13th July, 2011, of the Treasury and Resources Department, they are of the opinion:-

1. To appoint Robert Lawrence as a non-executive director of Guernsey Electricity Limited, in accordance with section 3 (1) of the States Trading Companies (Bailiwick of Guernsey) Ordinance, 2001.

2. To appoint Ian Hardman as a non-executive director of Guernsey Electricity Limited, in accordance with section 3 (1) of the States Trading Companies (Bailiwick of Guernsey) Ordinance, 2001.

SOCIAL SECURITY DEPARTMENT

BENEFIT AND CONTRIBUTION RATES FOR 2012

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

13 July 2011

Dear Sir

Executive summary

Introduction

1. The Department has undertaken its annual review of the social security and health benefits paid under the various schemes for which it is responsible and will recommend increases in all benefit rates.

2. The Department's benefit uprating policy is, over the long-term, to increase benefit rates at the mid-point of the increase in RPI (prices) and the increase in earnings. As the States has now adopted RPIX as the official measure of inflation and given that over the long-term, earnings generally exceed prices by 2% per year, the Department's benefit uprating policy is, effectively, RPIX plus 1%. The actuarial reviews of the Guernsey Insurance Fund, the Guernsey Health Service Fund and the Long-term Care Insurance Fund have now been undertaken and appear in the appendix to the Billet d'Etat containing this report. The actuarial reviews for the Guernsey Insurance Fund and the Long-term Care Insurance Fund show that the current contribution rates are inadequate to finance those schemes in the long-term.

3. Having regard to the June 2011 RPIX of 2.6% the Department is recommending increases of approximately 3.6% for the contributory (contribution based) social insurance and long-term care insurance benefits and increases of approximately 2.6% for the non-contributory benefits funded from general revenue.

Key Recommendations

The Department is recommending a number of changes and the key ones are set out below:-

- the third phase increase in the upper earnings limit for employed, self-employed and non-employed people as part of the 5 year phasing in period (as agreed at the July 2009 States meeting Billet d'Etat XXI of 2009) from £91,884 to £105,144 from 1 January 2012 (paragraphs 37, 44 and 48).

- increases in the upper earnings limit for employers from £120,900 to £125,268 per year and in the lower earnings limit from £117 to £121 per week from 1 January 2012 (paragraphs 38 and 42).

- an increase in the lower income figure at which non-employed contributions become payable from £15,210 to £15,730 per year from 1 January 2012 (paragraph 51).

- an increase in the non-employed allowance, which is subtracted from the annual income figure before liability is calculated, from £6,451 to £6,675 from 1 January 2012 (paragraph 52).

- an updating of the range of permitted investments for the funds which are controlled and administered by the Department (paragraphs 60 to 61).

- an increase in the prescription charge of 10p, taking the cost of a prescription to £3.10 per item from 1 January 2012 (paragraph 68).

- an extension of the Health Service (Benefit) legislation so that community nurses employed by the Health and Social Services Department can issue medical prescriptions for wound management products (paragraphs 69 to 72).

- an amendment to the Supplementary Benefit (Implementation) Ordinance, 1971 so that residence and adoption order allowances can be fully disregarded from the calculation of entitlement to supplementary benefit (paragraphs 114 to 119).

- an above RPIX increase in the benefit limitation which applies to supplementary benefit, taking it from £405.00 per week to £450.00 per week from 6 January 2012 (paragraphs 125 to 133).

- an increase in the supplementary fuel allowance from £24.67 to £27.09 per week for the 27 week period commencing from the last week in October 2011 (paragraphs 140 to 142).

- an increase in family allowance from £15.00 per week to £15.40 per week from 2 January 2012 (paragraphs 144 to 145).

REPORT

PART I
SOCIAL INSURANCE

Income and expenditure on Guernsey Insurance Fund

4. At the July 2009 States meeting, the Department reported on the future financing of the contributory social security schemes (Billet d'Etat XXI of 2009). The States approved the majority of the Department's proposals, but did not approve the proposed increase of 0.5% in the contribution rate paid by employers. This proposal would have increased the current rate from 6.5% of earnings to 7.0% of earnings and played a key part in a package of measures aimed at securing the long-term financing of the contributory social security schemes.

5. The Guernsey Insurance Fund accounts for 2010 are shown below.

2010 Guernsey Insurance Fund Accounts	
Income from contributions	£88.49m
Income from States Grant	£13.26m
Total (excluding investment income)	£101.75m
Total benefit expenditure and administration	£104.26m
Operating deficit	£2.51m
Depreciation (mainly IT systems)	£1.14m
Total operating deficit	**£3.65m**

6. The expected deficit in 2011 is £5.9m. Taking into account the proposed benefit uprating of 3.6%, the expected deficit in 2012 is £7.67m. The deficits will be covered by investment income or from the reserves of the Guernsey Insurance Fund.

Financial sustainability of Guernsey Insurance Fund

7. The Department is keen to put in place the necessary measures to ensure the long-term sustainability of the Guernsey Insurance Fund. At the request of the Policy Council's Fiscal and Economic Group, the Department has continued to await the resolution of the second phase of Zero-10 before bringing forward any further proposals on changes to contribution rates. That process has become extended and the Department is not aware of a conclusion being likely in the immediate future. Meanwhile, the absence of the 0.5% which had been recommended in July 2009 as an increase to the employer contribution is resulting in the Fund foregoing £6m per year in contribution income. Consequently, and although the long-term strategy is for a substantial draw-down of the Fund's reserves, the Fund is in a deepening operational deficit situation earlier than anticipated.

8. Furthermore, the Government Actuary's Department has reviewed the Guernsey Insurance Fund for the years 2004 to 2009, inclusive, and has made updated, long-term projections to 2070.

9. The actuarial review, which appears in the appendix to the Billet d'Etat containing this report, indicates that, if contribution rates remain unchanged, the reserves of the Fund will be exhausted by 2037. From the projections contained in the review and following further enquiries made of the actuaries it has been confirmed that, with no further reserves to draw on, there would then be an immediate need, from 2038 onward to:

   a. Either increase the pay-as-you go contribution rate from the current 8.3% (employee and employer combined) to around 13% of earnings; or
   b. Draw on General Revenue by around £90m per year (in 2011 prices); or
   c. Make substantial cuts in pension expenditure.

10. The Department considers that the financing of the Guernsey Insurance Fund needs to be addressed with the minimum of further delay in order to avoid reaching a position where any of the above measures would have to be contemplated.

11. The Department's 2009 proposals for financial sustainability of the Fund, which incorporated the proposed 0.5% on the employer contribution, envisaged a drawdown of the Fund over the long-term but, throughout the projection to 2060, envisaged a balance of approximately 2 years' expenditure being retained in the Fund to cope with the fluctuations of the economic cycle.

12. From further enquiries made of the actuaries following receipt of the actuarial review, it has been estimated that an increase in the employer's contribution rate of 1.7% instead of 0.5% would be required for long-term sustainability. This is a substantially worse position than previously indicated. The Department is informed that the difference is a result of a substantially increased longevity assumption. The increased longevity has added significance within the assumption of a constant level of population, which is the States policy, as the model assumes that the population is kept constant through a reduction of people of working age rather than pensioners. Clearly, this latest information concerning the estimated contribution increases necessary for sustainability adds weight to the need to address these matters very soon. It should be noted that there are similar issues with the contribution rates for long-term care insurance, which are referred to in paragraphs 94 to 99 of this report.

States Grants to Funds

13. The Guernsey Insurance Fund currently receives a grant from general revenue equal to 15% of the total amount collected in contributions. The Guernsey Health Service Fund receives a similar grant equal to 12% of the

contributions collected for that Fund. The Department is not recommending any change in the level of the States grants for 2012.

14. The estimated costs to general revenue for the States grants to the two funds is shown below.

Fund	General Revenue Grant	General Revenue Grant
	2012	2011
Guernsey Insurance Fund	£14,490,000	£13,845,000
Guernsey Health Service Fund	£4,395,000	£4,190,000
	£18,885,000	£18,035,000

Number of pensioners

15. At the end of May 2011, the Department was paying pensions to 15,289 pensioners worldwide. In 2010, benefit expenditure on old age pensions amounted to £82.12m and constituted 82% of the total expenditure of £100.30m on social insurance benefits.

Number of people unemployed

16. Using the International Labour Organisation's definition of unemployed, which excludes anybody on a government training scheme (such as the Community and Environmental Projects Scheme) and anybody who carries out at least one hour's paid work in a week (which could be the case for someone claiming supplementary benefit as a jobseeker), the number of unemployed at the end of May 2011 was 266 or 0.82% of the working population. Using local benefit definitions, there were 431 jobseekers at the end of May 2011, which is 1.35% of the working population. This included 231 people claiming contributory unemployment benefit and 165 people without entitlement to the contributory unemployment benefit but receiving supplementary benefit. 130 of these were in part-time or casual employment. A further 35 people were temporarily employed on the Community and Environmental Projects Scheme or other form of training scheme.

17. The Department continues to work closely with the Housing Department to ensure that employers seeking short-term housing licences engage with the Job Centre as part of their recruitment process. In the 2010 benefit uprating report the Department explained that it was exploring ways to work with professional recruitment consultants in order to maximise the opportunities to match the unemployed to vacancies. This resulted in a local recruitment agency working from within the Job Centre on a trial basis. Having considered the results of the trial (December 2010 outcomes below), the Department has undertaken a tender exercise in order to continue the service throughout 2011, with an option to extend into 2012.

Outcomes as at 22 December 2010					
Claim Duration	**Number Referred**	**Started work or claim closed**	**Claims Ongoing**	**Target Results**	**Actual Results**
< 14 weeks	39	20	19	50%	51%
14 to 26 weeks	32	21	11	40%	66%
> 26 weeks	65	38	27	30%	58%
Totals	**136**	**79**	**57**		

18. In the 2010 benefit uprating report (Billet d'Etat XX of 2010), the Department made reference to training courses commencing at its new training centre on the Raymond Falla House site in St Martins. "Get into Woodwork" and "Get into Plastering" have been delivered to jobseekers aged under 25. The Department is pleased to report that out of the 9 that completed the woodwork course, 5 moved into permanent employment. The Department continues to work with the other 4 to improve their work readiness. Of the 7 that attended the plastering course, 3 moved into permanent employment and the Department continues to work with the other 4 to improve their work readiness. At the time of writing this report a "Get into Decorating" course was being delivered and the Department is expecting equally positive outcomes. Further courses related to other trade skills will be delivered and it is hoped that this approach will continue to identify young people with an aptitude for particular trades which will lead to employment and generate additional interest in the Education Department's apprenticeship scheme.

19. In the 2009 benefit uprating report (Billet d'Etat XXIV of 2009), the Department explained that it was working on proposals to introduce a recruitment grant payable to employers who employ people who have been long-term unemployed or are returning to work following a prolonged illness. The Department is pleased to report that over the last 18 months the recruitment grant has helped facilitate a return to work for 22 individuals. 10 were paid in respect of people starting work again following long-term illness and 12 were paid in respect of long-term jobseekers returning to work. While the Department would like more employers to take advantage of this initiative, it is still great news for the individuals returning to work and their families because re-entering work following a prolonged absence is often difficult to achieve. The Department will continue to work with employers to help other long-term claimants return to the workplace.

20. The recent arrival of Waitrose in Guernsey has provided the Social Security Department and Education Department with the opportunity to develop a food and retail skills shop on the Admiral Park site. Once fully developed the skills shop will provide access to learning, recruitment and skills development for those looking to work in the food and retail industries and their employers. The Department is keen for jobseekers and people recovering from illness to make use of the skills shop to help them find out about work

opportunities within the food and retail sectors and to obtain advice, support and training relating to these sectors.

21. The skills shop is managed on a day to day basis by the College of Further Education and the services on offer will be gradually developed with input from the Job Centre, Careers Service and Chamber of Commerce. Social Security, Education and Chamber of Commerce see this as a great opportunity for the Guernsey community to raise the profile of careers, particularly within retail and customer care sectors. The report on skills produced by Frontier Economics in early 2010 highlighted employers views that customer handling skills were a priority area for further development and this new initiative should help to bridge this gap in provision.

22. The skills shop is the latest addition to the Department's various initiatives aimed at encouraging and supporting people back into work. The full range of initiatives is set out in the following table:

Initiative	Description
Work trial	Chance to demonstrate capability to an employer where a real job is on offer. (Benefit remains in payment).
Work experience	Extended work experience with learning goals. (Benefit remains in payment).
Gradual return to work	Phased return to work following long-term sickness. (Some benefit remains in payment).
Kick start	One to one training with trades people aimed at young people at risk of long-term unemployment. (CEPS wage paid).
Basic skills training	Help with basic I.T., reading and number skills. (Benefit remains in payment).
Short-term training	Help for the long-term unemployed or those requiring retraining following illness. (Benefit remains in payment).
Back to work bonus	One-off lump sum payable following a return to work and claim closure in cases of long-term unemployment and long-term sickness.
Job start expenses	Help with some of the costs associated with starting work, such as tools, boots, clothing etc.
GOALS	Motivational course aimed at tackling barriers to employment by improving self-esteem and developing a positive mental attitude. (Benefit remains in payment).
Community & Environmental Projects Scheme (CEPS)	Paid work and training opportunities for people who are not working due to unemployment or long-term illness. (CEPS wage paid).

Recruitment grant	Staged payments to an employer to recognise the extra training and support required when recruiting someone who has been long-term unemployed or long-term sick.
The "Get into ..." range of training courses	Short courses aimed at unemployed young people to help identify their skills aptitude. Type of course often dictated by vacancy market and feedback from employers on particular trades. (Benefit remains in payment).
Food and Retail Skills Shop	Promoting work opportunities within the food and retail sectors and provision of advice, support and training.

Update on the number of people receiving invalidity benefit

23. The Department has reported a rising trend in long-term incapacity in previous benefit uprating reports. The table below compares snapshot data on claim numbers at around the same date since 2008.

Snapshot comparison of number of invalidity benefit claims		
Date	**Claim Numbers**	**Percentage increase on previous year**
7 June 2008	786	4%
6 June 2009	837	7%
5 June 2010	911	9%
4 June 2011	923	1%

24. The Department is pleased that the snapshot data for June 2011 is only showing a 1% increase on the 2010 snapshot. While the Department continues to provide a one-to-one work rehabilitation service and senior officers continue to meet regularly with the Primary Care Committee and discuss early intervention and return to work issues, it is too early to ascertain whether these approaches have actually contributed to helping to stem the rising trend in claims on a permanent basis. The Department will continue to monitor the situation and provide a further update in its 2012 benefit uprating report.

25. The four tables that follow this paragraph set out the age ranges and gender of invalidity benefit cases, the turnover of claims, the ten most frequent diagnoses, and the breakdown of those ten by age and gender. As in previous benefit uprating reports, mental health-related incapacity accounts for a significant number of invalidity benefit claims. Altogether, mental health-related illness accounts for more than 30% of all invalidity benefit claims. As the Department only captures the primary diagnosis for any case, it is highly likely that many other invalidity benefit claimants who have been ill for prolonged periods will have secondary mental health conditions which also impede their return to work.

Age range and gender of invalidity benefit cases as at 4 June 2011				Difference compared to 2010
Age	Gender		Totals	
	M	F		
16-29	36	27	63	-9
30-39	50	44	94	+8
40-49	91	111	202	-4
50-59	164	128	292	-1
60-64	178	94	272	+18
			923	**+12**

Turnover in invalidity benefit claims during 2010	
Number of active claims at 1 January 2010	861
Less number of claims closed during 2010	361
No. of claims active throughout 2010	**500**
Plus number of new claims in 2010	437
Number of active claims at 31 December 2010	**937**

Ten most *frequent diagnoses on invalidity benefit claims as at 4 June 2011			
Diagnosis	**2011 claim numbers**	**2010 claim numbers**	**Difference compared to 2010**
Mental disorder	159	167	-8
Depression	77	68	+9
Chronic obstructive lung disease	25	18	+7
Cerebrovascular accident	23	19	+4
Anxiety	20	25	-5
Back pain	20	23	-3
Multiple sclerosis	17	15	+2
Chronic back pain	17	11	+6
Chronic fatigue syndrome	17	13	+4
Alcoholism	13	19	-6

*other less common diagnoses on invalidity benefit claims may also relate to some conditions listed above.

Ten most frequent diagnoses on invalidity benefit by age and gender as at 4 June 2011						

Diagnosis	16 - 29		30 - 39		40 - 49		50 - 59		60 - 64		Total
	F	M	F	M	F	M	F	M	F	M	
Mental disorder	5	12	20	13	31	14	22	26	3	13	159
Depression	6	8	8	3	9	6	13	10	6	8	77
Chronic obstructive lung disease	0	0	0	0	0	1	2	5	3	14	25
Cerebrovascular accident (stroke)	0	0	0	0	1	2	1	6	5	8	23
Anxiety	1	2	2	1	3	0	3	1	3	4	20
Back pain	1	0	0	4	2	1	2	4	3	3	20
Multiple sclerosis	0	0	0	0	4	3	4	4	1	1	17
Chronic back pain	1	0	2	0	2	3	3	1	1	4	17
Chronic fatigue syndrome	2	0	0	0	3	0	5	0	5	2	17
Alcoholism	0	0	0	1	0	3	2	4	0	3	13

26. At the June 2010 States meeting (Billet d'Etat XV of 2010), the States approved a Projet de Loi which has enabled the Department to finance through the Health Service Fund, a 2 year pilot for the provision of psychological therapies at primary care level. A steering group involving Social Security, Health and Social Services and the Primary Care Committee was formed during the first quarter of 2011 in order to oversee the creation of the new service, which is expected to commence in September 2011.

27. While the development of a psychological therapies service at primary care level is a significant development and should prevent some mental health-related claims from becoming long-term, the Department is still very concerned by the overall rising trend in sickness-related claims to benefit. To put this into perspective, in 2010 the Department paid out from the Guernsey Insurance Fund, £3.36m in sickness benefit and £7.41m in invalidity benefit. In addition, it paid a further £3.62m from its formula-led general revenue budget in respect of sickness claims from supplementary benefit claimants, thereby bringing the total expenditure on sickness-related benefits in 2010 to £14.39m.

28. In order to tackle the rising trend in the number and length of incapacity-related benefit claims the Department has identified the need to develop an Incapacity Strategy, in close consultation with the Health and Social Services Department (HSSD) and the Primary Care Committee. The Incapacity Strategy will be supported by a Work Rehabilitation Strategy. The development of these two strategies is scheduled to commence in early 2012. In the meantime the Department has commenced a project through the Financial Transformation Programme to introduce incapacity-related claims management within the supplementary benefit scheme. Further information on this project is set out in paragraphs 104 to 105.

29. In the 2010 benefit uprating report, the Department explained its intention to investigate how it might replace sickness benefit and invalidity benefit with a single incapacity benefit, which does not increase in value the longer a person remains out of work. The Department proposed that, pending the outcome of the investigation and as a first step towards closing the gap between the two benefits, invalidity benefit should not be increased by the same percentage level as that proposed for all the other contributory benefits, including sickness benefit. However, following a successful amendment from Deputy Stephens, invalidity benefit was increased in line with all other contributory based benefits from 2011.

30. The Department has identified the investigation into the creation of a single incapacity benefit as a project to be undertaken. However, work is not currently scheduled to commence until June 2012. In the meantime, the Department is recommending that invalidity benefit be increased in line with all other contributory benefits from 2012 as set out in paragraph 33.

Proposed Benefit Rates for 2011

31. The Department is recommending increases in the rates of pension and all other social insurance benefits of approximately 3.6% to take effect from 2 January 2012.

32. The proposed 3.6% increase in old age pension will add £6.44 per week to the full rate single pension, will add £3.22 per week to the so called 'married woman's pension' and will mean a £9.80 per week increase for a pensioner couple on full rate pension. The joint increase will be £12.88 per week in cases where both spouses were paying full-rate contributions throughout their working lives as they will receive two full pensions totalling £372.26 per week.

33. The proposed new rates of pension and other contributory social insurance benefits are shown below:

Weekly paid benefits	**2012**	**2011**
Old Age Pension -		
Insured person	£186.13	£179.69
Increase for dependant wife or pension for wife over 65 based on husband's record (marriages pre 01-01-04)	£93.24 £279.51	£90.02 £269.71
Widow's/Survivor's Benefits -		
Widowed Parent's Allowance	£195.72	£188.93
Bereavement Allowance/Widow's Pension	£168.28	£162.40
Unemployment, Sickness, Maternity and Industrial Injury Benefit	£136.99	£132.23

Invalidity Benefit	£164.64	£158.90
Industrial Disablement Benefit -		
100% disabled	£150.01	£144.83
One-off grants		
Maternity Grant	£343.00	£331.00
Death Grant	£534.00	£515.00
Bereavement Payment	£1,689.00	£1,630.00

34. These foregoing rates of weekly benefit and grants apply to persons who have fully satisfied the contribution conditions. Reduced rates of benefit are payable on incomplete contribution records, down to threshold levels.

Social insurance contributions

35. Pending the resolution of the second phase of Zero-10 referred to in paragraph 7, the Department will not be recommending any changes to the percentage contribution rates for 2012, which will therefore continue at the current rates and the income allocated across the 3 Funds as shown in the following tables.

Contribution rates for employed persons	**2012**	**2011**
Employer	6.5%	6.5%
Employee	6.0%	6.0%
Total	12.5%	12.5%

Contribution rates for self-employed persons	10.5%	10.5%

Contribution rates for non-employed persons under 65	9.9%	9.9%

Contribution rates for non-employed persons over 65	2.9%	2.9%

36. In accordance with the States Resolutions concerning the future financing of the contributory social security schemes (Billet d'Etat XXI of 2009) the upper earnings and income limits for employed people, self-employed people and non-employed people are to be incrementally increased from 1 January 2010 to match the upper earnings limit for employers. 2012 represents the third year of a 5 year phasing-in period.

2012 upper earnings limit for employed people

37. As the third step toward the alignment of the upper earnings limit with that applicable to employers, the Department recommends that, from 1 January 2012, the upper earnings limit for employed people should increase from £91,884 per annum to £105,144 per annum. For people paid weekly, this means an increase from £1,767 to £2,022 per week. For people paid less frequently than weekly, this means an increase from £7,657 to £8,762 per month.

2012 upper earnings limit for employers

38. The Department recommends that, from 1 January 2012, the upper earnings limit for the employers' contribution be increased by approximately 3.6%, from £120,900 per year to £125,268 per year. For people paid weekly, this means an increase from £2,325 to £2,409 per week. For people paid less frequently than weekly, this means an increase from £10,075 to £10,439 per month.

39. The effect of the proposed new upper earnings limit on people who pay a contribution at the new upper earnings limit is as follows:

Maximum 2012 contributions (2011 in brackets)

Weekly Earnings	**Contributions per week**		
	Employer	Employee	Total
	6.5%	6.0%	12.5%
Upper Earnings Limit	£2,409	£2,022	
	(£2,325)	(£1,767)	
Maximum payable	£156.58	£121.32	£277.90
	(£151.12)	(£106.02)	(£257.14)

Number of contributors paying at upper earnings limits

40. In 2011, with an upper earnings limit of £91,884 per year, there were 5% of employed persons and 16% of self-employed persons paying on earnings at or above that level.

41. In 2011, with an upper earnings limit of £120,900 per year for employers, contributions were being paid at or above that level of earnings in respect of 3% of employees.

2012 lower earnings limit for employed people

42. The Department recommends that the lower earnings limit be increased from £117 per week to £121 per week. The corresponding monthly limit would be £524.33.

43. The effect of the foregoing changes on a contribution at the lower earnings limit is as follows:

Minimum 2012 contributions (2011 in brackets)

Weekly Earnings	**Contributions per week**		
	Employer	Employee	Total
	6.5%	6.0%	12.5%
Lower Earnings Limit			
£121	£7.86	£7.26	£15.12
(£117)	(£7.60)	(£7.02)	(£14.62)

2012 upper and lower earnings limit for self-employed people

44. As the third step toward the alignment of the upper earnings limit with that applicable to employers, the Department recommends that the upper earnings limit for self-employed persons be increased from 1 January 2012 from £91,884 to £105,144 per year.

45. The effect of the proposed new upper earnings limit on self-employed people who pay a contribution at the upper earnings limit is as follows:-

Maximum 2012 contributions (2011 in brackets)

Annual earnings from self-employment	**Contributions per week**
	10.5%
£105,144 or more	£212.31
(£91,884 or more)	(£185.53)

46. Self-employed people who have applied to pay earnings-related contributions, and whose earned income from self-employment was less than £105,144 per year, will pay less than the maximum contribution.

47. The proposed increase in the lower earnings limit from £117 to £121 per week would mean that the lower annual earnings limit for self-employed persons in 2012 would be increased from £6,084 to £6,292 (£121 x 52). The minimum self-employed (Class 2) contribution in 2012 would be £12.70 per week (£12.28 in 2011).

2012 upper and lower income limit for non-employed people

48. As the third step toward the alignment of the upper income limit with that applicable to employers, the Department recommends that the upper income limit for non-employed persons be increased from 1 January 2012 from £91,884 to £105,144 per year.

49. As with the self-employed, non-employed contributors are liable to pay non-employed, Class 3 contributions, at the maximum rate unless application is made to the Department and authorisation given for the release of the relevant information by the Director of Income Tax. This allows an income-related contribution to be calculated.

50. There are two categories of non-employed contributions:

- Full percentage rate contributions to cover social insurance, health service and long-term care insurance liabilities. This is the rate of contribution that non-employed adults under the age of 65 are liable to pay, based on their personal income. The contribution rate is 9.9% of income, after the deduction of an allowance, up to the upper income limit;

- Specialist health insurance and long-term care insurance contributions. These contributions, which are payable by people aged 65 and over, go towards funding the specialist health insurance scheme and the long-term care insurance scheme. The contribution rate is 2.9% of income, after the deduction of an allowance, up to the upper income limit.

51. The Department recommends that the lower income limit at which non-employed contributions become payable be increased from £15,210 per year to £15,730 per year from 1 January 2012.

Non-employed person's allowance

52. From 2010 the Department introduced an allowance for non-employed people, which is subtracted from their annual income figure with liability being calculated on the balance. The Department recommends increasing the allowance from £6,451 to £6,675.

53. The following table shows the minimum and maximum weekly contributions payable in 2012 by non-employed people. People with income at some point between the upper and lower income limits will pay pro-rata.

2012 non-employed weekly contributions (2011 in brackets)

Annual Income	**Full rate (under 65)**	**Specialist health and long-term care only (over 65)**
	9.9%	2.9%
Less than £15,730	zero	zero
(less than £15,210)	(zero)	(zero)
£15,730	£17.24	£5.05
(£15,210)	(£16.67)	(£4.88)
£105,144	£187.47	£54.91
(£91,884)	(£162.65)	(£47.64)

Voluntary contributions

54. As shown above, where a non-employed person's annual income is below £15,730, that person will be exempted from the payment of contributions. However, this could affect old age pension entitlement. A voluntary contribution which counts towards old age pension can be paid by or on behalf of non-employed people, resident in Guernsey and under pension age, with personal income below the lower income limit.

55. The voluntary contribution in 2011 is £16.67 per week. The rate is calculated by applying the social insurance element of the non-employed contribution rate, being 5.7% of the total 9.9%, to the lower income limit. With a proposed lower income limit of £15,730 per annum in 2012, the voluntary contribution will increase to £17.24 per week.

Overseas voluntary contributions

56. People living outside of the Island are able to pay contributions in order to maintain their entitlement to old age pension. The rate payable in 2011 is £79.50 per week for the non-employed and £87.88 for the self-employed. It is recommended that, from 1 January 2012, the overseas voluntary contribution should be increased in line with the general 3.6% increase. This means that from 1 January 2012 the voluntary overseas contributions would rise from £79.50 to £82.36 per week for non-employed people and from £87.88 to £91.04 per week for self-employed people.

Special (minimum) rate Class 3 contributions

57. A special rate non-employed contribution is payable by insured persons who would normally rely upon employed contributor's employment for their livelihood, but have a small gap in their record where they were neither employed nor receiving an unemployment contribution credit. The rate of this contribution is aligned with the rate of the voluntary contribution. The special rate Class 3 contribution would, therefore, be £17.24 per week in 2012.

Estimated operating surplus/deficit on Guernsey Insurance Fund

58. Taking into account all of the foregoing including the proposed revised rates of benefits, for the Guernsey Insurance Fund, it is estimated that:

    1) there will be an operating deficit in 2011 in the order of £5.9m; and

    2) there will be an operating deficit in 2012 in the order of £7.7m.

59. The estimated operating deficit in 2012 will only just be covered by investment income. As explained in paragraphs 7 to 12 of this report, although the long-term strategy is to draw down on the capital value of the

Guernsey Insurance Fund to meet increased demand due to demographic ageing, this strategy is combined with a necessary increase in contribution rates. With no increases to contributions having been made, pending resolution of the second phase of the Zero-10 taxation reforms, the operating deficits for the Guernsey Insurance Fund are occurring earlier than previously envisaged. The deficits will rapidly become deeper and the drawdown of the reserves will accelerate unless contributions are increased.

Permitted investments

60. The Social Security Department is responsible in law for the control and management of the Guernsey Insurance Fund, the Guernsey Health Service Fund and the Long-term Care Insurance Fund. Adding to the provisions in the relevant laws, the types of investments that the Department may pursue are governed by Resolution of the States. The Resolution at present in force is Resolution 6 on Article 16 of Billet D'Etat XVII of 2006.

61. As part of the Budget report for 2010 (Billet D'Etat XXXII of 2009), the States approved a Proposal from the Treasury and Resources Department to update the permitted investment rules for the Funds under control of that Department. The Social Security Department was invited to seek a similar update to the rules applicable to the funds under its control but had no requirement at that time and was content to await more fundamental review of the investment rules, which was anticipated at that time. The Department now has a requirement, principally in order to make appropriate investments in alternative asset classes, to match, for the three funds referred to in the preceding paragraph, the permitted investment rules which currently apply to the Superannuation Fund, managed by the Treasury and Resources Department. The Department is recommending that the States rescinds Resolution 6 mentioned above and approves the permitted investment rules as set out in Annex 2 to this report.

PART II
HEALTH SERVICE BENEFITS

62. The health service benefits and administration, costing £34.77m in 2010, were financed by £33.40m from contributions allocated to the Health Service Fund and £4.00m from the States' grant from general revenue. There was an operating surplus, before investment income, of £2.63m.

Medical Benefit Grants

63. The total benefit expenditure on consultation grants in 2010 was £3.51m. This represented a decrease of around 0.8% on the 2009 cost. The consultation grants remained unchanged at £12 towards a consultation with a doctor and £6 towards a consultation with a nurse.

64. The Department will not be recommending any change in the level of the consultation grants for 2012.

Pharmaceutical Service

65. Prescription drugs cost a total of £16.28m in 2010, before netting off the prescription charges paid by patients. This was an increase of 3.9% over the previous year.

66. The total cost to the Health Service Fund of the drugs dispensed was reduced by £1.74m collected in prescription charges.

67. The number of items prescribed under the pharmaceutical service increased by 4.4% in 2010 to 1.41 million items. Despite the increase in items prescribed, the Department is pleased that there has only been a modest increase in costs.

Prescription charge

68. The prescription charge for 2011 is £3.00 per item. For a number of years the States have approved annual increases of 10p in the charge. The Department recommends the same increase this year, with a charge of £3.10 per item effective from 1 January 2012.

Nurse Prescribing

69. At present, nurses are not permitted to issue medical prescriptions for the supply of pharmaceutical benefit under the Health Service (Benefit) (Guernsey) Law, 1990. The Prescribing Support Unit (PSU) Steering Group, which includes the Ministers, Deputy Ministers and Chief Officers of the Social Security Department and the Health and Social Services Department, the Director of Public Health, the Chief Pharmacist and the Prescribing Adviser, has recommended to the Social Security Department, that community nurses should be allowed to prescribe wound management products, as listed in section 13.13 of the Limited List. The Limited List is contained in Regulations of the Department and is the catalogue of drugs and medicines which can be prescribed at the cost of the Guernsey Health Service Fund.

70. Section 13.13 of the list includes various dressings, bandages, tapes, plasters and antimicrobials. These products can only be prescribed by doctors despite the fact that community nurses are responsible for managing patients' wounds in the community and, as a result, know a great deal about wound care products. In practice, this means that community nurses have to contact their patient's GP if they wish to recommend the use of, for example, a new type of dressing on the patient's wound. The GP then considers the nurse's recommendation and writes the prescription for the dressing if they consider it appropriate. This can lead to delays and distress for the patient. In addition,

patients may incur additional charges as medical practices charge a fee for prescriptions signed by doctors when the patient has not been seen.

71. In the UK, healthcare professionals other than doctors and dentists have been permitted to prescribe medicines for several years. In Guernsey, the Health and Social Services Department changed their legislation in October 2009 so as to enable the prescribing by professionals other than doctors. The Health and Social Services Department is planning a trial period of nurse prescribing but this will only permit the prescribing of medicines for hospital inpatients. This does not extend to people living in the community who are entitled to pharmaceutical benefit under the Health Service (Benefit) (Guernsey) Law, 1990.

72. The Department recommends that the necessary legislation be prepared so as to allow community nurses employed by the Health and Social Services Department whose names are held on the Nursing and Midwifery Council's register, with an annotation signifying that the nurse has successfully completed an approved programme of preparation and training for nurse prescribing, to issue medical prescriptions for the supply of wound management products, as listed in section 13.13 of the Limited List.

Specialist Health Insurance Scheme

73. The cost of the specialist health insurance scheme, which funds the services provided through the Medical Specialist Group, was £13.22m in 2010 and is expected to cost £13.47m in 2011.

74. The contract with the Guernsey Physiotherapy Group cost £1.73m in 2010 and is expected to cost £1.78m in 2011.

75. The Community Health Insurance Purchasing Sub-Committee (CHIPS), which includes the Ministers, Deputy Ministers, Chief Officers and Contract Managers of the Social Security Department and the HSSD and representatives of the Medical Specialist Group and the Guernsey Physiotherapy Group, meets regularly to review adherence to and performance against contractual obligations and to consider potential changes to the scope and resources permitted under the contracts with the Medical Specialist Group and the Guernsey Physiotherapy Group.

76. The contracts were included in a review of secondary healthcare services undertaken by Sector Treasury Services under contract to the Public Accounts Committee. Sector's report, published in June 2011, concluded that although the contracts provided high quality, accessible secondary medical care in Guernsey, the contracts appeared not to offer optimum value for money. The Department was pleased to learn from the report that the expertise, experience and contractual focus provided by its Head of Finance had been beneficial in terms of recent contract governance. The Department is working with the

HSSD, in the context of the HSSD's 20:20 vision, to formulate proposals for the nature and scope of secondary care contracts to replace the current contracts when they expire at the end of 2017.

Costs of visiting medical consultants

77. The work referred to above on the secondary health care contracts will include consideration of the financing from the Guernsey Health Service Fund of medical consultants who visit from the UK, currently under contract to the HSSD, to treat Guernsey patients on-Island.

Transfer of Travelling Allowance Grant from Guernsey Insurance Fund to Guernsey Health Service Fund

78. In last year's benefit uprating report the States resolved that the provisions for Travelling Allowance Grants should move from the Guernsey Insurance Fund to the Guernsey Health Service Fund, with appropriate updating of the provisions. Although work has commenced within the Department, this has not been a high priority. There is a need for consultation on the scope of the legislation and on the travel costs to be covered by the updated legislation.

Pilot programme for mental health service in primary care practices

79. As referred to in paragraph 26 of this report, the States approved a Projet de Loi (Billet d'Etat XV of 2010) to enable the Department ,through the Health Service Fund, to finance, a 2 year pilot for the provision of psychological therapies at primary care level. Consequently, the Health Service (Benefit) (Guernsey) (Amendment) Law 2010 was approved and came into force 28 February 2011.

80. A steering group involving the Social Security Department, the Health and Social Services Department and the Primary Care Committee was formed during the first quarter of 2011 in order to oversee the creation of the new service, which is expected to commence from September 2011.

81. The detail of the service to be supplied under the pilot programme has been proposed by professional staff of the HSSD. The pilot programme will comprise 5 therapists employed by the HSSD. Three of the therapists will be psychological well-being practitioners (low-intensity therapists). There will be 1 cognitive-behavioural therapist and 1 clinical psychologist (both being high-intensity therapists). The clinical psychologist will lead the service. Key performance indicators have been identified for the new service and the steering group will review these routinely during the pilot programme. The expected benefits of the new service include:

- access to mental health primary care as and when need arises, without stigma and without long waiting times;

- common mental health conditions do not escalate into chronic conditions;
- reduced demand on mental health secondary care services.

82. Referral to the service will be from General Practitioners and an estimated 300 referrals will be received per year.

83. The cost of the pilot programme is approximately £265,000 per year in 2010 terms. The Department intends to run the pilot programme for 2 years, with evaluation starting at the end of the first year. During the second year of operation, and informed by the evaluation, the Department will either develop proposals to convert the pilot programme into a permanent benefit, adjusted as necessary in the light of experience, or decide to terminate the pilot programme at the end of 2 years without replacement. The Department, however, believes that there is great potential in this initiative to make a positive contribution to the mental health of the community and to reduce social security costs by way of sickness benefit and supplementary benefit.

Financing of Guernsey Health Service Fund

84. The actuarial review of the Guernsey Health Service Fund for the years 2006 to 2009, inclusive, appears in the appendix to the Billet d'Etat containing this report. The review includes only a short-term projection to 2014. This is customary in the case of health service funds, where assumptions on long-term future expenditures can be very unreliable.

85. On the short-term projection, the review indicates that the Guernsey Health Service Fund will maintain an operating surplus, with the reserves of the Fund increasing to more than 2 years' annual expenditure by 2014. There is, therefore, no need for any increases in the rates of contributions to the Guernsey Health Service Fund in the short or medium term. The longer-term position will be influenced by the progression of the developments mentioned in the foregoing paragraphs.

PART III
LONG-TERM CARE INSURANCE

86. The Long-term Care Insurance Scheme pays benefits to assist with fees in residential and nursing homes. The Department is recommending increases of 3.6% in the benefit rates.

87. Contribution income to the Long-term Care Insurance Fund was £16.37m in 2010. With benefit and administration expenditure of £15.30m for the year, the Fund had an operating surplus of £1.07m.

Co-payment by person in care

88. It is a condition of entitlement to benefit under the long-term care insurance scheme that the person in care should make a co-payment. The 2011 co-payment is £170.45 per week. The Department recommends a co-payment of £176.61 per week from 2 January 2012.

89. It should be noted that the co-payment to the long-term care insurance scheme also sets the level of fees to be charged for accommodation in the States-run homes including the Castel and King Edward VII hospitals, Maison Maritaine and Longue Rue House as well as the long-stay beds in the Mignot Memorial Hospital, Alderney.

Nursing care benefit

90. The maximum nursing care benefit, which also applies to the Guernsey Cheshire Home, is currently £705.32 per week. The Department recommends that it should be increased to £730.73 per week from 2 January 2012.

Residential care benefit

91. The maximum residential care benefit is currently £377.79 per week. The Department recommends that it should be increased to £391.37 per week from 2 January 2012.

Elderly Mental Infirm (EMI) Residents

92. Through the 2010 benefit uprating report, the States approved the introduction of a new rate of long-term care benefit in respect of residents of registered residential care homes who have substantial additional care needs by reason of elderly mental infirmity. The maximum EMI rate of benefit is currently £497.77 per week. The Department recommends that it should be increased to £515.69 per week from 2 January 2012.

Respite care benefit

93. Persons needing respite care in private sector residential or nursing homes are not required to pay a co-payment. The long-term care fund pays instead. This is to acknowledge the value of occasional investment in respite care in order to allow the person concerned to remain in their own home as long as practicable. It also acknowledges that persons having respite care also continue to bear the majority of their own household expenditure. The respite care benefits, therefore, are the sum of the co-payment and the residential care benefit or nursing care benefit, as appropriate. The Department, therefore, recommends a nursing care respite benefit of up to £907.27 per week, an EMI rate of up to £692.30 per week and a residential care respite benefit of up to £567.98 per week from 2 January 2012.

Financing of Long-term Care Insurance

94. The actuarial review of the Long-term Care Insurance Fund for the years 2006 to 2009, inclusive, and projections to 2070, appear in the appendix to the Billet d'Etat containing this report.

95. The review shows that the current rate of contribution for the Long-term Care Insurance Fund, which is 1.3% of earnings for an employed person, is unsustainable. Based on the assumptions used in the review, if the rate remained unchanged, the reserves of the Fund would be exhausted by around 2027.

96. The review indicates that, on the pay-as-you-go basis, the current contribution rate of 1.3% for employed persons would have to increase steadily to reach about 2.0% by 2028, 3% by 2040 and levelling off at 3.5% by around 2050.

97. The assumptions within the actuarial review include assumptions that the scope of the long-term care benefits is not changed and that benefit expenditure increases proportionate to the increases in the older age cohorts. For the purposes of the periodic review, those assumptions are a practical necessity. However, it is highly unlikely that the number of residential and nursing care beds in Guernsey and Alderney will in reality increase in direct proportion to the increased numbers of people in the older age groups. It is far more likely that there will be a shift of emphasis towards care in the person's own home and new models of delivery including extra-care housing.

98. Following the Resolution of the States on the joint report from the Housing Department and the Health and Social Services Department concerning the provision of extra-care housing at Maison Maritaine and Longue Rue House, a working party chaired by the Minister of the Treasury and Resources Department is examining the short-term and long-term financing options for extra-care housing.

99. Given the foregoing, and the scope for major change in the way that long-term care services will be provided and financed to meet the needs of the ageing population, there has to be considerable caution in the future rates of contribution contained in the projections in the actuarial review.

PART IV
NON-CONTRIBUTORY SERVICES FUNDED FROM GENERAL REVENUE

100. For the non-contributory benefits contained in this part of the report, which are funded entirely from general revenue, the Department recommends general increases of 2.6%, with some small variations for roundings.

Supplementary benefit

101. Supplementary benefit expenditure amounted to £16.99m in 2010. The expected outturn for 2011 is £17.31m.

102. At 4 June 2011, there were 2,273 active supplementary benefit claims as set out in the table below.

Classification	**Active claims at 4 June 2011**
Pensioners	*719
Incapacitated	530
Single parent	416
Jobseeker	325
Disability	204
Incapable of self-support	51
Carer	19
Pregnant	5
Prisoner's spouse	4
Partner in hospital	0
Total (excluding dependants)	**2273**

*Includes 138 pensioners covered for their medical expenses.

103. The Department has, for many years, kept staffing levels as low as reasonably practicable in order to discharge its obligations. Since 2009, the Department has, through its annual benefit uprating report, explained the resourcing difficulties experienced in relation to the extra work in the supplementary benefit section arising from higher levels of unemployment. This resourcing constraint generally leads to priority being given to paying the benefits due and insufficient time is given to interviewing people about their job-finding efforts and assisting that endeavour. However, the Department is pleased to report that through the 2011 budget process, the Treasury and Resources Department agreed a 2011 cash limit for Social Security which included specific additional funding in respect of the temporary staff required within the job centre and to fund the continued employment of a project officer in 2011 to progress the review of the supplementary benefit scheme.

104. During 2011, officers of the Department have been involved in the value for money work stream of the Financial Transformation Programme. This has resulted in the identification of a small number of potential cost savings relating to general revenue expenditure. One of these relates to an invest-to-save initiative involving the introduction of claims management in relation to incapacity claims within the supplementary benefit section. While claims management of this nature has been utilised effectively for a number of years in relation to the contributory benefits (sickness and invalidity benefits), the constraints on the Department's capped administrative general revenue

budget have restricted staff resources and, as stated above, priority has been given to taking, validating and paying benefits.

105. Officers from the Department have assisted with the development of the business case recommending the introduction of claims management in relation to incapacity claims. The Department is pleased to report that the business case was approved by the Transformation Executive on 4 May 2011. The Department has commenced the implementation of the strategy set out in the business case and the 2 year project is expected to achieve net savings of £189,000.

Review and reform of the Supplementary Benefit scheme

106. In the 2010 benefit uprating report, the Department explained that due to the lack of resource to undertake the review, the project would be carried out in phases. The Department decided that phase one would include rent rebate integration, work incentivisation and young adults in education. The following paragraphs provide an update on each of these issues.

Rent rebate integration

107. The Social Security Department and the Housing Department have worked closely to develop a strategy for the phased integration of the rent rebate scheme into the supplementary benefit scheme. Given the complexity of the subject, the two Departments submitted a Green Paper to the States (Billet d'Etat XIII of 2011) inviting the views of the States on the anticipated measures to achieve integration.

108. At the July 2011 States meeting, the States noted the following intentions of the Social Security Department and Housing Department:

- to produce minimum income standards for Guernsey;
- to replace the supplementary benefit scheme's benefit limitation with a range of maximum rent allowances;
- to apply an above-RPI increase to the benefit limitation for 2012;
- in relation to the Housing Department, to apply changes to the minimum and maximum tariffs on the rent rebate as part of the phased withdrawal of the rent rebate scheme;
- to bring forward to the States detailed proposals, including financial implications, at the earliest opportunity.

109. In noting the above intentions the States directed the Social Security Department and the Housing Department to bring back to the States costed transitional and final proposals for debate before any actions are taken to phase out the rent rebate scheme or replace the supplementary benefit scheme's single benefit limitation with a range of maximum benefit rates.

Work incentivisation

110. Through the 2010 benefit uprating report, the Department obtained States approval to amend the Social Insurance Law so that the Guernsey Insurance Fund can be used to provide access to the back to work benefits for anyone who is an insured person. Subsequently, the Social Insurance (Guernsey) Law (Amendment) Ordinance, 2011 was considered and approved during the July 2011 States meeting (Billet d'Etat XIII of 2011). As a result, with effect from 27 July 2011 insured people claiming supplementary benefit who have no entitlement to the insurance-based benefits (sickness and unemployment) can access the work incentives which are available through the back to work benefits.

111. Significant progress has been made during 2011 on the development of a range of proposals aimed at incentivising those people who are able to work to rejoin the Island's workforce. These proposals centre on several main themes, including greater emphasis on the roles and responsibilities of people to engage in work, work-related activities or training, new incentives to encourage people to increase their participation in the labour market, regular work-focussed meetings for all working age people and appropriate utilisation of sanctions. Dan Finn, Professor of Social Inclusion at the University of Portsmouth and Associate Director at the Centre for Economic and Social Inclusion has agreed to provide the Department with his views on the proposals so that these can be taken into account.

Young adults in education

112. The Department has also made progress with regard to the way young people in education are supported by supplementary benefit. Consultation with the Education Department and the HSSD has assisted in the development of proposals which will support children at risk or in need. These proposals will also aim to ensure that young people are not incentivised to leave education prematurely in order to claim supplementary benefit at the expense of their education.

113. The Department has also been in consultation with the Education Department regarding the administrative arrangements for the payment of the education maintenance grant, which is payable by the Education Department to some low income households where a student aged 16 to 19 is attending full-time education. The two Departments expect phase one of the supplementary benefit review to report on how the education maintenance grant will be administered in the future.

Residence and adoption order allowances

114. The introduction of the Children Law in January 2010 placed new duties on the States to children who are in need of services and support, including those

children in the care of the HSSD and those previously in care, and those children who fall within the legal definition of being 'at risk'.

115. Residence orders were introduced under the Children Law as one of a range of new orders to replace custody and access. Residence orders settle where the child should live and gives parental responsibility to that person(s) which is shared with the child's parents.

116. The HSSD has a legal and professional duty to provide the least intrusive legal framework to protect children's interests. A residence order is far less intrusive than a care order. Therefore, the HSSD has a duty to assess and support relatives and significant others to make an application for a residence order as a possible alternative to the child's admission to the care system. Some families need financial support to do this and the HSSD has the discretionary ability to provide this help via a residence order allowance. This is a means-tested weekly payment. Residence order allowance rates are two thirds of the full, age-related fostering network rates, and are payable until the child is 16.

117. As part of the adoption process, prospective adopters are assessed on their ability to financially provide for the adopted child. However, for a small minority of carers, financial support is needed to care for those children who have special needs, illness or disability, which necessitate additional financial support compared to children without those needs, or where the adopter has been requested by the HSSD to care for a sibling of the adopted child, or where the adopter is experiencing hardship which threatens the placement and could result in the child returning to the care system. Adoption order allowances are available on a discretionary basis. Adoption order allowance is a means-tested weekly payment and the rates are two thirds of the full, age-related fostering network rates.

118. The HSSD has requested that residence order allowances and adoptive order allowances be disregarded for the purposes of calculating a person's entitlement to supplementary benefit. In practice this means that if a child who is the subject of a residence order or adoption order is part of or becomes part of the household of a person in receipt of supplementary benefit, and the HSSD pays a residence order allowance or adoption order allowance to that person, that child will not be treated as a member of that person's household for the purposes of calculating that person's requirements, and the allowance paid by the HSSD will be wholly disregarded for the purposes of calculating that person's resources. This same principle is already applied in respect of families in receipt of a fostering allowance and the same approach is taken by Jersey and the UK when calculating a person's entitlement to Income Support.

119. The Department is, therefore, recommending that the First Schedule of the Supplementary Benefit (Implementation) Ordinance, 1971, which sets out the

method for calculating the amount of supplementary benefit to which a person is entitled, be amended accordingly, to bring this into effect.

Supplementary benefit requirement rates

120. The Department recommends supplementary benefit requirement rates, to take effect from 6 January 2012, as follows:

(a)

Long-term supplementary benefit (after payment of short-term rates for 6 months)	**2012**	**2011**
Married couple	£228.97	£223.16
Single householder	£158.41	£154.42
Non-householder**:**		
18 or over	£122.99	£119.84
*16 - 17	£66.71	£65.03
Member of a household -		
18 or over	£122.99	£119.84
16 - 17	£104.16	£101.50
12 - 15	£64.40	£62.79
5 – 11	£46.69	£45.50
Under 5	£34.44	£33.60

*Varied upwards in relation to single parents and significant disability.

(b)

Short-term supplementary benefit rates (less than 6 months)	**2012**	**2011**
Married couple	£185.57	£180.88
Single householder	£128.87	£125.58
Non-householder**:**		
18 or over	£98.14	£95.62
*16 - 17	£66.71	£65.03
Member of a household -		
18 or over	£98.14	£95.62
16 -17	£83.30	£81.20
12 - 15	£51.59	£50.26
5 – 11	£37.45	£36.47
Under 5	£27.30	£26.60

*Varied upwards in relation to single parents and significant disability.

A rent allowance, on top of the above short-term or long-term rates, will apply to people living in rented accommodation.

121. Through the 2010 benefit uprating report, the States approved the introduction of a reduced requirement rate for 16 and 17 year old non-

householders who were not in full-time education. This change took effect from 7 January 2011, but did not apply to 16 and 17 year old non-householders who qualified for benefit by reason of a disability or by being a single parent or being at risk of falling into the category of children in need. In these instances, the requirement rate was enhanced so that these young people received the same rate payable to 16 and 17 year olds living as part of a supplementary benefit household. The Department can report that the change in policy was introduced without any complications or individual complaints in relation to the reduction in benefit entitlement.

122. At the September 2009 States meeting (Billet d'Etat XXIV 2009) the States approved the amendment of the Supplementary Benefit Law so that single parents could only claim supplementary benefit if their youngest dependant is below the age of 12. As a result, since 8 January 2010, single parents with older children (12 and over) wishing to claim supplementary benefit are classified as jobseekers and must actively seek work.

123. Since June 2010, the claims of a further 18 single parents in receipt of supplementary benefit where the youngest child has reached 12, have been reviewed. Of these, 8 were reclassified as jobseekers of whom 5 are working and 3 are still receiving intensive support from the Department's work rehabilitation team. It is worth noting that one of the single parents reclassified as a jobseeker had not worked for 20 years but has recently been successful in completing a period of part-time temporary work. It is also worth noting that the assistance that the Department is now providing to single parents with older children has attracted interest from single parents with younger children who have approached the Job Centre and work rehabilitation team with requests for help.

124. The officers working with single parents to help them get back into work have identified a number of issues which can act as barriers to work including lack of unskilled work opportunities within school hours, the lack of up to date skills held by some single parents and poor understanding of modern job seeking methods and interview techniques. While the Department will continue to work on a one-to-one basis with single parents, it is hopeful that working jointly with business through the development of the Skills Strategy will improve the work opportunities for single parents and other jobseekers, including those recovering from long-term illness.

Benefit limitation - community

125. The benefit limitation, currently £405.00 per week, is the maximum level allowed for the combination of supplementary benefit and income from other sources, excluding family allowances. In the 2011 Green Paper on the future of the supplementary benefit and rent rebates schemes (Billet d'Etat XIII of 2011), the Department outlined its intention to recommend an above RPIX increase to the benefit limitation. The purpose of introducing an above RPIX

increase ahead of any other proposals to modernise the supplementary benefit scheme is that it would provide immediate assistance to around 75 families currently affected who are being paid less benefit than they need and are struggling to support themselves.

126. In 2002, with the approval of the States, the Department increased the benefit limitation by 20%, taking it from £208 to £250. The above RPI increase was recommended as the Department felt that too many low income households were not getting the help they needed.

127. The issue was last considered by the Department in 2007, when the States, upon the Department's recommendation, agreed an 18% increase in the overall benefit limitation, lifting it from £297 to £350 per week. Again, the increased benefit limitation was set with reference to real life supplementary benefit cases where benefit being paid was significantly less than claimants needed.

128. As the Department explained in its Green Paper (Billet d'Etat XIII of 2011), while the benefit limitation is effective in controlling benefit expenditure it is seen by many as a punitive measure, generally penalising larger families living in social housing and families renting in the private sector. It would even affect couples with just one child renting in the private sector who could only have £151 to pay their rent.

129. There are currently 1,724 supplementary benefit claimants who rent property or are home owners, with or without a mortgage. Of these, 75 (4%) are affected by the benefit limitation. As reported in the Green Paper, the problem occurs most frequently with families renting in the private sector. It occurs less frequently for families in Housing Department or Guernsey Housing Association accommodation, which is eligible for rent rebate.

130. A breakdown of supplementary benefit claims, comprising rents and owner occupation, and showing the numbers affected by the benefit limitation, is shown below:

	Total claims	Affected by benefit limitation	%
Private sector rental	633	48	8%
Housing Department rental	738	24	3%
Housing Association rental	127	1	1%
Owner occupier	144	2	1%
HSSD accommodation	50	0	0%
Housing 21	32	0	0%
	1,724	75	4%

131. The Department is recommending that the benefit limitation be increased from £405.00 per week to £450.00 per week from 6 January 2012. Of the 75 claims currently affected by the benefit limitation, there are 45 cases where

the impact is between £1 and £45 per week. If applied today, the increased benefit limitation would allow these 45 families to receive the full amount of benefit that they need. The 30 remaining families, for whom the impact of the benefit limitation is currently between £46 and £147 per week would still not receive the full benefit that they need but would at least be £45 per week better off.

132. Increasing the benefit limitation to £450 per week will increase supplementary benefit expenditure by an estimated £117,000 per year. An increase from the normal uprating of 2.6%, to £416 per week would have resulted in an estimated increase of £41,000. This means that the proposed step increase to £450 per week adds a net, additional £76,000. As this figure is under £100,000, it is not necessary for the proposal to be subject to the procedures for a new service bid.

133. In accordance the requirements of Rule 15(2) of the Rules of Procedure (which relates to a proposition which may have the effect of increasing revenue expenditure), the Department indicates that the estimated £76,000 of additional revenue expenditure could be funded in the same way that formula-led increases within the supplementary benefit system as a whole are funded. There would therefore be no effect on the Fiscal and Economic Policy Plan.

Benefit limitation - residential homes

134. Notwithstanding the existence of the long-term care insurance scheme, there needs to remain a benefit limitation applicable to a person residing in a residential home who does not satisfy the residence requirements for long-term care insurance and may, therefore, need to rely on supplementary benefit assistance. The benefit limitation is currently £474 per week. The Department recommends an increase to £486.00 per week from 6 January 2012. It should be noted that this particular benefit limitation, and that in the following paragraph, are very seldom called into effect.

Benefit limitation - nursing homes, elderly mental infirm residents (EMI) and Guernsey Cheshire Home

135. Being necessary for the reason explained above, the Department recommends that the benefit limitation applicable to a person residing in a nursing home or a residential home with EMI care needs or the Guernsey Cheshire Home be increased from £680.00 per week to £698.00 per week from 6 January 2012.

Personal allowance for residents of residential or nursing homes

136. The amount of the personal allowance for supplementary beneficiaries in residential or nursing homes is currently £27.13 per week. It is intended to allow modest purchases of, say, newspapers, confectionary, toiletries, small

family presents and so on. The Department recommends that the personal allowance be increased to £27.84 per week from 6 January 2012.

Personal allowance for Guernsey residents in UK hospitals and care homes

137. The HSSD pays for Guernsey and Alderney residents to be placed in UK hospitals and specialized institutions if their mental or physical health needs cannot be met on-island. While the HSSD meets the cost of accommodation and care, residents are expected to pay from their own resources for items of personal expenditure. Residents who cannot afford these things can apply to the Social Security Department for a personal allowance.

138. There is a need for this particular personal allowance to be higher than the rate which applies in Guernsey residential and nursing homes, because the people living temporarily off-island tend to be a much younger age group, more active and with more opportunities for using a personal allowance in the course of their supervised activities and outings.

139. The personal allowance is currently £45.70 per week and the Department recommends that the allowance be increased to £46.89 per week from 6 January 2012.

Supplementary Fuel Allowance

140. A supplementary fuel allowance is paid from general revenue for 27 weeks from the last week in October until the last week in April of the year following. The fuel allowance was £24.67 per week for the 2010 to 2011 period.

141. The continued increases in global oil and fuel prices has led to higher heating oil and gas costs for all islanders. In the year to June 2011, the cost of fuel, light and power increased by 9.8%. The Department, therefore, recommends an increase of 9.8% in the fuel allowance, taking it to £27.09 per week for the winter of October 2011 to April 2012.

142. The fuel supplement will cost in the region of £950,000 over each 27 week payment period referred to above. However, the Department has identified the winter fuel allowance as an issue that might be reviewed as part of the supplementary benefit modernisation project. In particular, the Department is keen to explore whether its flat rate for all strategy still holds good given that claimants' fuel bills vary depending, in part, on whether their accommodation is energy efficient.

Cost of proposals for Supplementary Benefit

143. The expected outturn for supplementary benefit expenditure for 2011 is £17.39m. It is estimated that benefit expenditure in 2012, taking account of

the above proposals and allowing for current trends, will increase by £0.55m to £17.94m.

Family Allowances

144. Family allowances expenditure amounted to £9.08m in 2010. The allowance is paid at £15.00 per week per child. The budget for 2011 is £9.29m.

145. The Department recommends that family allowance be increased by approximately 2.6% to £15.40 per week from 2 January 2012. It is estimated that expenditure on family allowances in 2012 will be approximately £9.56m.

Attendance and Invalid Care Allowances

146. Through the 2009 and 2010 benefit uprating reports, the Department provided updates on its review into the adequacy and effectiveness of attendance allowance and invalid care allowance. In particular, the Department highlighted its concern that carers wishing to claim invalid care allowance were being adversely affected by the strict earnings limitation, which in 2011 prevents a person in receipt of invalid care allowance earning more than the lower earnings limit of £117.00 per week. In addition, the Department highlighted the fact that the review had identified a need to market actively the two allowances and increase the level of information available to healthcare professionals.

147. The review has continued through the first half of 2011 and is nearing completion. The Department is planning to submit its report to the States for debate in October 2011.

148. Pending the outcome of that States report the Department is recommending that attendance allowance and invalid care allowance be increased with effect from 2 January 2012 as shown below:-

	2012	**2011**
Attendance Allowance - weekly rate	£92.12	£89.81
Invalid Care Allowance - weekly rate	£74.48	£72.59
Annual income limit for both allowances	£85,000	£83,000

149. The annual income limit is the upper limit of income that a family may have, while still being entitled to receive either attendance allowance or invalid care allowance.

150. Benefit expenditure on attendance and invalid care allowances in 2010 was £3.07m. The estimated budget for 2011 is £3.32m. It is estimated that the

Department's proposals set out in paragraph 148 will increase expenditure in 2012 by £150,000 to £3.47m.

Community and Environmental Projects Scheme

151. The Department administers the Community and Environmental Projects Scheme (CEPS), which offers short-term employment opportunities for unemployed people. The Department contracts with States Works for the necessary supervision of the work teams and also for the provision of transport, equipment and tools.

152. The CEPS teams have undertaken numerous and wide ranging activities during the last year, including:

- Longue Hougue Recycling Centre
- Fontaine waste segregation site
- Bulk refuse collections
- Cleaning bring bank sites
- Furniture redistribution
- Greenhouse clearance in preparation for St Sampson's allotments
- Picking noxious weeds from all coastal paths
- Litter picking all nature trails
- Painting goal posts for schools
- Digging ground in preparation for electrical cable at Saumarez Park

153. The hourly wages rates for the CEPS scheme are set by the Department and do not require a resolution of the States. From 1 October 2010 the rates payable were brought into line with minimum wage rates. From 1 October 2011, the rates payable will mirror the minimum wage rates set by the Commerce and Employment Department as set out below.

	2011
Under 19	£4.36 per hour
For 36 hours	£156.96
19 and over	£6.15 per hour
For 36 hours	£221.40

Free TV licences

154. In accordance with the resolutions of the States on the 2001 budget (Billet d'Etat XXIV of 2000), the Department administers a scheme to provide free TV licences for Guernsey and Alderney residents aged 75 or over and residents aged 65 or over and in receipt of supplementary benefit. Benefit expenditure under this scheme was £569,000 in 2010. The scheme is expected to cost £586,000 in 2011. The costs in 2012 will depend on the

standard charge per TV licence made by the UK Department of Culture, Media and Sport.

PART V
RECOMMENDATIONS

155. The Department recommends:

(i) that, from 2 January 2012, the standard rates of pension and contributory social insurance benefits shall be increased to the rates set out in this Report;

(paragraph 33)

(ii) that, for employed persons, the upper weekly earnings limit, the upper monthly earnings limit and the annual upper earnings limit, from 1 January 2012, shall be £2,022, £8,762 and £105,144 respectively;

(paragraph 37)

(iii) that, for employers, the upper weekly earnings limit, the upper monthly earnings limit and the annual upper earnings limit, from 1 January 2012, shall be £2,409, £10,439 and £125,268 respectively;

(paragraph 38)

(iv) that, for employed persons and employers, the lower weekly earnings limit and the lower monthly earnings limit, from 1 January 2012, shall be £121 and £524.33 respectively;

(paragraph 42)

(v) that, for self-employed persons, the upper earnings limit and lower earnings limit, from 1 January 2012, shall be £105,144 per year and £6,292 per year, respectively;

(paragraphs 44 and 47)

(vi) that, for non-employed persons, the upper and lower annual income limits, from 1 January 2012, shall be £105,144 per year and £15,730 per year respectively;

(paragraphs 48 and 51)

(vii) that the allowance on income for non-employed people from 1 January 2012, shall be £6,675 per year;

(paragraph 52)

(viii) that the voluntary contribution from 1 January 2012, shall be £17.24 per week for non-employed people;

(paragraph 55)

(ix) that the overseas voluntary contribution from 1 January 2012, shall be £82.36 per week for non-employed people and £91.04 for self-employed people;

(paragraph 56)

(x) that Resolution 6 on Article 16 of Billet D'Etat XVII of 2006 be rescinded and replaced with the permitted investment rules set out in the Appendix to this report;

(paragraph 61)

(xi) that, from 1 January 2012, the prescription charge per item of pharmaceutical benefit shall be £3.10;

(paragraph 68)

(xii) that the Health Service (Benefit) (Guernsey) Law, 1990 and related subordinate legislation be amended to allow community nurses employed by the Health and Social Services Department, whose names are held on the Nursing and Midwifery Council's register, to be empowered to issue medical prescriptions for the supply of wound management products, as listed in section 13.13 of the Limited List;

(paragraph 72)

(xiii) that, from 2 January 2012, the contribution (co-payment) required to be made by the claimant of care benefit, under the long-term care insurance scheme, shall be £176.61 per week;

(paragraph 88)

(xiv) that, from 2 January 2012, nursing care benefit shall be a maximum of £730.73 per week for persons resident in a nursing home or the Guernsey Cheshire Home and residential care benefit shall be a maximum of £391.37 per week for persons resident in a residential home;

(paragraphs 90 to 91)

(xv) that, from 2 January 2012, elderly mentally infirm (EMI) care benefit shall be a maximum of £515.69 per week for qualifying persons resident in a residential home;

(paragraph 92)

(xvi) that, from 2 January 2012, respite care benefit shall be a maximum of £907.27 per week for persons receiving respite care in a nursing home or the Guernsey Cheshire Home, an elderly mental infirm rate of £692.30 for persons receiving respite care in a residential home and a maximum of £567.98 per week for persons receiving respite care in a residential home;

(paragraph 93)

(xvii) that the First Schedule to the Supplementary Benefit (Implementation) Ordinance, 1971 be amended to allow the requirements of a child in respect of whom residence order allowance or adoption order allowance is payable,

to be disregarded for the purposes of calculating the requirements of a person whom that child is living with under a residence order or adoption order, and to allow for residence order allowance and adoption order allowance to be disregarded for the purpose of calculating that person's resources;

(paragraph 119)

(xviii) that, from 6 January 2012, the supplementary benefit requirement rates shall be as set out in paragraph 120 of this Report;

(xix) that, from 6 January 2012, the weekly benefit limitations for supplementary benefit shall be:

(a) £450 for a person living in the community;

(b) £486 for a person who is residing in a residential home; and

(c) £698 for a person who is residing as a patient in a hospital, nursing home, the Guernsey Cheshire Home or as an elderly mental infirm resident of a residential home;

(paragraphs 125 to 135)

(xx) that, from 6 January 2012, the amount of the personal allowance payable to persons in Guernsey and Alderney residential or nursing homes who are in receipt of supplementary benefit shall be £27.84 per week;

(paragraph 136)

(xxi) that, from 6 January 2012, the amount of the personal allowance payable to persons in UK hospitals or care homes who are in receipt of supplementary benefit shall be £46.89 per week;

(paragraph 139)

(xxii) that a supplementary fuel allowance of £27.09 per week be paid to supplementary beneficiaries who are householders from 28 October 2011 to 26 April 2012;

(paragraph 141)

(xxiii) that, from 2 January 2012, family allowance shall be £15.40 per week;

(paragraph 145)

(xxiv) that, from 2 January 2012, the rates of attendance allowance and invalid care allowance and the annual income limits shall be as set out in paragraph 148 of this Report;

(xxv) that the Treasury and Resources Department be directed to take account of the 2012 estimates for Social Security Department Formula Led expenditure when recommending, as part of the 2012 Budget Report, Cash Limits for Departments and Committees;

(xxvi) that such legislation as may be necessary to give effect to the foregoing shall be prepared.

Yours faithfully

M H Dorey, Minister
A H Brouard, Deputy Minister
S J Ogier
A R Le Lièvre
M W Collins

ANNEX 1 – LEGISLATION

1. THE NEED FOR LEGISLATION

The proposed increased rates of old age pension and other contributory social insurance benefits, the proposed new amounts of the upper weekly and upper monthly earnings limits for the purpose of primary and secondary Class 1 contributions, the lower income limit for Class 3 contributions, the Class 3 income allowance and the voluntary and overseas voluntary contribution rates can only properly be given effect by legislation. In addition, the rates of long-term care benefit, the amount of the weekly co-payment which a claimant must make by way of contribution to the cost of their care under the Long-term care insurance scheme, the supplementary benefit requirement rates, benefit limitations and the amount of the personal allowances payable to persons in Guernsey or Alderney residential or nursing homes or UK hospitals or care homes who are in receipt of supplementary benefit, the rate of family allowance, the amount of the prescription charge, the rates of attendance allowance and invalid care allowance and the amounts of the annual income limits applied in respect of these benefits, can also only properly be given effect by legislation. These changes can all be achieved by Ordinance.

The application of Section 10(2) of the Health Service (Benefit) (Guernsey) Law, 1990, will need to be extended by Ordinance so as to enable community nurses employed by the Health and Social Services Department to issue medical prescriptions for the supply of pharmaceutical benefit. A number of consequential amendments to subordinate legislation will also be necessary to restrict the description of items which may be ordered to be supplied by medical prescriptions issued by community nurses to those items specified in section 13.13 of the Limited List and to provide a form of medical prescription for use by community nurses.

Amendment of the First Schedule of the Supplementary Benefit (Implementation) Ordinance, 1971, which sets out the method for calculating the amount of Supplementary Benefit to which a person is entitled, will be required to allow the requirements of a child in respect of whom residence order allowance or adoption order allowance is payable, to be disregarded for the purposes of calculating the requirements of a person whom that child is living with under a residence order or adoption order, and to allow for residence order allowance and adoption order allowance to be disregarded for the purpose of calculating that person's resources.

2. FUNDING IMPLICATIONS

The proposals made in this report are of a routine nature and will, in respect of contributory benefits, be funded from the Guernsey Insurance Fund, the Long-term Care Insurance Fund and the Guernsey Health Service Fund and in respect of non-contributory benefits, be funded from general revenue on a formula led basis.

3. RISKS/BENEFITS ASSOCIATED WITH ENACTMENT/ NON-ENACTMENT

If benefit rates are not increased annually, those people reliant on benefits may face financial hardship in the medium to long-term.

If the upper earnings and income limits are not increased, the amount of contribution income payable in 2012 will be less than budgeted and the operating deficit of the Guernsey Insurance Fund will be higher than estimated. It may not be possible to cover this increased operating deficit by investment income alone.

If the Department's proposals to allow community nurses to prescribe wound care products are not implemented, patient care will, in some cases, continue to be compromised due to delays in prescribing.

If residence order allowances and adoptive order allowances are not disregarded for the purposes of calculating a person's entitlement to supplementary benefit, the amount of supplementary benefit payable to a family with whom a child in respect of whom an allowance is payable is living, would reduce by the amount of that allowance less the requirement rate of the child. The result being that a family on supplementary benefit would not retain the full value of the financial support available from the Health and Social Services Department.

4. ESTIMATED DRAFTING TIME

The amendments which are necessary to implement the changes proposed in the States Report are not major. In terms of pure drafting time, preparation of the amending legislation should take no longer than one day.

ANNEX 2

Resolution of the States pursuant to Section 100(4) of the Social Insurance (Guernsey) Law, 1978, Section 1(7) of the Health Service (Benefit) (Guernsey) Law, 1990 and Section 1(7) of the Long-term Care Insurance (Guernsey) Law, 2002

The Social Security Department (hereinafter referred to as "the Department") shall be authorised to invest monies forming part of the Guernsey Insurance Fund, the Guernsey Health Service Fund and the Long-term Care Insurance Fund in investments of any or all of the following descriptions:

a) Bonds

Debentures, debenture stocks, loan notes, unsecured loan stocks, bonds, structured products, secured loans and short term interest bearing instruments (such as certificates of deposit, bills and commercial paper), issued or guaranteed by, and interest bearing deposits with:

i) any Government of any country or territory, or

ii) the States of Guernsey, or

iii) any local authority or other public body in any of the above countries or territories, or

iv) any building society in the United Kingdom, or

v) any supranational institution,

vi) or any company incorporated in any country or territory.

b) Equities

Equity stocks and shares, whether nil paid, partly paid or fully paid, of companies incorporated in any country, provided that they are traded on or under the rules of a Stock Exchange recognised for this purpose by the Treasury and Resources Department.

c) Property

Real property or interests in real property including:

i) commercial property,

ii) residential property,

iii) land for residential or commercial use,

iv) agricultural land,

v) forestry,

vi) any form of pooled investments for categories i) to v), including, but not limited to, limited partnerships, property unit trusts, fund of property unitised vehicles, Sociétiés

d'Investissement à Capital Variable (SICAVs) and real estate investment trusts.

d) Derivatives

Derivative instruments based on financial securities, currencies or financial markets such as options, warrants, futures contracts, swaps, forward foreign exchange contracts, and contracts for differences, whether quoted on a stock market or an exchange or over the counter.

e) Pooled Funds

i) any form of pooled investment including, but not limited to, a limited partnership, unit trust, SICAV, fund of funds or exchange traded fund,

ii) policies issued by a properly constituted insurance or assurance company.

f) Other Assets

The following assets may be held:

i) Hedge funds of any type including fund of hedge funds,

ii) Infrastructure assets of any type, including Private Finance Initiative investments,

iii) Private equity,

iv) Currency and currency overlays,

v) Pooled funds where the underlying assets are commodities.

Other Controls

The Department will set detailed controls on position, size and quality of all investments to ensure that the Fund is properly and fully diversified by individual security and asset type.

Additional Powers

The Fund has power to:

i) sub underwrite or underwrite a new issue,

ii) enter into stock lending arrangements with financial institutions,

iii) guarantee the obligation of a company owned or partly owned by the Fund,

iv) borrow on a temporary basis to a maximum of 5% of the total market value of the Fund,

v) enter into arrangements for a common investment fund with other Funds under the control and management of the Social Security Department.

(NB As stated on previous occasions, the Treasury and Resources Department is of the view that the States should not be considering decisions on non contributory benefit rates in isolation from the remainder of the Budget process. The concurrent compilation and presentation of all proposals affecting the States Financial position will facilitate effective prioritisation in that, the relative merits of all the measures that would affect States income and expenditure, would be considered at the same time.

The Department is disappointed that above inflationary increases in the benefit limitation are being proposed in advance of the production of minimum income standards for Guernsey which will provide the necessary evidence on which to base any future proposals. The Department does recognise however that these minimum income standards may lead to further pressure for increased benefits which will need to be considered alongside competing requests for the scarce resources available.

The proposals contained in this Report are estimated to increase expenditure on Social Security Formula-Led headings by more than £2million of which £1.3m is attributable to an increase in the Grants to the Funds through a formula which sees the Grants increase as contributions rise. An overall increase of £2million would equate to a 4.3% increase in the budget for formula-led Social Security expenditure between 2011 and 2012. If approved, the increase, to the extent that it exceeds RPIX, will require reductions elsewhere in the 2012 States Budget in order to remain within the Fiscal & Economic Policy target of no real growth in aggregate revenue expenditure.")

(NB The Policy Council, by a majority, support the States Report, whilst acknowledging that further work is required in relation to the sustainability of funds in relation to other inter-dependent policies.)

The States are asked to decide:-

XIII.- Whether, after consideration of the Report dated 13th July, 2011, of the Social Security Department, they are of the opinion:-

1. That, from 2 January 2012, the standard rates of pension and contributory social insurance benefits shall be increased to the rates set out in this Report.

(paragraph 33)

2. That, for employed persons, the upper weekly earnings limit, the upper monthly earnings limit and the annual upper earnings limit, from 1 January 2012, shall be £2,022, £8,762 and £105,144 respectively.

(paragraph 37)

3. That, for employers, the upper weekly earnings limit, the upper monthly earnings limit and the annual upper earnings limit, from 1 January 2012, shall be £2,409, £10,439 and £125,268 respectively.

(paragraph 38)

4. That, for employed persons and employers, the lower weekly earnings limit and the lower monthly earnings limit, from 1 January 2012, shall be £121 and £524.33 respectively.

(paragraph 42)

5. That, for self-employed persons, the upper earnings limit and lower earnings limit, from 1 January 2012, shall be £105,144 per year and £6,292 per year, respectively.

(paragraphs 44 and 47)

6. That, for non-employed persons, the upper and lower annual income limits, from 1 January 2012, shall be £105,144 per year and £15,730 per year respectively.

(paragraphs 48 and 51)

7. That the allowance on income for non-employed people from 1 January 2012, shall be £6,675 per year.

(paragraph 52)

8. That the voluntary contribution from 1 January 2012, shall be £17.24 per week for non-employed people.

(paragraph 55)

9. That the overseas voluntary contribution from 1 January 2012, shall be £82.36 per week for non-employed people and £91.04 for self-employed people.

(paragraph 56)

10. That Resolution 6 on Article 16 of Billet D'Etat XVII of 2006 be rescinded and replaced with the permitted investment rules set out in the Appendix to this report.

(paragraph 61)

11. That, from 1 January 2012, the prescription charge per item of pharmaceutical benefit shall be £3.10.

(paragraph 68)

12 That the Health Service (Benefit) (Guernsey) Law, 1990 and related subordinate legislation be amended to allow community nurses employed by the Health and Social Services Department, whose names are held on the Nursing and Midwifery Council's register, to be empowered to issue medical prescriptions for the supply of wound management products, as listed in section 13.13 of the Limited List.

(paragraph 72)

13. That, from 2 January 2012, the contribution (co-payment) required to be made by the claimant of care benefit, under the long-term care insurance scheme, shall be £176.61 per week.

(paragraph 88)

14. That, from 2 January 2012, nursing care benefit shall be a maximum of £730.73 per week for persons resident in a nursing home or the Guernsey Cheshire Home and residential care benefit shall be a maximum of £391.37 per week for persons resident in a residential home.

(paragraphs 90 to 91)

15. That, from 2 January 2012, elderly mentally infirm (EMI) care benefit shall be a maximum of £515.69 per week for qualifying persons resident in a residential home.

(paragraph 92)

16 That, from 2 January 2012, respite care benefit shall be a maximum of £907.27 per week for persons receiving respite care in a nursing home or the Guernsey Cheshire Home, an elderly mental infirm rate of £692.30 for persons receiving respite care in a residential home and a maximum of £567.98 per week for persons receiving respite care in a residential home.

(paragraph 93)

17. That the First Schedule to the Supplementary Benefit (Implementation) Ordinance, 1971 be amended to allow the requirements of a child in respect of whom residence order allowance or adoption order allowance is payable, to be disregarded for the purposes of calculating the requirements of a person whom that child is living with under a residence order or adoption order, and to allow for residence order allowance and adoption order allowance to be disregarded for the purpose of calculating that person's resources.

(paragraph 119)

18. That, from 6 January 2012, the supplementary benefit requirement rates shall be as set out in paragraph 120 of this Report.

19. That, from 6 January 2012, the weekly benefit limitations for supplementary benefit shall be:

(c) £450 for a person living in the community;

(d) £486 for a person who is residing in a residential home; and

(c) £698 for a person who is residing as a patient in a hospital, nursing

home, the Guernsey Cheshire Home or as an elderly mental infirm resident of a residential home.

(paragraphs 125 to 135)

20. That, from 6 January 2012, the amount of the personal allowance payable to persons in Guernsey and Alderney residential or nursing homes who are in receipt of supplementary benefit shall be £27.84 per week.

(paragraph 136)

21. That, from 6 January 2012, the amount of the personal allowance payable to persons in UK hospitals or care homes who are in receipt of supplementary benefit shall be £46.89 per week.

(paragraph 139)

22. That a supplementary fuel allowance of £27.09 per week be paid to supplementary beneficiaries who are householders from 28 October 2011 to 26 April 2012.

(paragraph 141)

23. That, from 2 January 2012, family allowance shall be £15.40 per week.

(paragraph 145)

24. That, from 2 January 2012, the rates of attendance allowance and invalid care allowance and the annual income limits shall be as set out in paragraph 148 of this Report.

25. Treasury and Resources Department be directed to take account of the 2012 estimates for Social Security Department Formula Led expenditure when recommending, as part of the 2012 Budget Report, Cash Limits for Departments and Committees.

26. To direct the preparation of such legislation as may be necessary to give effect to their above decisions.

COMMERCE AND EMPLOYMENT DEPARTMENT

REVIEW OF UTILITY REGULATION

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

8 July 2011

Dear Sir

1. Executive Summary

1.1 In April 2010, following considerable public debate over proposals put forward by the OUR to open up the postal sector to increased competition by amending Guernsey Post's Reserved Area, the States approved a Requête entitled "*Competition in Electricity and Postal Services*" which required the Commerce and Employment Department to report back to the States with recommendations for amending the States' Directions in respect of the introduction of competition in both the postal and electricity sectors. The Commerce and Employment Department considered the Requête, but was of the view that the debate had been symptomatic of a much wider concern about the operation of Regulation in Guernsey's economy and the context in which it was operating, and that this could only be addressed by a wider study.

1.2 This issue was raised at a meeting with representatives of the signatories of the Requête, at which it was agreed to commission a study into the issue from a body with experience of the operation of economic regulation. The terms of reference of the study were also agreed at that meeting. Following a tender process the Regulatory Policy Institute (RPI) was commissioned to undertake the study in July 2010.

1.3 Following extensive local consultations, the RPI published its Report in October 2010 and, together with a consultation paper, this was put out for public consultation. Comments received have been taken into account in the drafting of this States Report, a draft of which was circulated for further comment to interested parties. All comments received have been given detailed consideration and where considered appropriate have influenced the contents of this Report.

1.4 RPI took as its starting point a consideration of the appropriate role of Regulation in a small island market economy such as Guernsey. In particular, it

identified a number of specific factors that it considered to be especially relevant to Regulation in Guernsey, leading to a number of conclusions, including the following:

- In general terms, within a small community such as Guernsey a less activist and more adjudicative style of Regulation than elsewhere would be justified, summarised as "Doing a Limited Number of Biggish Things Well".
- To an extent, however, if there has been a perception that the OUR has been over-active in its approach, this may be attributed, at least in part, to a lack of activity by other parties.
- Standard methods of regulation, and in particular price control, are less effective for government-owned utilities than for private sector companies.
- There is a need for a balance of responsibilities between all parties in the regulation process, and in particular between the Regulator and the shareholder, in this case the Treasury and Resources' Department acting as the States' shareholder representative[1].

1.5 Taking these and other issues into account, RPI came forward with a programme of proposals that in its view would result in a significant improvement in the performance of regulation in the Island, with particular reference to the postal and electricity sectors. RPI stressed that these recommendations would need to be implemented in their entirety if significant and sustainable improvements were to be achieved. The Commerce and Employment Department has examined and consulted on this programme in detail and considered the extent to which the proposals are practical and achievable within the Guernsey context. The responses from stakeholders have been invaluable in helping the Department in its deliberations. As a result it has brought forward a programme of pragmatic proposals adapted to take fully into account the Island's specific circumstances and which have been designed to achieve a similar result. Again, however, if is to be fully effective, the programme needs to be implemented in its entirety. In particular, changes made solely to the role of the Regulator would be unlikely to achieve the desired result and may be to the detriment of the interests of the consumer and the Guernsey economy.

1.6 The principal Recommendations of this Report can be summarised as follows:

- The States should approve principles to underpin economic regulation and direct the Director General of Utility Regulation to take these principles into account in implementing the legislation. In addition, the

[1] The States Trading Companies (Bailiwick of Guernsey) Ordinance, 2001 actually states that the Minister and Deputy Minister of the Treasury and Resources Department hold the shares on trust for the States and who act in accordance with the Treasury and Resources Board's instructions. For ease of reference the shareholder throughout this report is referred to more generally as the States and more specifically with regard to the shareholder role as the Treasury and Resources Department.

Director should be required to draw up Memoranda of Understanding with Guernsey Post and Guernsey Electricity, setting out how the regulation of the two companies will proceed (Section 5).

- The States should also approve principles of corporate governance for the States' owned utilities and direct the Treasury and Resources Department to take these into account when performing the role of shareholder representative (Section 6).
- The complementary roles of the OUR and the Treasury and Resources Department as shareholder should be clarified to avoid duplication (Section 6).
- The "shareholder resource" concept should be explored further with Jersey through the Policy Council External Relations Group and a report brought to the States by September 2012. (Section 6).
- Consideration should be given in the review of the duties of the Scrutiny and Public Accounts committees as to how best the regulatory regime including the shareholder role should be scrutinised on a regular basis. (Section 7).
- The Director General should in future produce a three-year strategic plan, and annual business plans setting out the actions to be taken in the following year. (Section 7).
- The legislation should be amended to allow for the introduction of a Universal Service Fund for postal services, should such a fund be required at some time in the future. (Section 9).
- In future the extent of the reserved/exclusive area in postal services should be agreed by the States of Guernsey. (Section 9).
- Subject to de minimis exceptions, in future all postal operators should require a licence from the OUR. (Section 9).
- The present arrangements whereby Guernsey Electricity enjoys a monopoly in the conveyance and retail of electricity, but not in its generation, should be continued until the end of January 2022, subject to the matter being reviewed earlier if there are significant changes in the electricity market. (Section 10).
- The authority of the Treasury and Resources Department should be required by Guernsey Electricity and Guernsey Post before registering an appeal against a decision of the OUR, and the time period for registering an appeal should be increased to 56 days. (Section 11).
- As in Jersey, the current structure of the OUR should move towards a Board and Executive Officer function, if possible establishing a joint Board with the Jersey Competition Regulatory Authority (JCRA). If this can be achieved the OUR's Audit and Remuneration Committee should be abolished. (Section 12).

1.7 In addition to this comprehensive programme of recommendations, this Report also comments on wider issues raised by RPI and confirms that the implementation of competition law is essential to provide the tools that are necessary for regulation to work effectively and in a more flexible manner, and

that the States should establish a formal Energy Policy to give guidance to Guernsey Electricity, its shareholder and the regulator.

2. Introduction – the April 2010 Requête

2.1 In April 2010 a Requête entitled "*Competition in Electricity and Postal Sectors*" was laid before the States[2], the prayer of which was to require the Commerce and Employment Department to report back to the States with recommendations for amending or supplementing the States' Directions to the Director General in respect of the special or exclusive rights of Guernsey Electricity Limited, and of Guernsey Post Limited in respect of the introduction of competition in the electricity and postal sectors, together with proposed amendments to the relevant legislation should such amendments be considered to be necessary and appropriate.

2.2 The Commerce and Employment consented to the prayer of the Requête, but in giving consideration to its contents was of the view that the issues raised were symptomatic of a broader concern about the operation of Regulation in Guernsey. Subsequently therefore, the Minister of the Department met with representatives of the Requête's signatories and it was agreed that what was required was a wider review of the operation of Regulation in the Island, and the following terms of reference were agreed for such a Review:

- To review the States of Guernsey's existing objectives for the regulation of electricity, post and telecoms, with particular reference to the liberalisation of the post and electricity markets.
- To assess the effectiveness, and appropriateness, of Guernsey's regulatory regime in delivering these objectives.
- In the light of these findings to identify and assess options capable of achieving the States' objectives; and
- To provide evidence based recommendations for the Commerce and Employment Department to take to the States of Deliberation which will ensure that Guernsey has a form of regulation that meets the present and future needs of the States of Guernsey, consumers, and the Guernsey economy.

2.3 This decision was reported to the States at its June 2010 meeting and the terms of reference were circulated as part of a tender process to a number of professional bodies with expertise in Regulatory matters. As a result, the Regulatory Policy Institute (RPI) was appointed to carry out the Review and following consultation and visits undertaken in August and September 2010 the Institute's Report was published in October 2010, and made available for consultation purposes together with a Consultation Paper. Responses to the Report's recommendations were received from bodies with a close interest in

[2] Billet d'Etat IX, 2010, page 461

Regulation in Guernsey and those responses as well as the recommendations of the Report itself have been taken fully into account in formulating the recommendations of this States Report.

2.4 The full RPI Report is attached as Appendix 1 and the responses are available on the States website[3]. Also attached, as Appendix 2, is a letter from RPI in response to the Department's consultation explaining in further detail some of the concepts they have put forward. A list of the organisations and individuals who responded to the consultation is attached as Appendix 3.

3. Background – the Commercialisation Process

3.1 The introduction of Regulation in Guernsey came about because of concerns that the operation of what were then the States Trading Boards was no longer appropriate and in accordance with accepted best practice elsewhere for the provision of utility services, where a more overtly commercial approach was being implemented based on competition where feasible. In particular it was felt that the self-regulation that was implicit in the then Trading Board arrangement was not effective in promoting efficiency and in meeting the needs of consumers, and that without action being taken this lack of efficiency would intensify with higher than necessary charges being passed on to consumers and businesses, thereby making the Island increasingly uncompetitive. Therefore, the "Regulation of Trading Undertakings" States' Report[4] set out a framework for the achievement of the commercialisation of utilities in Guernsey through the establishment of a system of economic regulation, and this framework continues to underpin the arrangements that are in place in order to implement and maintain the commercialisation process.

3.2 In particular, the 2000 Report set out the envisaged overall structure of Regulation in the Island, the differing but complementary roles of the Regulator and the Owner/Shareholder (in effect the States of Guernsey represented by the Advisory and Finance Committee) and the policies and legislative and administrative procedures that were considered to be appropriate.

3.3 The framework established in 2000 has provided a firm basis for the commercialisation of utilities in Guernsey, but that Report is now ten years old and since that date there have been significant changes in the Island's economy, and significant experience of Regulation has been gained in both Guernsey and other administrations that can help to provide guidance for future Regulatory policies and procedures. It is therefore entirely appropriate that at the ten year mark the system of economic regulation in the Island is fully reviewed, and the RPI Report has provided the opportunity for this to be achieved.

3.4 A review of commercialisation, commissioned jointly by the Treasury and Resources and Commerce and Employment Departments, was carried out in

[3] http://www.gov.gg/ccm/navigation/commerce---employment/published-reports/
[4] Billet d'Etat II, 2000, page 6

2006[5], and this review included a detailed report by the National Audit Office. That Review emphasised a number of fundamental characteristics of a successful Regulation approach, including the responsibilities of the shareholder and the Regulator, and came to the following overall conclusions which were considered appropriate at that time:

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

3.5 The 2006 Review was principally operational and did not address the more strategic issues that are relevant to Regulation in Guernsey, including the structures, policies and procedures that are appropriate to Guernsey.

3.6 Nevertheless, as a result of this review the States made a number of Resolutions relating to the operation of Regulation in Guernsey, and their implementation has produced a number of improvements in how Regulation has functioned during the recent period.

4. The RPI Report

4.1 The October 2010 RPI Report describes a number of attributes of good regulatory frameworks and identifies recommendations related to specific sectors and issues that are considered in detail in later sections of this Report. It also identifies some specific factors that it considers to be especially relevant to Regulation in Guernsey:

- The small size of relevant markets
- The structure of government in Guernsey
- Public ownership of Guernsey Post and Guernsey Electricity
- Corporate Governance in the commercialised public sector
- Prospects for cooperation with Jersey
- Guernsey's save-to-spend policy
- The operation of Regulation on the principle of "Doing a Limited Number of Biggish Things Well"
- The establishment by the States of a formal Energy Policy to provide strategic direction

[5] Billet d'Etat X, 2006, page 931

- The implementation of competition legislation

4.2 In the production of the Report, RPI also had regard to the following factors which it considered to be particularly relevant to the Island:

- Any assessment of the effectiveness of a regulatory regime requires an examination not just of the regulator, but also of the broader policy and institutional structure of government within which regulation operates.
- Any general differences in conduct and performance are to be ascribed to differences in context.
- In particular, in Guernsey the system of formal regulation is operated at a scale much smaller than is typically observed in other jurisdictions, leading to a need for scope and proportionality in Regulation under the overall principle of **"doing a limited number of biggish things well".**
- The scope for competition in the Island is greater than generally assumed.
- Utilities remaining in public ownership tend to dull the managerial incentives for improving performance and require a very activist shareholder.
- A broad shareholder role involving trade-offs between price levels and financial returns is not the approach envisaged under the standard "independent regulation" way of doing things.
- The fixing of prices will not create the same desirable incentives for cost reduction in the commercialised States-owned entities as it does in private companies.

4.3 One of the most important comments made in the RPI Report, however, was that certainly in some circumstances the actions of the OUR may be interpreted as being over intrusive, but this may have been because the corporate governance arrangements are comparatively ineffective. This is because:

- In a publicly owned enterprise price control and other surrogate market constraints are not as effective as in the private sector, and this fact had not been appreciated in setting up the original framework.
- There is a tendency built into the system to assume that regulatory practices that are successful in bigger jurisdictions can be successfully imported into a small market economy such as Guernsey, with consequences for some of the procedures used by the OUR, for example in the use of consultants.
- There is confusion in the role of the Treasury and Resources Department (as shareholder representative) which includes a responsibility to consider the effect of increased charges on the community. This is not the appropriate independent model.
- Inadequate attention has been given within the structure of government to ensuring that, as in the private sector, the shareholder is equipped to undertake an active shareholder role in the supervision of the Boards of Guernsey Electricity and Guernsey Post.

4.4 The conclusions and recommendations in the RPI Report can be divided into two principal areas:

- Those which apply to particular utilities, principally post and electricity, and which were the reason for the referral of the Requête to the States in the first place (see sections 8-10).
- Those that cover general topics that apply to all of the regulated sectors and indeed to the role of Regulation within the Island's economy (see sections 5-7 and 11-14).

4.5 In terms of those that cover general topics that apply to all of the regulated sectors and indeed to the role of regulation within the Island's economy, the three principal themes that can be considered essential to the design of any amendments to the system are that:

- Regulation within Guernsey needs to be adapted to the particular circumstances of the Island as a small market economy. Although this sounds simple it is in fact a significantly complex task, involving the consideration of factors that would not be relevant in a larger economy.
- There needs to be an appropriate balance of responsibilities between the various stakeholders within the Regulation system, perhaps best illustrated by the comment that to some extent the Regulator has perhaps been, or at least has appeared to be over active in his procedures because of the lack of action in other quarters.
- The Regulation of Utilities needs to be seen within the context of broader States' policies related to the Island's economy as a whole, for example in relation to competition where the current lack of competition legislation means that unlike in Jersey the Regulator does not have the additional tool in the box that would enable him to move towards a less intrusive approach, and for Guernsey Electricity the lack of a formal States Energy Policy to give strategic guidance to Guernsey Electricity.

4.6 These three themes have the following principal consequences that are given further consideration in the later sections of this Report.

4.7 There is a requirement to ensure that the costs of regulation in Guernsey are commensurate with what it can realistically achieve, described in the Report as "Doing a limited Number of Biggish Things well". This implies:

- A flexible attitude to price controls, and where possible to move to an ex-post rather than an ex-ante form of regulation, which to be achieved requires the full implementation of competition law (see section 13).
- The need to minimise the costs of resolving disagreements, given in particular the very extensive administrative and legal costs that an appeal to the Royal Court entails. This may in certain circumstances imply a

method of mediation – in effect an informal "adjudication panel" to help resolve disputes (see section 11).
- A clear system of States' objectives as well as the fundamental principles that should govern the actions of the OUR (see section 5).
- The OUR taking a less activist and more adjudicative role in its activities (see section 5).
- A clear system of accountability to ensure that these principles are being adhered to and any potential difficulties are addressed (see section 7).

4.8 There also needs to be a clearer separation between the responsibilities of the Regulator and those of the shareholder, with the interests of the consumer being clearly the focus of the OUR as an independent body, and the responsibilities of the Treasury and Resources Department as shareholder's representative being to take an active role focussed closely on promoting the efficiency of both Guernsey Electricity and Guernsey Post. This represents a re-balancing of the current responsibilities and implies:

- An amendment to the States' Direction to the Treasury and Resources Department in respect of its responsibilities to take into account the effect of pricing decisions on the community, which are more properly the responsibility of the OUR (see section 6).
- A clear statement of the principles that should underpin the corporate governance of the Treasury and Resources Department in its undertaking of its responsibilities for the States-owned utilities (see section 6).
- A clear system of accountability to ensure that these principles are being adhered to and that any difficulties are being addressed (see section 7).

4.9 There is a need for the operation of Regulation to have the flexibility to respond to broader changes in the Island's economy, taking into account broader States' economic, financial and fiscal policies and the requirements of local businesses. This implies:

- Giving enhanced priority to the implementation of competition legislation in consideration by the States of the new service bids for 2012 (see section 13).
- Given the presence of many businesses in both Islands and the current financial position, consolidating and developing further the harmonisation of policies and procedures between the OUR and JCRA, which will reduce costs for both Guernsey and Jersey and businesses in both Islands (see section 12).

4.10 **Taken together, the proposals put forward in this Report represent an integrated and pragmatic way forward which, if implemented in its entirety should result in a significant improvement in the operation of economic regulation in the Island.** The Department believes, based on the evidence from RPI's independent review that changes made solely to the role of the regulator

would be unlikely to achieve the desired result and may be to the detriment of the interests of the consumer and the Guernsey economy.

5. Principles for Economic Regulation – the Role of the Regulator

5.1 Reference has already been made to the need to re-define clearly the role of the Regulator and the Shareholder and to achieve some re-balancing of the current responsibilities. This and the following section deal with these issues in more detail and put forward sets of principles that the Commerce and Employment Department is recommending that the States adopt for both the OUR and the Treasury and Resources Department in order to provide guidance.

5.2 In 2006 the States approved an Amendment to the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 that allows the States to provide directions to the Director General in a number of areas.

> *"(1A) The States may, on the recommendation of the Commerce and Employment Department made after consultation with the Director General, and without prejudice to the provisions of subsection (1), by Ordinance give the Director General directions of a strategic or general nature including, without limitation, directions concerning the priorities to be taken into account by him in the exercise of his functions and powers in respect of any utility service.*

5.3 In 2006 the States also approved an amendment to the 2001 Law dealing with the manner in which the Director General was to exercise his functions (the new text is underlined):

> *"(2) The Director General shall exercise his functions and powers with fairness, impartiality and independence and in a manner which is –*
> *(a) timely, transparent, objective and, subject to the exception set out in section 3(1), consistent with States' Directions and the provisions of this Law and any relevant Sector Law,*
> *(b) <u>proportionate to the Bailiwick's circumstances, and</u>*
> *(c) <u>accountable, consistent and targeted only at cases in respect of which action on his part is necessary."</u>*

5.4 Despite this amendment, however, RPI found that there was still a perception by those consulted that there remained concerns about the conduct of the OUR (for example over-reliance on detailed models which imposed a burden on companies to produce information to fit the model).

5.5 These comments concern more the style and format rather than the content of the OUR's operations, and can best be summarised by the comment that in future the OUR should move towards a more adjudicative and less activist style of regulation. While to some extent this will depend on the judgement of the Director General in specific circumstances, an agreed set of principles as

described below should provide essential guidance on the conduct of Regulation which the Director General is obliged to take into account in making his decisions.

5.6 In the UK, the Department for Business Innovation and Skills has in April 2011[6] published a document entitled "Principles of Economic Regulation" following the publication of a call for evidence in January 2011. The document recognises that "high quality and efficient economic infrastructure plays a vital role in supporting a competitive and growing economy by providing services on which all businesses and citizens depend", and that while "competitive markets are the best way in the long run to deliver these services to consumers and provide incentives to invest and improve efficiency and service quality", "network effects and/or economies of scale create circumstances, such as natural monopolies, which, under current technological patterns, limit the prospects for effective competition". Under these circumstances, independent economic regulation is "needed over the long term to continue to provide vital consumer protections and ensure consumers' interests are promoted through efficient provision of good quality, reliable and sustainable services", in effect operating as an alternative to the market to ensure the protection and promotion of the long-term interests of Guernsey's consumers and its economy.

5.7 As a feature of their responsibilities, it is common practice for governments to adopt principles for how economic regulation should be applied. This enables the government to set out its general expectations as to how economic regulation should be implemented through the provision of a regulatory framework. It is important to note that this is separate from the day to day operation of the regulatory decision making process. The original States Directions to the Director General[7] and the general statutory duties and obligations set out in the primary legislation[8] do provide a set of objectives for the Director General, but while there have been two reviews of commercialisation and regulation since 2001, no framework of principles as such applies in Guernsey.

5.8 RPI highlighted in respect of the shareholder role that "*the OUR may have done too much because government has done too little.*" This comment might equally apply with respect to the States setting a framework within which to operate, not just for the regulator, but also for the shareholder, the regulated businesses and other stakeholders. Indeed, a number of respondents to the consultation made similar points about the need for ensuring the co-ordination of regulatory objectives with broader States objectives set out in the States Strategic Plan and supporting Plans.

5.9 One of the conclusions of the review that lead to the "Principles for Economic Regulation" in the UK was that "the fundamentals of the UK's system for

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[6] http://www.bis.gov.uk/assets/biscore/better-regulation/docs/p/11-795-principles-for-economic-regulation.pdf

[7] http://www.regutil.gg/docs/our0308.pdf

[8] The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001

economic regulation are sound and not in need of major reform". While committed therefore to its system of regulation, the UK Government recognised the scale of the challenges facing the UK's infrastructure and decided to revisit the regulatory regime to reinforce its key foundations and ensure it provided the right degree of clarity, certainty and consistency. The review was also prompted by a number of concerns that there was a lack of clarity in the duties of economic regulators (particularly with respect to trade-offs between economic, social and environmental duties) and a lack of clarity around the long-term strategy for Regulation.

5.10 There is a certain relevance of these points to the Guernsey context. Whilst the Director General has performed his statutory duties in accordance with the legislative requirements it could be said that the States have not provided sufficient clarity on their general and strategic objectives. For example, with respect to electricity generation the regulator has been required to focus on least costs which has meant that Guernsey Electricity cannot deviate from its Merit Order, regardless of the effect of carbon emissions. In practice the Director General has implicitly made allowance for the higher costs of some inputs, such as low sulphur oil, in line with his general duties under Section 2 of the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001. However, there is scope for the States to provide greater clarity in certain areas where it considers this necessary.

5.11 The Commerce & Employment Department is therefore recommending that the States by Ordinance directs the Director General of Utility Regulation to adopt the following Six Principles for Economic Regulation which are based upon the BIS proposals but modified to suit Guernsey's unique characteristics.

a) Accountability

independent regulation needs to take place within a framework of duties and policies set by the democratically accountable States of Deliberation

roles and responsibilities between the States of Guernsey and the OUR should be allocated in such a way as to ensure that regulatory decisions are taken by the body that has the legitimacy, expertise and capability to arbitrate between the required trade-offs

decision-making powers of the OUR should be, within the constraints imposed by the need to preserve commercial confidentiality, exercised transparently and subject to appropriate scrutiny and challenge

b) Focus

the role of the OUR should be concentrated on protecting the interests of end users of infrastructure services by ensuring the operation of well-functioning and contestable markets where appropriate or by designing a system of

incentives and penalties that replicate as far as possible the outcomes of competitive market.

the OUR should have clearly defined, articulated and prioritised responsibilities focussed on outcomes rather than specified inputs or tools

the OUR should have adequate discretion to choose the tools that best achieve these outcomes

c) Predictability

the framework of economic regulation should provide a stable and objective environment enabling all those affected to anticipate the context for future decisions and to make long term investment decisions with confidence

the framework of economic regulation should not unreasonably unravel past decisions, and should allow efficient and necessary investments to receive a reasonable return, subject to the normal risks inherent in markets

d) Coherence

regulatory frameworks should form a logical part of the States of Guernsey's broader policy context, consistent with established priorities

regulatory frameworks should enable cross-sector delivery of policy goals where appropriate

e) Adaptability

the framework of economic regulation needs capacity to evolve to respond to changing circumstances and continue to be relevant and effective over time

f) Efficiency

policy interventions must be proportionate and cost-effective while decision making should be timely, and robust.

5.12 Clearly there will be times when there is conflict between these principles and it will be necessary for Guernsey's regulatory framework to strike an appropriate balance between them. There should also be a clear distinction between the established intent of the States through legislation and the regulatory policy framework, and shorter-term priorities in response to more fluid and unstable needs. The Department does not believe that these principles will compromise the Director General's independence as a statutory body in undertaking its legal duties.

5.13 However, while these principles provide operational guidance to the OUR, they are at a high regulatory level and there is a risk that for a number of reasons they may not be successfully translated into effective practice. There is therefore a need to consider how to provide greater certainty that the benefits arising from the adoption of these principles will in practice be achieved.

5.14 The Commerce and Employment Department has noted the comments received during the consultation process on this Report and believes that the appropriate method would be for a "Memorandum of Understanding" to be agreed between the OUR and the two States-owned utilities that would set out in sufficient detail the new systems, processes and agreements (including processes as to dispute resolution) to give all parties assurance and certainty that the high level principles stated above will be effectively administered and put into operation and the benefits achieved. The Memorandum of Understanding would set out a productive and cost-efficient way of working that would significantly reduce uncertainty and risk, without detracting in any way from the OUR's independence and specific legal responsibilities.

5.15 While the contents of the Memorandum of Understanding would be up to the OUR to decide in conjunction with the States' owned utilities, it is anticipated that the MOU would include provisions dealing with subjects such as:

a) How the price setting process would operate, in line with the aim of moving to a less activist form of Regulation.

b) Methods of scrutiny of the utilities' profitability levels.

c) Methods of defining and improving utilities' efficiency levels.

d) Arrangements for dealing with any uncontrollable costs (for example fuel).

e) Procedures for resolving disputes instead of, or prior to, an appeal to the Royal Court.

f) Procedures related to the definition and assessment of major capital expenditure.

g) Proposals for implementing accountability to the States of Guernsey and the broader general public.

Recommendation 1: The Commerce and Employment Department recommends that the States by Ordinance direct the Director General of Utility Regulation to:

a) follow the six principles for economic regulation set out in paragraph 5.11 of this Report and to take them into account in performing his statutory duties.

b) prepare a Memorandum of Understanding setting out formally the

approach, process, practice and procedure, objectives, deliverables and measurements of success for future regulation of each States-owned utility, as described in paragraphs 5.14 and 5.15 of this Report.

6. Principles for Corporate Governance – the Role of the Shareholder

6.1 The Commerce and Employment Department's consultation on current corporate governance arrangements for the commercialised utilities failed to generate a consensus view on possible solutions. The Department agrees with RPI that broadening of the scope of the review was essential in that the effective functioning of the regulatory system depends upon the interaction of a number of structural factors including legal, public policy and institutional frameworks (including the corporate governance arrangements) in which regulation occurs. As the RPI Report clearly states, context is everything.

6.2 Issues of corporate governance are important at two different levels:

- The role, responsibilities and actions of the commercial boards of the States-owned utilities.
- The role, responsibilities and actions of the Treasury and Resources Department as the designated representative of the States as shareholder.

6.3 In June 2010 the Financial Reporting Council in the UK, an independent regulator supported by the Department for Business Innovation and Skills published the "UK Corporate Governance Code" [9] which sets out a number of principles in terms of leadership, effectiveness, accountability, remuneration and relations with shareholders through which the commercial boards of listed companies can facilitate by effective, entrepreneurial and prudent management their long term success, including issues related to the appointment of non-executive directors, their terms of office and responsibilities. The Commerce and Employment Department is of the view that the principles contained in the Corporate Governance Code provide important guidance to the commercial boards of both Guernsey Electricity and Guernsey Post. As representative of the States as shareholder, the application of its principles and reporting to the shareholder is the responsibility of the Treasury and Resources Department.

6.4 However, the Treasury and Resources Department in their response to the consultation did not accept that the corporate governance arrangements required any change. In particular the Treasury and Resources Department did not believe that RPI's criticisms were based on substantive evidence. The Commerce and Employment Department believes that the RPI report did identify some shortcomings in the shareholder role and corporate governance arrangements[10]. Therefore, and as identified by RPI, changes to elements of the

[9] http://www.frc.org.uk/corporate/ukcgcode.cfm. It is known as the "Combined Code".

[10] Issues raised by RPI re corporate governance for Post relate to the banking "diversification episode" incurring costs of up to £800,000 without first seeking confirmation that the company would acquire a

regulatory regime in isolation and without considering corporate governance issues would not provide a sustainable and efficient solution.

6.5 In terms of the responsibilities of the shareholder, in addition to a set of principles for the Regulator it is also common practice for governments to define a similar set of principles to guide the actions of the shareholder – in this case the Treasury and Resources Department as representative of the States of Guernsey – in carrying out its responsibilities, and both the 2000 States Report and the 2005 NAO Review[11] dealt in some detail with the shareholder role. As with the duties of the Regulator, to an extent the duties of the shareholder are set out in legislation[12], as well as in the States' Guidance to Shareholders that the States agreed initially in 2001[13] and which is now incorporated in the States' Strategic Plan.

6.6 In the UK the Department for Business Innovation and Skills is responsible for the Shareholder Executive[14] which attempts to ensure that the Government is an effective and intelligent shareholder in the businesses that it controls, with a view to creating long term shareholder value and securing best value for taxpayers' investments. In order to achieve this, the Executive has been set a number of objectives to be pursued, and these have been adapted as follows to suit Guernsey's situation:

- **Governance Frameworks:** where appropriate, ensure that corporate governance is compliant with the principles[15] of the UK Corporate Governance Code (formerly known as the Combined Code) and fits the needs of the shareholder and business.
- **Strategy:** set overall objectives for the business, including responsibility for resolving any conflict between the Government's objectives. Agree with the commercial boards strategic plans for delivering those objectives: the boards are then accountable for their delivery.
- **Appointments:** recommend to the States appointments as the Chair and actively participate in other board appointments.

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banking licence from the GFSC (pages 47-50 of RPI report) and to the appointment of suitable Non Executive Directors at Guernsey Post (page 53). For Electricity, RPI refer to a relatively inactive shareholder and the problems of not ring-fencing cash reserves for the Save to Spend policy. In addition the terms of some non-executives are beyond the recommended period in any corporate governance guidelines and that NED remuneration is not provided in the Annual Accounts as required by the Combined Code and as is the case in Jersey.

[11] Review of Commercialisation and Regulation in the States of Guernsey, Report by the National Audit Office, September 2005, see in particular Appendix 3, and Appendices 3A and 3B

[12] The States Trading Companies (Bailiwick of Guernsey) Law, 2001, and The States Trading Companies (Bailiwick of Guernsey) Ordinance 2001.

[13] Billet d'Etat XXIV, 2001, page 1603 in respect of electricity and Billet d'Etat XVIII, 2001, page 1216 in respect of post.

[14] http://www.bis.gov.uk/policies/shareholderexecutive. The remit of the Shareholder Executive covers a portfolio of 28 businesses (from organisations as large as the Royal Mail to smaller businesses like the UK Hydrographic Office) spanning more than 12 government departments.

[15] These are separate from the core principles established by the UK Independent Commission on Good Governance in Public Services and adopted by the States in March 2011 (Billet d'Etat IV, 2011)

- **Remuneration and incentivisation:** set or agree remuneration principles so that management and shareholder interests are aligned.
- **Financing and Investments:** work with businesses to optimise capital structures, agree dividend policy and approve significant investments and realisations.
- **Monitoring and intervention:** monitor performance to ensure that the strategic plan is on track and that shareholder interventions are timely and well-informed.

6.7 The Commerce and Employment Department is of the view that these principles set out in a succinct form the responsibilities of the Treasury and Resources Department in the exercise of its functions as shareholder and should be adopted as such in a formalised manner (which may also require some minor amendments to the States Trading Company Ordinance).

Recommendation 2: The Commerce and Employment Department recommends that the States as shareholder direct the Treasury and Resources Department acting as their representative to follow the six principles of corporate governance set out in paragraph 6.6 of this Report and to take them into account in performing the shareholder representative role.

6.8 More specifically, and as the RPI Report makes clear, for the system of Regulation to be effective it requires both a balance and a clear separation of the responsibilities and objectives of both the Regulator and the Shareholder, so that each role can be clearly identified and understood by both, and that an appropriate tension can be created between both sets of objectives.

6.9 At present, the States' Guidance to Shareholders[16] includes the following statement with regard to the financial performance targets of both Guernsey Electricity and Guernsey Post, which should be set so as to:

1. Deliver improved efficiency in fulfilling the requirements of the Public/Universal Supply Obligation imposed under the regulatory regime whilst drawing a balance between seeking a commercial return on the resources employed and the effect on the community of any increase in charges which may result; and
2. Achieve as soon as practicable an appropriate commercial return on the resources employed in the provision of other services.

6.10 In reality, and while understanding the requirement placed on the Treasury and Resources Department to define a commercial rate of return taking into account the economic, social and environmental policies adopted by the States, the effect of price rises on the community and the broader economy is under the established Regulation model very clearly the responsibility of the Regulator,

[16] For Guernsey Post, see Billet d'Etat XVIII, 2001, page 1241, and for Guernsey Electricity, Billet d'Etat XXIV, 2001, page 1612

and in political terms of the Commerce and Employment Department in its mandate for consumer affairs.

6.11 The Commerce and Employment Department is of the view that the current guidance results in confusion as to the responsibilities of the Treasury and Resources Department in its role of shareholder, which should be focused clearly on efficiency improvements in the delivery of services by the States-owned utilities, as well as the definition of their overall strategic objectives and the monitoring of performance against these objectives.

Recommendation 3: The Commerce and Employment Department recommends that the States agree that paragraph 4 of the States Guidance to Shareholders with respect to Guernsey Electricity, and paragraph 2 with respect to Guernsey Post be amended to read as appropriate:

a) Deliver improved efficiency in fulfilling the requirements of the Public/Universal Supply Obligation imposed under the regulatory regime; and
b) Achieve as soon as practicable an appropriate commercial return on the resources employed in the provision of services.

6.12 In the Department's view, the reference in the States Guidance to Shareholders to the States economic, social and environmental policies should be sufficient to allow adequate flexibility in the definition of an appropriate commercial return, for example if those policies were to state that a strong anti-inflation strategy should be pursued.

6.13 Finally, in considering corporate governance arrangements, reference is made above to the need for the Treasury and Resources Department as shareholder representative to have the appropriate resources at its disposal to enable it to carry out its responsibilities, particularly given the Department's broader fiscal and financial mandate.

6.14 The option that was identified by RPI as worth considering was the creation of a 'shareholder resource' within the Treasury and Resources Department, preferably in cooperation with Jersey. This shareholder resource would be responsible for engaging with the utilities on financial matters and holding them to account in terms of their performance against their plans and shareholder objectives. It is interesting to note that Jersey has felt that their previous arrangements (which mirror Guernsey's current arrangements) were not fit for purpose and required change, and through its own Treasury Department has commissioned from Deloitte a Report entitled "States of Jersey Owned Utilities Governance Review"[17] which was published in June 2010. Jersey is currently

[17] http://www.gov.je/Government/Pages/StatesReports.aspx?ReportID=411

establishing a shareholder resource which will be funded through an annual charge on the four Jersey commercialised entities, where the States are sole shareholder of Jersey Post and Jersey Telecom, and majority shareholder of Jersey Water and Jersey Electricity.

6.15 The Commerce and Employment Department is therefore disappointed with Treasury and Resources' reluctance to pursue this option either separately or with Jersey. The Department continues to believe that such a model might be suitable in Guernsey and should be assessed properly. It is of the view that it would be sensible for the Treasury and Resources Department to monitor Jersey's experience with these new arrangements as part of the ongoing dialogue between the two jurisdictions. This workstream could be pursued as a priority through the Policy Council's External Relations Group using the services of the informal Cooperation with Jersey Working Group.

6.16 The Commerce and Employment Department fully agrees with Treasury and Resources that there must be political influence and oversight of the business, albeit at strategic level, for as long as the States remain the principal shareholder in Guernsey Post and Guernsey Electricity. Similarly, the Department agrees that the role of the shareholder must be focused on the companies' strategic and financial plans, major business developments, and putting in place appropriate arrangements that meet current day governance requirements.

6.17 However, the Department supports RPI's conclusions about the fundamental problems associated with the States owned enterprises and believes that many of the recommendations to improve regulation can only be considered if steps are also taken to improve the two companies' governance arrangements.

Recommendation 4: The Commerce and Employment Department recommends that the States direct that the "shareholder resource" concept be explored by the Policy Council's External Relations Group in its ongoing dialogue with Jersey and that the Policy Council bring a Report before the States by the end of September 2012.

7. Accountability

7.1 In addition to improvements to corporate governance, there are issues of accountability that need to be taken into consideration in respect of both the Regulator and the Shareholder Representative, and these are considered in this section. In particular, and especially if the shareholder resource option is not to be pursued and implemented at this time, the Department believes it necessary to find a pragmatic and cost effective solution to improve the accountability of the Shareholder and the commercial boards to the States of Guernsey.

7.2 The question of accountability of the regulator identified by RPI was a key issue raised in the Commerce and Employment Department's consultation paper.

7.3 It is recognised that best practice for the effective accountability of a regulator comprises four key elements:

- regulators should be transparent and provide information on their activities and how they go about making their decisions and, unless barred by a need for confidentiality, how they arrived at their decisions;
- closely allied to transparency is the requirement for regulators to explain their reasons for a decision to those affected by their actions;
- following on from this, interested parties should have the right to challenge the regulator's decisions and have their case settled by an independent third party; and
- regulators should be required to answer questions and provide the means through which scrutiny can be made meaningful.

7.4 These four components are essential to ensure that regulatory decisions are appropriate and effective and together play an important role in establishing the legitimacy of an independent regulator.

7.5 Firstly, and with regard to transparency, the Commerce and Employment Department believes that the OUR has demonstrated through its actions since 2001 an open and transparent approach to consultations and the publication of its decisions. The process of publishing consultation documents, draft decisions and then final decisions has ensured that the licensees have been able to understand the logic of decisions and the Director General's objectives. At the same time, publication of the reasons for regulatory decisions after the event provides clarity about their basis and rationale, to help guide assessments of whether they were appropriate and proportionate judgements.

7.6 Secondly, the Department is aware of some criticisms of the style of the OUR publications, in that they are often perceived as highly technical and complex. By their very nature, as RPI note in their report, *"many of the technical issues addressed by regulatory policy might be considered to be 'as dull as dishwater',"* and as a result consultations may not be accessible and understandable to a layperson. However, many citizens will have an interest in certain aspects of the three utilities and it is important that the published documents are readable and easily understandable by members of the public.

7.7 The third element of accountability relates to the provision of an appeals mechanism for interested parties to seek an independent adjudication of regulatory decisions. The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 does provide such a mechanism and allows for relevant parties to challenge decisions taken by the Director General and take their grievances to the Royal Court which has the power to overturn decisions. Improvements to Guernsey's appeal system are addressed fully in Section 11.

7.8 The final area of accountability concerns the need for appropriate scrutiny. It is normal practice for the government department that both sponsors and has responsibility for the legislation underpinning the regulator to be required to ensure that the regulator is carrying out its functions effectively and efficiently and remains fit for purpose. The Commerce and Employment Department performs this role through regular meetings with the Director General, the publication of the regulator's Annual Report each year, and through representation on the OUR's Audit and Remuneration Committee. In addition, since 2001 there have now been two independent reviews of Guernsey's economic regulatory regime. Both the NAO and now the RPI have carried out independent and in-depth reviews of Guernsey's economic regulatory regime.

7.9 The Commerce and Employment Department acknowledges that the actions of the regulator need to be scrutinised appropriately and that improvements can be made to the current scrutiny arrangements. The Department therefore proposed in the consultation paper that the Director General of Utility Regulation should be required to publish an annual business plan setting out the OUR's future work programme and also to hold annual meetings for States Members, explaining its actions and future work programme. There was broad general support to such a procedure being introduced in the future. Since then, the JCRA has published a three-year strategic plan along with an annual business plan detailing the actions proposed to be taken in the subsequent year and the Department considers that a similar process should be introduced in Guernsey.

7.10 Best practice should also include a scrutiny procedure to be carried out by the body that has granted the regulator its mandate and obligations. Consequently economic regulators, whose primary remits derive from statute, are typically scrutinised by Parliament or the equivalent political body. Typically, in other jurisdictions a regulatory authority is called to account for its actions through regular and periodic questioning by Members of Parliament through the "Select Committee" process. The equivalent process in Guernsey is that provided by the Scrutiny and Public Accounts Committees.

7.11 The Commerce and Employment Department is of the view that in principle consideration should be given to the establishment of a form of "Select Committee" system for the Island as a development of the current responsibilities of the Scrutiny and Public Accounts committees. However, the issue of governance in the States of Guernsey was the subject of a Report by the Public Accounts Committee that was considered by the States in March 2011[18] and that Report included consideration of methods of engaging stakeholders and making accountability real. In this regard, it understands that the powers, resources, mandates and effectiveness of the Scrutiny and Public Accounts Committees are being independently reviewed both as separate Committees and in terms of jointly providing a full scrutiny process on behalf of the States of Guernsey.

[18] Bilet d'Etat IV, 2011 page 241

7.12 The Scrutiny Committee has indicated that the review could include consideration of the most appropriate mechanism for scrutinising the regulatory regime to see if this would require changes to current committees' resources, structures and mandates, and that it would be happy to support the inclusion of this in the terms of reference in its further discussions with the Public Accounts and States Assembly and Constitution Committees. The Commerce and Employment Department agrees with this proposal, which places the needs of the regulatory regime within the broader context of the good governance of Guernsey's system of government, and is formally requesting that the Scrutiny Committee give consideration to the most appropriate method of scrutinising the regulatory regime on a regular basis, including the responsibilities of the shareholder.

Recommendation 5: The Commerce and Employment Department recommends that the review of the powers, duties, mandates, and effectiveness of the Scrutiny and Public Accounts Committees referred to in paragraph 7.11 should include consideration of the most appropriate method of scrutinising the regulatory regime (including the responsibilities of the shareholder) on a regular basis.

Recommendation 6: The Commerce and Employment Department recommends that the States direct the Director General of Utility Regulation to produce and publish a three-year strategic plan, along with an annual business plan detailing the actions proposed to be taken by the OUR in the subsequent year.

8. Telecommunications

8.1 Overall, the conclusions of the RPI Report with regard to telecoms were that Regulation was working effectively and that no significant changes were necessary. However, in the response to the consultation from Cable & Wireless there was some concern as to the fees charged, although the principles of regulation would dictate that the fees charged to telecoms operators should relate solely to the telecoms sector, with no cross-subsidisation between different sectors.

8.2 In addition, the RPI Report supported enhanced working with Jersey on telecommunications regulation matters, and on enhancing competition, including by attracting new businesses to the market place. The Commerce and Employment Department notes that these recommendations constitute an enhancement of the policies that the OUR is already following in telecommunications regulation, and therefore no further action is required.

9. Post

9.1 The RPI Report came to a number of conclusions with regard to the operation of Guernsey Post, and in particular emphasised two particular external difficulties that the utility is currently facing:

- Although nominally the reserved (exclusive) area under the Universal Service Obligation (USO) is a monopoly, competition from electronic mail means that postal volumes are declining, not just in Guernsey but worldwide, and
- Changes in the arrangements with Royal Mail in the UK have lead to significant increases in operating costs.

9.2 In addition, in future Guernsey Post may be affected by possible amendments to the current arrangements in respect of Low Value Consignment Relief (LVCR).

9.3 Against the background of these external factors, there is a need to assess the operation of Regulation in the postal sector, including:

- the level of the USO that would be appropriate in current circumstances, and
- whether it should be self-funded or funded by some other means, for example a Universal Service Fund.

9.4 As it was the operation of the postal service that led to the Requête in the first place, the relevant issues are dealt with in some detail in this section.

Reforming the Postal Regulatory Regime

9.5 The April 2010 Requête argued that the situation in 2010 was different from that in the late 1990s when it was first proposed that the States should commercialise the Trading Boards with a view to the eventual introduction of competition in the postal sector. The Petitioners considered that the existing framework which governs the regulation of the commercialised utilities required review, following which the States should consider giving further, more explicit Directions to the Director General in respect of the special or exclusive rights that apply to the two States-owned entities (i.e Guernsey Post and Guernsey Electricity). This current section considers RPI's proposed reform to the postal regulatory regime and institutional arrangements, with Guernsey Electricity being considered in Section 10.

9.6 The Petitioners were concerned that the potential for the introduction of competition in the postal sector is undesirable, and that further steps taken by the Director General to stimulate competition in the postal sector could very well compromise the future sustainability of Guernsey Post and therefore undermine the wider interests of Guernsey and its people. Consequently, the Petitioners believed that the uncertainties surrounding the potential for the introduction of competition should be clarified for the benefit of the States by the Commerce and Employment Department. The States in April 2010 directed the Department to return with substantive proposals in this regard.

9.7 RPI have concluded that the current regulatory structure and arrangements for

the postal sector have not performed effectively in the recent past; (and more importantly) are not fully adapted to handle future challenges, particularly the erosion of the current sources of funding for the USO; and are therefore in need of reform. The regulatory system has not, in RPI's view, performed effectively, and RPI conjecture that this is the result of a combination of factors including:

- the weaknesses of the broader governance and oversight arrangements (as highlighted by the failed banking diversification "episode");
- the application of the standard price control approach; and
- the absence of any second-opinion review panel which could deal with issues as and when they arise.

These points and related issues are addressed in turn below.

Universal Service Obligation

9.8 Looking forward, RPI believed that the priority should be to address the issues surrounding the USO.

9.9 In September 2001, the States issued Directions to the Director General of Utility Regulation that required the Director General to issue the licence to provide universal services to Guernsey Post Limited. At the same time the States set out the minimum level of universal postal service that Guernsey Post is obliged to provide – the Universal Service Obligation:

"The following universal postal service shall be provided (. . .) throughout the Bailiwick of Guernsey at uniform and affordable prices, except in circumstances or geographical conditions that the Director General of Utility Regulation agrees are exceptional:

- *One collection from access points on six days each week;*
- *One delivery of letter mail to the home or premises of every natural or legal person in the Bailiwick (or other appropriate installations if agreed by the Director General of Utility Regulation) on six days each week including all working days;*
- *Collections shall be for all postal items up to a weight of 20Kg*
- *Deliveries on a minimum of five working days shall be for all postal items up to a weight of 20kg;*
- *Services for registered and insured mail.*

In providing these services, the licensee shall ensure that the density of access points and contact points shall take account of the needs of users, "access point" shall include any post boxes or other facility provided by the Licensee for the purpose of receiving postal items for onward transmission in connection with the provision of this universal postal service."[19]

[19] Billet d'Etat XVIII, 2001, page 1247

9.10 In reviewing the postal services sector, RPI have identified a number of major issues surrounding the operation and regulation of Guernsey Post over the recent past, and which were the cause of the concern that lead to the Requête, in particular:

- Declining mail volumes, which have called into question the sustainability of the Universal Service Obligation, at least at current service levels. RPI note that this is a not a Guernsey specific issue, with postal authorities worldwide having to consider how best to respond to this development.
- Proposals from the Director General of Utility Regulation for a controlled contraction of the protected/exclusive areas, thereby potentially increasing the scope for other providers to enter the market, in fulfilment of the objective to introduce competition, as specified in the legislation.

9.11 Of these two, far more threatening to incumbent postal operators than the controlled contraction of the protected/exclusive areas has been the loss of business to electronic communications systems. These substitutable methods of communicating mean that basic postal services are effectively no longer a monopoly, and that governments are increasingly incapable of protecting them from competition. Guernsey Post is in reality competing with electronic communications, and in broad terms is losing local business at what currently is a relatively rapid rate. This is the existential threat that all competition brings, and it cannot be avoided. However, it does have very obvious implications for the universal service, and for public policy towards the Universal Service Obligation.

9.12 The Commerce and Employment Department is cogniscent of these facts and in co-operation with and with input from Guernsey Post, Treasury and Resources and the OUR has consulted on the Universal Service Obligation for the postal sector[20]. The results of this process will be presented to the States in a separate Report, but notwithstanding that Report's conclusions and recommendations, there are two key points to emphasise regarding the Universal Service Obligation:

- Firstly, the scope of the Universal Service Obligation is a matter for the States to determine as set out in the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001[21].
- Secondly, the current Universal Service Obligation does not place any specific requirements for the number of Post Offices within the Bailiwick. The Universal Service Obligation simply requires that Guernsey Post shall ensure that the number of post offices (referred to as access points and contact points in the Direction) shall take account of the needs of users.

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[20] http://www.gov.gg/ccm/commerce-and-employment/review-of-the-universal-postal-service---obligation.en

[21] See section 3.1(c) of the Regulation of Utilities Law.

9.13 Guernsey Post has set out in its Customer Charter how it interprets the provision of this service to postal users as follows:

"We also endeavour to maintain easy access to stamps outside our own retail branches. There are currently over one hundred supermarkets, garages, stationers and local stores that stock booklets of stamps for local and UK addresses.

However, every Guernsey resident should have a Guernsey Post retail branch within a 2-mile radius of his home. Their hours of opening are clearly displayed at each premise, are published on our website and in our Service Guides.

All branches are closed on Sundays and Public Holidays."[22]

Therefore the question of the number of post offices in the Bailiwick is a matter for Guernsey Post's Board and shareholder.

9.14 The Commerce and Employment Department's separate States Report on Guernsey's postal Universal Service Obligation addresses the points raised by RPI in this regard. However, whatever the scope of the Universal Service Obligation the issue of how it would be funded will need to be addressed and RPI's proposals in this regard are addressed below.

Universal Service Fund

9.15 RPI propose that a "Universal Service Fund (USF)" should be set up to help finance the USO, which would derive its funds through financial contributions from other postal providers, in effect a form of tax to support an important public service. Such a system is comparatively common in the telecommunications sector. If this were to occur, the determination of the exclusive area should not be particularly controversial, since its shrinkage would simply imply a wider base on which the USF levy would be applied. Indeed, under the RPI's proposals the exclusive area could, in principle, be abolished entirely, yet Guernsey Post would still be able to sustain the level of service decided by the States.

9.16 The Commerce and Employment Department notes the considerable opposition to RPI's proposals from Guernsey Post, the OUR and the JCRA Non Executive Directors.

9.17 Guernsey Post recognised that a Universal Service Fund raises a number of complex issues that would need to be resolved. Its preference for addressing the USO is for it to be funded through prices, cost control and reduction, narrowing the scope of the USO to satisfy demand and the exclusive area. Its view is that a Universal Service Fund should only be implemented as a last resort.

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[22] http://www.guernseypost.com/about_us/customer_charter/

9.18 The JCRA commented that RPI's proposals were flawed in theory and possibly unworkable in practice[23]. The introduction of a Universal Service Fund would introduce an unnecessary level of bureaucracy into Guernsey's postal market.

9.19 The Commerce and Employment Department has noted that the Jersey Economic Development Department issued a Green Paper in June 2010 on "The Universal Service Obligation for Postal Services in Jersey", and this Paper included the following statement:

> *"5.5 The reality, therefore, is that the postal services USO should ideally be self-funded a point that has been recognised by the company's shareholder and also by Jersey Post."*[24]

9.20 The JCRA Non Executive Directors in their response to the Commerce and Employment Department's consultation paper clarified their views further by stating:

> *" The conclusion was clear: "there is no significant scope for other providers of postal services to provide a subsidy sufficient enough to maintain the USO". There is no reason to think that the situation is any different in Guernsey."*[25]

9.21 The OUR also believed that the introduction of a Universal Service Fund would not work in practice. The first requirement was to ensure that the USO is being provided as efficiently as possible, and the OUR welcomed the commitment of the new management at Guernsey Post to address this issue. The OUR also raised questions on the impact of the levy on possible new entrants and the threat that such a levy would pose to the bulk mail sector which was an important part of Guernsey's economy.

9.22 The Commerce and Employment Department's own research in this area has also been informed by the OXERA report for a number of European Postal Operators[26] which examined in detail a number of options for funding the USO in the postal sector, including a Reserved Area and a Universal Service Fund, which in the telecommunications sector is a widely used mechanism for compensating providers for the net costs of complying with a Universal Service Obligation. Guernsey has not established a universal fund for either the postal or telecommunications sectors and the Commerce and Employment Department is not aware of any such funds in similar smaller jurisdictions.

9.23 However, the Department is aware that a number of EU Member States have

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[23] Review of Guernsey's Utility Regulatory Regime – comments by JCRA Non-Executive Directors on Commerce and Employment Consultation Paper, 15 December 2010 page 3 para 13.

[24] http://www.gov.je/Government/Consultations/Current/Pages/PostalServicesReview.aspx.

[25] Review of Guernsey's Utility Regulatory Regime – comments by JCRA Non-Executive Directors on Commerce and Employment Consultation Paper, 15 December 2010 page 4 para 16.

[26] OXERA "Funding universal service obligations in the postal sector" Prepared for La Poste, De Post-La Poste, Hellenic Post, Post Italiane, P&T Luxembourg, Correos, Magyar Posta, Cyprus Post, Poczta Polska, January 2007

made provisions to set up a compensation fund in order to guarantee the provision of the universal service in the postal market (e.g. Belgium, Cyprus, Denmark, Spain, Great Britain, Italy, Latvia, Portugal and Slovenia), although at the present time it would appear that only Italy has actually used a compensation fund to fund the universal service. In Italy the deficit incurred in the scope of the universal service is partly financed by a compensation fund based on a tax on postal operators' revenues (capped by 3% of revenues in the scope of the universal service). Further financial contributions are received through a public subsidy and from the "Banco Posta" (Post Office Bank)[27].

9.24 As highlighted by Guernsey Post the implementation of a Universal Service Fund requires a number of complex questions to be addressed including:

- How will the money for the fund be raised?
- How should the taxable base be defined?
- Who should contribute?
- How will the money be allocated to the universal service providers?
- How will the funds be administered?

9.25 Oxera concludes its report on funding mechanisms with the statement *"Therefore the question of which mechanism is the most relevant to the postal sector is empirical, and one that may differ from country to country"* and in the light of the responses to the consultation and its own research, the Commerce and Employment Department believes that the introduction of a Universal Service Fund is likely to be complex, bureaucratic and disproportionate to Guernsey's circumstances.

9.26 It has decided therefore not to recommend the introduction of a Universal Service Fund to fund Guernsey's postal USO at the current time. However the Department believes that in recognition of the fact that a Universal Service Fund may be required at some point in the future (as Guernsey Post noted as a "last resort") it would be prudent to future proof the legislation so that the primary legislation will allow for a Universal Service Fund if it becomes necessary.

Recommendation 7: The Commerce and Employment Department recommends that the legislation be amended to allow for the introduction of a Universal Service Fund, if it becomes necessary in future in order to fund the Universal Service Obligation for Postal Services.

Reserved (Exclusive) Area

9.27 As an alternative to a Universal Service Fund to fund the USO, the Oxera Report identified that as a traditional way of funding the USO in the European postal sector the Reserved Area has certain advantages in terms of certainty,

[27] "USO" Net Cost on the Postal Sector – Where do we stand?" by Bernard Roy, March 2010 for Groupe La Poste (French Postal Service).

practicability and low administrative costs.

9.28 To implement an exclusive (i.e. " Reserved") Area for postal services in Guernsey, in accordance with the legislative provisions[28] in 2001 the States resolved to give a direction to the Director General to:

- award to Guernsey Post Office Limited the exclusive right to provide postal services in the Bailiwick to the extent that such exclusive right is necessary to ensure the maintenance of the universal postal service specified by States' directions under section 3 (1)(c) of that Law; and
- request the Director General to review and revise the award of exclusive rights from time to time with a view to opening up the Bailiwick postal services market to competition, provided that any such opening up does not prejudice the continued provision of the universal postal service.

9.29 The Commerce and Employment Department believes that the Director General's regulatory actions in regard to the liberalisation of the postal market through a reduction in the exclusive area were entirely consistent with the original States Directions. However as noted by RPI this issue has been a contentious element of the regulatory regime and the Department believes that doing nothing and continuing with the status quo is simply not an option.

9.30 The liberalisation of the postal market caused considerable media and political interest during 2010 and it is interesting to note that the subsequent outcome of the agreement between the Regulator and the Guernsey Post was close to the implications of the Director General's original decision. The original decision would have resulted in 30% of Guernsey Post traffic being opened up to competition, up from 16%. Guernsey Post eventually agreed to open up nearly 29% of its traffic to competition, a difference of about 1% [29].

9.31 The introduction of competition was targeted specifically at introducing choice and alternative suppliers for Guernsey's bulk mailers. Since commercialisation, Guernsey Post has experienced a significant increase in its operating costs with Royal Mail adopting a more commercial approach to its operations driven by its own regulator and the Postal Act 2000. Historically, Guernsey Post and Royal Mail did not charge each other for the mail volumes between the two operators. In the absence of any "terminal dues" (i.e. the delivery charge) Guernsey Post was able to retain the full revenue of the postal tariff for an item sent for delivery in the UK. It transpired however that the volumes and the types of mail items transported northbound (i.e. originating from Guernsey for delivery in the UK) and southbound (i.e. from the UK for delivery in the Bailiwick) were very different. Guernsey was sending more items northbound and our traffic was

[28] The Regulation of Utilities (Bailiwick of Guernsey) Law, 2010, section 3 (1) b

[29] Liberalisation of the market was focused on primarily bulk mail leaving the Bailiwick for delivery to the UK. It would not have meant the introduction of competing companies replicating Guernsey Post's collection and delivery network in the Bailiwick through new post offices, post boxes and fleet of delivery vans as was portrayed at times in the media.

heavier and bulkier (as a result of the bulk mailers). The effect of this is that in the past the bulk mail customers and Royal Mail were subsidising the provision of the universal service obligation in Guernsey. As the contractual arrangements between the two postal operators were being put on a more commercial footing the bulk mailers experienced significant increases in charges to cover the Royal Mail's terminal dues.

9.32 The charges were further exacerbated by the introduction of Pricing in Proportion (or Size Based Pricing) which again increased the costs for larger and heavier items. In light of these cost increases Guernsey Post has taken steps to rebalance its tariffs with standard mail items for local and UK prices also increasing to be more broadly cost reflective.

9.33 Faced with increasing postal charges the bulk mailers have found themselves in an increasingly competitive market and found their margins under threat. The bulk mail sector is an important part of Guernsey's economy, employing over 600 FTEs and contributing in excess of £6m in ETI each year. Guernsey cannot assume any divine right to these businesses, and if relocating to jurisdictions with lower postal charges makes commercial sense to ensure their viability in their markets then it is an understandable though regrettable decision.

9.34 It is clear that it is no longer an option to return to the past when the bulk mailers were subsidising Guernsey's postal services as the markets in both post and bulk mail have changed significantly. Hence the introduction of competition through the liberalisation of the postal market is one way of ensuring that the dominant incumbent operator focuses on ensuring it operates efficiently and effectively. It is interesting to note how the threat of competition in Jersey's postal markets has focused management's attention at Jersey Post.

9.35 The Commerce and Employment Department notes Guernsey Post's view that the liberalisation of the postal market is such an important matter that it should be a matter for the States of Deliberation.

9.36 The Commerce and Employment Department concurs that the scope of the exclusive area should be a matter for the States of Deliberation.

Recommendation 8: The Commerce and Employment Department recommends that:

a) **The 2001 Direction to the Director General to review and revise the award of exclusive rights from time to time, with a view to opening up the Bailiwick postal services market to competition, provided that any such opening up does not prejudice the continued provision of the universal postal service, should be rescinded; and**

b) **The States of Guernsey should determine any revisions to the exclusive rights having taken into account any advice and comments from the Director General of Utility Regulation.**

9.37 If the States of Guernsey is to assume responsibility for setting the exclusive area, it is important to note that under the provisions of Section 2 of the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001, both the States and the Director General have the duty to promote the following objectives in having equal regard to all islands of the Bailiwick:

a) To protect the interests of consumers and other users in the Bailiwick in respect of the prices charged for, and the quality, service levels, permanence and variety of, utility services,

b) To secure, as far as practicable, the provision of utility services that satisfy all reasonable demands for such services within the Bailiwick, whether those services are supplied from, within or to the Bailiwick,

c) To ensure that utility services are carried out in such a way as best to serve and contribute to the economic and social well-being of the Bailiwick,

d) To introduce, maintain and promote effective and sustainable competition in the provision of utility services in the Bailiwick, subject to any special or exclusive rights awarded to the licensee by the Director General pursuant to States' Directions,

e) To improve the quality and coverage of utility services and to facilitate the availability of new utility services within the Bailiwick, and

f) To lessen, where practicable, any adverse impact of utility activities on the environment.

Licensing of All Postal Operators

9.38 One of the issues that was raised by the Requête was the lack of regulatory control of postal operators under the current system, with the sole exception of Guernsey Post. The Commerce and Employment Department is of the view that, as is already common practice elsewhere including in Jersey, all postal operators with certain de minimis exceptions should require a licence from the OUR in order to operate. This would have the following advantages:

- It clearly provides a level playing field for all postal services.
- It provides the ability for a level of control on services to be exercised should this be considered to be appropriate.
- It provides a framework for a levy to be introduced on postal services in order to fund the USO, should this be required in the future.

The procedures for obtaining licences will of course be those laid down by the Regulation of Utilities and the Post Office Laws and should not in normal circumstances be particularly onerous or difficult for the companies concerned.

Recommendation 9: The Commerce and Employment Department recommends that the Post Office (Bailiwick of Guernsey) Law, 2001 be amended to require all postal operators with specified de minimis exceptions to obtain a licence from the Office of Utility Regulation.

This issue was the subject of a consultation process undertaken by the OUR, which identified that there was general support for the extension of licensing.[30]

Price Controls

9.39 The RPI Report suggests that the standard UK regulatory model of controlling prices through a formula such as RPI-X or +Y is not appropriate for Guernsey, and that it should not be necessary for the OUR to set price controls in future. RPI recognise however that for such a system to be effective and to minimize the scope for disagreement there must be an effective Commercial Board scrutinizing the Executive of the company to ensure consumers and other operators are being charged efficient prices or charges. The Commerce and Employment Department believes that, if implemented, the recommendations set out in Sections 6 and 7 of this Report should improve the effectiveness of Guernsey Post's Commercial Board in this respect and if this occurs then a move away from price controls may be justified.

9.40 The RPI Report also considers that the substantive issues that are currently addressed via price controls would be addressed more directly and transparently, under their proposed methods for addressing the USO as an essential process in the establishment of a Universal Service Fund.

9.41 However, having taken into consideration the evidence obtained and points raised from the informed responses to the consultation, the Commerce and Employment Department has decided not to move towards a Universal Service Fund at the present time. Consequently, and at least for the time being, price controls should remain as one of the "Limited Number of Biggish Things Done Well" ("LNBTDW") functions for the economic Regulator.

9.42 It is pertinent that the public and expensive disputes between the Guernsey Post and the OUR have been due to disagreements on the pace of liberalisation of the postal market, and not on price controls as such. The Commerce and Employment Department believes that its recommendations regarding the USO and the exclusive area described above should address the underlying problem. In coming to this opinion, the Department took particular account of Guernsey Post's view that "the OUR should continue to manage the price control process, and disagrees that postal regulation has been ineffective, or that it cannot work for Guernsey Post."[31]

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[30] Office of Utility Regulation, Licensing of Postal Operators, Draft Decision November 2010. http://www.regutil.gg/docs/OUR1014.pdf

[31] Guernsey Post's response, 23 December, 2010, page 6.

9.43 It should also be noted that the full implementation of competition legislation would provide additional flexibility as to how the Regulator deals with pricing issues in the future (see section 13).

10. Electricity – Competition in Guernsey's Electricity Network and Retail Markets

10.1 Energy is an issue of essential importance to the Island and electricity is a vital component of the energy mix. In addition to regulatory issues, it is clear that there may be significant developments in the provision of energy in the Island in coming years, including through the production of renewables. This, as well as expected future increases in the cost of fossil fuels and concerns about climate change are likely to change significantly the context within which the electricity supplier operates.

10.2 The RPI report raised significant concerns regarding the operation of regulation in respect of Guernsey Electricity, but unlike for Guernsey Post, apart from the cost pass-through mechanism there were few issues of detail that required specific comment, with the general view being expressed that initiatives described elsewhere in this Report may prove effective in improving recent performance, with particular reference to:

- The establishment of an "adjudication panel" (see section 11).
- The possibility of improved corporate governance including establishing a "shareholder resource" with Jersey (see section 6).
- A move to a more adjudicative style of regulation, based less on price controls (see section 13).
- The adoption by the States of a formal energy policy (see section 14).

10.3 The Commerce and Employment Department concurs with this view and will be monitoring the future development of the economic Regulation of Guernsey Electricity before deciding whether any further actions would be appropriate.

10.4 The April 2010 Requête, approved by the States, did however raise questions regarding the extent of competition in both the postal and electricity sectors and this section addresses as a priority the scope for competition in Guernsey's electricity retail and network markets based on current and likely future circumstances.

10.5 The Requête also gave the opinion that the States-owned utilities should remain fully in democratic public ownership. The Commerce and Employment Department recognises that while the future ownership arrangements of the utilities may be a matter that is worthy of investigation, it considers that such an issue, in respect of both Guernsey Electricity and Guernsey Post, is a matter that goes beyond the terms of reference of the RPI Report and has therefore not given any detailed consideration to the options that may be available.

10.6 In January 2003 the Board of Industry presented to the States a Report entitled "Review of Guernsey's Retail and Generation Electricity Markets"[32]. The States of Deliberation approved a number of Resolutions, including inter alia to:

1. Prepare for the potential introduction of retail competition in future by amending the licensing regime within the Electricity (Guernsey) Law, 2001 to reflect a functional split (Retail, Network and Generation) as outlined in the Office of Utility Regulation Report.
2. Issue a States Direction to the Director General of Utility Regulation that an exclusive licence be issued to Guernsey Electricity for supply activities subject to any exemptions granted by the Director General under Section 1(2) of the Electricity (Guernsey) Law 2001 for the period ending 31st January 2012.
3. Issue a States Direction to the Director General of Utility Regulation to issue to Guernsey Electricity an exclusive licence for conveyance activities, subject to any exemptions granted by the Director General under Section 1(2) of the Electricity (Guernsey) Law, 2001 for the period ending 31st January 2012.
4. Direct the Director General of Utility Regulation that the exclusive licences set out in Recommendations 3 and 4 above should be replaced with exclusive licences for retail and network activities respectively when new legislation consistent with Recommendation 1 is enacted.
5. Direct the Board of Industry to monitor the development of the energy sector in the Channel Islands and bring forward a review of these arrangements by 31st January 2011 or sooner in the event of any material changes to the structure of the sector.

10.7 Since then there have been no significant material changes in the energy sector in the Channel Islands and as such the Commerce and Employment Department believes that there are no grounds to alter the original analysis and recommendations regarding exclusivity for Guernsey Electricity in its retail and network activities. However, there is a need to update the above States' Directions.

Recommendation 10: The Commerce and Employment Department recommends that the States:

a) Issue a States Direction to the Director General of Utility Regulation that an exclusive licence be issued to Guernsey Electricity for supply activities subject to any exemptions granted by the Director General under Section 1 (2) of the Electricity (Guernsey) Law, 2001 for the period ending 31st January 2022.

b) Issue a States' Direction to the Director General of Utility Regulation to issue to Guernsey Electricity an exclusive licence for conveyance activities, subject to any exemptions granted by the Director General under Section 1 (2) of the Electricity (Guernsey) Law, 2001 for the period ending 31st

[32] Billet d'Etat I, 2003, page 50

January 2022.

c) **Direct the Director General of Utility Regulation that the exclusive licences set out in Directions (a) and (b) above should be replaced with exclusive licences for retail and network activities respectively when new legislation is enacted amending the nomenclature.**

d) **Direct the Commerce and Employment Department to monitor the development of the energy sector in the Channel Islands and bring forward a review of these arrangements by 31st January 2022 or sooner in the event of any material changes to the structure of the sector.**

10.8 These Propositions simply extend the current arrangements whereby Guernsey Electricity enjoys a legal monopoly in the distribution (i.e. conveyance) and retailing (i.e. supply) of electricity, but not in its generation.

10.9 Finally, in order to give greater certainty and consistency the RPI report considers that it would be useful for the States to adopt a more formal energy policy than exists at present and it is understood that this issue is being addressed by the Policy Council through the Energy Policy Group (see section 14 below).

11. Adjudication Panel

11.1 One of RPI's more radical proposed changes to the regulatory regime was the recommendation to assemble an adjudication panel, to be called (and remunerated) on an 'as needed' basis, to adjudicate on disagreements between the regulated companies and the OUR. The Commerce and Employment Department's Consultation Paper set out in detail some of the issues involved in such a process and sought comments from all stakeholders on the merits of an Adjudication Panel.

11.2 The views from licensees were split on this proposal. Both Guernsey Post (an "excellent idea" that should be included in the legislation) and Guernsey Gas (widened to allow interested parties to refer to the Panel) were supportive of this proposal. However Cable & Wireless were not entirely convinced by the proposal and feared that if not implemented effectively there would be further delays and cost in the regulatory process. Guernsey Electricity agreed that the Adjudication Panel within a legal framework could well lead to high implementation costs. The key to the successful implementation of the proposal would be to find a route to formalize the use of the Adjudication Panel without starting to replicate the costs which a formal Appeal to the Royal Court entails. Guernsey Electricity suggested an alternative whereby an Adjudication Panel would be the subject of a States Direction to the Director General. This might entail simple but formal guidance to the Director General to allow for the use of an Adjudication Panel within the regulatory process.

11.3 The responses from the OUR, the OUR's Audit Risk and Remuneration Committee and the Non Executive Directors of the Jersey Competition and

Regulatory Authority (JCRA) were all opposed to RPI's recommendations. The OUR noted that this development would hinder future harmonization of the regimes in both jurisdictions, if that was a route the States might wish to consider in the future. The JCRA in particular noted that such a model appeared to be unprecedented in other jurisdictions and possibly unworkable in practice as it would undermine a basic tenet of good regulation, namely predictability. Instead, the JCRA Non Executive Directors suggested that the obvious and cheaper solution would be for the JCRA and the OUR to share the same Board (i.e. move from a Director General model to the common Board model for regulators). Whilst this would incur additional costs for the OUR these would be significantly less than the costs involved in having two separate Boards and establishing and operating the Adjudication Panel.

11.4 The Treasury and Resources Department stated that if a mechanism is introduced for holding the Director General to account, then an Adjudication Panel would be unnecessary. Treasury and Resources wished to see measures introduced that would reduce the cost of regulation.

11.5 The Commerce and Employment Department has carefully considered all the comments and also sought the advice from the Law Officers' Chambers on the practicalities of implementing such a change. The Department has given consideration to all of the opinions expressed and has come to the conclusion that the opportunity to use an adjudication panel could provide a useful additional tool in some circumstances, provided that the panel could be established in such a way as to keep costs to a minimum. In particular, it should not seek to function as a form of appeals tribunal, but more as an "independent technical expert" panel that would consider technical rather than legal issues. This should help to keep costs down and ensure that where possible disputes can be resolved within a reasonably short timescale. The panel would not however remove the possibility of an appeal to the Royal Court in circumstances where other methods of resolving differences had proved ineffective.

11.6 In terms of legislation, there is nothing to prohibit the regulator convening a specialist panel when necessary (as was the case with the Independent Expert Panel which considered a complex technical issue concerning Guernsey Electricity's Regulatory Asset Base) and this mechanism therefore remains in the "regulator's toolbox", available for use prior to the Regulator taking his final decision. In addition, regulated utilities, including both of the States Trading Companies, are free to suggest to the Director General that some form of independent panel may be useful to act as a form of mediation to help resolve differences during the regulation process and prior to the final decision being made. There is therefore no need for any specific Recommendation in this regard.

11.7 It must not be forgotten, however, that the primary purpose for introducing an Adjudication Panel is to try and avoid the lengthy and highly expensive legal process that would result from a full appeal to the Royal Court. The difficulty is

that the more the adjudication panel is formalised the higher the costs are likely to be, in particular if specific provisions are included in the legislation. Such provisions would be likely to result in the use of legal representation to put forward specific cases, again resulting in significant costs that in one form or another would be passed on to the consumer. Indeed, over a period of time there would be a significant danger that the Adjudication Panel would evolve into a clone of the Utility Appeals Tribunal that the States agreed to abolish in 2006, but which would have the added complication of operating in addition to the formal appeal process to the Royal Court.

11.8 Given this, the Commerce and Employment Department has debated this issue at great length and considered whether there is an alternative way of approaching the issue, i.e. attempting to arrive at a satisfactory resolution of disputes while minimising costs. The Department has noted in particular the provisions for conciliation services included in the Employment Protection Law[33], whereby there is a requirement for conciliation to be attempted before the matter is referred to the Tribunal, where costs are controlled by there being no provision for legal representation costs to be recovered. In the Department's view, such a constraint would not be effective in dealing with regulation matters, but there would nevertheless be significant advantage to be gained by the introduction of a form of mediation as a "cooling-off" procedure before more formal legal appeal proceedings are engaged. Indeed, and in order to achieve this, agreement on procedures for dispute resolution should be included in any Memorandum of Understanding agreed between the Director of Utility Regulation and the States-owned utilities (see Section 5 above).

11.9 At present the States owned utilities have the full right to institute an Appeal without reference to the shareholder, even though the costs of such an Appeal can be highly significant. The Commerce and Employment Department is of the view that it would be appropriate in future for the commercial boards of Guernsey Post and Guernsey Electricity to seek the approval of the Treasury and Resources Department as the States' shareholder representative before registering an Appeal against a decision by the Director General of Utility Regulation, and that that Appeal should only go ahead with the Department's written agreement. This qualification on the powers of the boards will enable the Treasury and Resources Department to ensure that all avenues of dispute resolution have been explored, or, in the particular circumstances, reasonably discounted. Specifically, a company should be expected to have attempted mediation and an appeal should be regarded as a last resort. In terms of legislation, the new provision could be best achieved by an appropriate amendment to the Articles of Incorporation of both companies.

11.10 In addition, and in order to allow sufficient time for this procedure to be completed, the Department also recommends that the time period for registering an Appeal should be increased from 28 to 56 days.

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[33] The Employment Protection (Guernsey) Law, 1998, Section 18 (1).

Recommendation 11: The Commerce and Employment Department recommends that:

a) **The Articles of Incorporation of both Guernsey Post and Guernsey Electricity are amended to require the written authority of the States Treasury and Resources Department before registering an appeal against a decision of the Director General of Utility Regulation, and**
b) **The time period for registering an Appeal against a decision by the Director General of Utility Regulation should be extended from 28 to 56 days (with power to the Courts to extend further in exceptional circumstances).**

12. A Regulatory Commission

12.1 The non-executive directors of the JCRA were of the view that the need for an adjudication panel has not proved necessary in Jersey, partly because the JCRA operates under an arrangement whereby there is a non executive board and a chief executive. The JCRA submission highlights that this is the default position for an independent regulator. The presence of a board provides additional expertise to the organisation, provides checks and balances and reduces the potential for regulatory disputes to become personalized. This latter point was also made in both the RPI report and the 2006 Report by the National Audit Office. An independent regulator with an effective board, combined with the Commerce and Employment Department's recommendations regarding accountability (set out in section 7) should lead to greater confidence in regulatory decisions, reducing the likelihood of an Appeal.

12.2 The OUR is funded through licence fees to cover its regulatory activities as a basic cost recovery mechanism. Moving to a Board structure for regulatory functions will have no impact on the States General Revenue as the additional costs will be incurred by the OUR's licensees. However, there would be additional costs incurred for the implementation of competition legislation (see section 13), should this be introduced in Guernsey, and the additional costs of competition legislation attributable solely to the establishment of a joint Board are estimated at £20,000 per year.

12.3 Legislative changes would be needed to the primary legislation to allow for the creation of a Board structure to replace the current Director General role and practical arrangements would need to be addressed regarding the appointment of the Board members.

12.4 In considering this proposal, the Commerce and Employment Department has in particular noted the operation of the JCRA, which comprises a Chairman, Executive Director and three Non-Executive Directors (short biographies of the JCRA Board Members are provided in Appendix 4). The Department further notes that one of the current Non-Executive Directors will retire in 2012, which will create a vacancy on the JCRA Board. The annual fees paid to Board Members are around £100,000, made up of £42,000 paid to the Chairman and an

average of £19,000 paid to each of the Non-Executive Directors. Travel and accommodation expenses are about £10,000 a year.

12.5 Following an agreement between the JCRA and the Department, the Director General of Utility Regulation is now also the Executive Director of the JCRA; the two authorities are now working together on joint projects and are increasingly sharing resources.

12.6 The Commerce and Employment Department's experiences to date (i.e. sharing the Director General and JCRA Chief Executive, and sharing the Director of Civil Aviation roles) have been positive and demonstrate that pan Channel Island solutions can enable the sharing of expertise and costs for the benefit of both Bailiwicks. The current JCRA Board costs around £110,000 a year and this cost (together with incremental costs reflecting the additional responsibilities and workload) would need to be apportioned between the JCRA's and OUR's licensees, should it be possible to have a shared Board. This would of course result in a significant reduction in costs for both islands, compared to two separate boards.

12.7 The Commerce and Employment Department has already demonstrated its ability to work with Jersey's Economic Development Department, and the extension of the duties of Guernsey's Director General of Utility Regulation to include the JCRA is proof that this joint arrangement is working. The operation of both the OUR and the JCRA under a single board that would have regulatory, and potentially competition law, responsibilities for both islands would constitute a logical extension of the joint working that is already in place.

12.8 One of the advantages of a joint Board is that there would no longer be a need for the Audit and Remuneration Committee which was established by States' Resolution following consideration by the States of the 2006 Report. In effect, the duties of the Committee would, as for the JCRA in Jersey, be undertaken by the joint Board. This proposal has the support of the JCRA Board and the Department would make the necessary arrangements for Guernsey representation on the Board. The Commerce and Employment Department recommends therefore that if a joint Board is appointed, that part of Resolution XIV, 1 (f), Billet d'Etat X, 2006 related to the establishment of an Audit and Remuneration Committee should be rescinded.

12.9 The Commerce and Employment Department considers that this would be the optimum solution if it can be achieved and would recommend working towards this objective.

Recommendation 12: The Commerce and Employment Department recommends that:

a) The Regulation of Utilities legislation be amended to alter the organisational structure of the OUR, thereby replacing the role of the Director General of Utility Regulation with an executive director and

independent Board, and,

b) Subject to the agreement of the Jersey Authorities, the Boards of the JCRA and OUR should comprise the same people, who in practice would operate as a single Board, while administering two separate sets of laws.

c) Once the Board has been established, that that part of Resolution XIV 1 (f), Billet d'Etat X, 2006 related to the establishment of an Audit and Remuneration Committee should be rescinded and the Audit and Remuneration Committee shall be abolished.

13. Introduction of Competition Law

13.1 The Commerce and Employment Department has noted that RPI are strongly supportive of the introduction of competition law in Guernsey, provided only that care is taken to adjust 'standard' thresholds relating to market shares towards the realities of competition in a small market. In that regard it is interesting to note that at the time of writing the JCRA is undertaking a consultation process on proposals to amend the merger thresholds in Jersey to align them more closely with those that the States have agreed are appropriate for Guernsey.

13.2 Competition law enforcement is, when appropriately implemented, more adjudicative in style than it is 'activist', and it tends to rest more on ex post than on ex ante assessments. The introduction of Guernsey's competition law will allow the Regulator to move towards the less activist role recommended by RPI. It will also allow harmonisation of the competition and regulatory regimes in Guernsey and Jersey in the future if that is the political will in both jurisdictions. These views were also expressed by a number of respondents to the Department's consultation paper.

13.3 The principle of the introduction of competition legislation was approved by the States in 2006[34]. A further approach to the States in 2009[35] gave drafting instructions to the Law Officers for a future Mergers and Acquisitions Ordinance and put forward revised arrangements for the administration of the legislation from what had been envisaged in 2006. The Competition (Enabling Provisions) (Guernsey) Law was approved by the States in February 2009 and has now received Royal Assent. The detail of the legislation will be implemented through Ordinances, first drafts of which have been prepared.

13.4 As has been acknowledged and stated throughout the introduction of this package of legislation, competition is fundamental for the market mechanism to deliver benefits to the consumer. It forces companies to increase efficiency and reduce costs, keep prices to a minimum (after allowance for reasonable profit to provide funds for return on capital and continued investment) and drive

[34] Billet d'Etat XIII, 2006, page 1354
[35] Billet d'Etat XXI, 2009, page 1536

innovation to provide new products and services. Without competition, or the threat of competition, the incentive on firms to undertake these three activities, i.e. reduce costs, minimise prices, and innovate is absent to the detriment of consumers.

13.5 The principles of the need for and the practice of competition regulation are fully accepted and well developed worldwide. The lack of such regulation makes Guernsey something of an 'outlier' when it comes to international practice, and as such provides the potential for negative perceptions of Guernsey to develop amongst outside audiences, which include supranational bodies whose views and opinions may have a significant influence on the Island's future.

13.6 The States have resolved to introduce a competition law regime and it is an integral part of the States Fiscal and Economic Policy anti-inflationary strategy endorsed by the States in 2009 and in September 2010, helping to further the following objectives:

- **Fiscal and Economic Policy Objective 5 - Stable and low inflation: RPIX 3.0%.** An increase in competition within the local economy achieved through competition legislation should result in greater efficiencies within the local economy resulting in a relative reduction in prices over a period of time. Concern about inflation was a major influence on the introduction of competition legislation in Jersey and there is evidence to suggest that there has been a dampening effect on inflation in that Island since its introduction.

- **Fiscal and Economic Policy Objective 9 - Well-regulated, competitive domestic markets.** Competition Legislation is the primary tool in achieving this and in correcting or compensating for instances where there has been market failure, for example the emergence within the local context of an over dominant market player who is not subject to normal market constraints, or where there is collusion between suppliers in the setting of prices or dividing up the market.

- **Fiscal and Economic Policy Objective 4 - Average economic growth of 2% or more per annum.** Competition Legislation should not only result in reduced costs in individual economic sectors but also throughout the economy through the more efficient allocation of resources. Such reduced costs will help to maintain and enhance Guernsey's competitiveness in international markets and promote its economic growth.

- **States Objective 1 - Maintenance and enhancement of Guernsey's standing in the global community.** Well functioning competition legislation is now accepted as an essential tool in a market economy, in particular within a global context, and has now been implemented in

most small jurisdictions, including Malta, Liechtenstein and the Faroe Islands. The absence of such legislation locally could result in access being denied to some markets for Guernsey products, including from the financial services sector, because of the lack of protection from market abuse that may be perceived to exist locally.

- **Social Policy Objective 5 - Meet welfare needs and reduce poverty.** A reduction in inflation through greater competition should be of particular benefit to persons having to survive on a low income.

13.7 Despite the registration of the primary legislation, the Commerce and Employment Department was unsuccessful in acquiring additional funding through a new service development bid in the 2010 States Strategic Plan debate.

13.8 While this is a complex area of economic policy and a technical subject area, and consequently less "popularist" compared to other competing New Service Development bids, it is unlikely that many other bids will have as high a Cost Benefit Ratio as the competition law proposal.

13.9 Since the 2010 Strategic Plan Debate, the closer co-operation between the JCRA and the OUR has lead to the potential for additional synergies through economies of scale and scope, and it is estimated that the new arrangements will reduce the cost of implementing competition legislation (separate from the costs of economic Regulation which are met by licence holders) in Guernsey from approximately £400,000 per annum to approximately £200,000.

14. Energy Policy

14.1 The Commerce and Employment Department agrees with RPI that the regulatory framework for the electricity sector as applied in Guernsey would benefit from a clear and stable articulation of a coherent energy policy for Guernsey. A clear and concise energy policy will provide certainty for all stakeholders and particularly for those who have to invest significant capital investment in long lived assets. The Department notes that these points were recognised and supported by both Guernsey Electricity and Guernsey Gas.

14.2 The Commerce and Employment Department has been charged by the Policy Council to assist the Energy Policy Group in developing and refining the existing States Energy Policy and intends to work with all key stakeholders in defining a clear energy policy for Guernsey. The Department understands that the Policy Council's Energy Policy Group is developing a revised Energy Policy at the current time.

15. Consultation

15.1 The Department has consulted extensively in the preparation of this States Report. The terms of reference for the independent review were approved by

representatives of the signatories of the requete. RPI met with all interested parties and the Department issued RPI's Report for public consultation.

15.2 In addition, a draft of this Report was circulated to the following for comment: The Treasury and Resources Department, the Office of Utility Regulation, Guernsey Electricity, Guernsey Post, Sure (Cable & Wireless), Guernsey Airtel, Wave, Jersey Economic Development Department, Jersey Competition Regulatory Authority (JCRA), the Scrutiny Committee, and Sark and Alderney. St James Chambers have also been consulted in the preparation of the States Report. The comments received have been given serious consideration by the Commerce and Employment Department and have proved to be of substantial assistance in finalising the evidence-based recommendations of this Report.

16. Conclusions

16.1 In presenting the conclusions of their review of utility regulation in Guernsey, the Regulatory Policy Institute made it clear that the proposals that they were putting forward were to be considered as a package, and a satisfactory outcome would not be attained by attempting to "cherry-pick" the actions that were considered to be most attractive or easiest to achieve.

16.2 The Commerce and Employment Department has consulted widely on the proposals put forward by RPI and considered carefully all the comments received, particularly in terms of the practicality of some of the proposals put forward and their suitability for Guernsey as a small market economy given its particular economic and political structure. It has devised a comprehensive and practical set of recommendations tailored to Guernsey's unique characteristics reflecting comments from interested parties which will deliver the same objectives. The Department is firmly of the view that, again, the proposals need to be implemented in their entirety if a satisfactory outcome is to be achieved. What is important is not just the proposals that are put forward in specific areas, but also the balance between these proposals, which in itself is essential if a comprehensive, revised approach is to prove successful in future. In particular, without a strengthening of the shareholder function, other changes to the regulatory framework would have little or no effect or could put the quality of the Guernsey infrastructure at risk by weakening regulatory pressures.

16.3 In considering the conclusions and recommendations of the RPI Report and in formulating its own propositions to be laid before the States of Guernsey, the Department has:

- Considered carefully and taken fully into account the contents of the various responses received from the consultees.
- Adapted the RPI recommendations to constitute a programme that it considers to be appropriate for, and adapted to, Guernsey's specific circumstances.

- Used the contents of the RPI Report to facilitate an informed discussion and to consider what other measures may be important in ensuring that regulation operates efficiently and effectively in the Island in future.

16.4 **It should be noted that none of the Recommendations put forward in this Report have any implications for the States of Guernsey General Revenue account.**

17. Recommendations

17.1 The Commerce and Employment Department recommends:

1. That the States by Ordinance direct the Director General of Utility Regulation to:
   a) follow the six principles for economic regulation set out in paragraph 5.11 of this Report and to take them into account in performing his statutory duties.
   b) prepare a Memorandum of Understanding setting out formally the approach, process, practice and procedure, objectives, deliverables and measurements of success for future regulation of each States-owned utility, as described in paragraphs 5.14 and 5.15 of this Report.
2. That the States as shareholder direct the Treasury and Resources Department acting as their representative to follow the six principles of corporate governance set out in paragraph 6.6 of this Report and to take them into account in performing the shareholder representative role.
3. That the States agree that paragraph 4 of the States Guidance to Shareholders with respect to Guernsey Electricity, and paragraph 2 with respect to Guernsey Post be amended to read as appropriate:
   a) Deliver improved efficiency in fulfilling the requirements of the Public/Universal Supply Obligation imposed under the regulatory regime; and
   b) Achieve as soon as practicable an appropriate commercial return on the resources employed in the provision of services.
4. That the States direct that the "shareholder resource" concept be explored by the Policy Council's External Relations Group in its ongoing dialogue with Jersey and that the Policy Council bring a Report before the States by the end of September 2012.
5. That the review of the powers, duties, mandates, and effectiveness of the Scrutiny and Public Accounts Committees referred to in paragraph 7.11 should include consideration of the most appropriate method of scrutinising the regulatory regime (including the responsibilities of the shareholder) on a regular basis.
6. That the States direct the Director General of Utility Regulation to produce and publish a three-year strategic plan along with an annual business plan detailing the actions proposed to be taken by the OUR in the subsequent year.

7. That the Post Office (Bailiwick of Guernsey) Law 2001 be amended to allow for the introduction of a Universal Service Fund, if it becomes necessary in future in order to fund the Universal Service Obligation for Postal Services.
8. That:
   a) The 2001 Direction to the Director General to review and revise the award of exclusive rights from time to time, with a view to opening up the Bailiwick postal services market to competition, provided that any such opening up does not prejudice the continued provision of the universal postal service, should be rescinded; and
   b) The States of Guernsey should determine any revisions to the exclusive rights having taken into account any advice and comments from the Director General of Utility Regulation.
9. That the legislation be amended to require all postal operators with specified de minimis exceptions to obtain a licence from the Office of Utility Regulation.
10. That the States:
    a) Issue a States Direction to the Director General of Utility Regulation that an exclusive licence be issued to Guernsey Electricity for supply activities subject to any exemptions granted by the Director General under Section 1 (2) of the Electricity (Guernsey) Law, 2001 for the period ending 31st January 2022.
    b) Issue a States' Direction to the Director General of Utility Regulation to issue to Guernsey Electricity an exclusive licence for conveyance activities, subject to any exemptions granted by the Director General under Section 1 (2) of the Electricity (Guernsey) Law, 2001 for the period ending 31st January 2022.
    c) Direct the Director General of Utility Regulation that the exclusive licences set out in Directions (a) and (b) above should be replaced with exclusive licences for retail and network activities respectively when new legislation is enacted amending the nomenclature.
    d) Direct the Commerce and Employment Department to monitor the development of the energy sector in the Channel Islands and bring forward a review of these arrangements by 31st January 2022 or sooner in the event of any material changes to the structure of the sector.

11. That:
    a) The Articles of Incorporation of both Guernsey Post and Guernsey Electricity are amended to require the written authority of the States Treasury and Resources Department before registering an appeal against a decision of the Director General of Utility Regulation, and
    b) The time period for registering an Appeal against a decision by the Director General of Utility Regulation should be extended from 28 to 56 days (with power to the Courts to extend further in exceptional circumstances).
12. That:

a) The Regulation of Utilities legislation be amended to alter the organisational structure of the OUR, thereby replacing the role of the Director General of Utility Regulation with an executive director and independent Board, and
b) Subject to the agreement of the Jersey Authorities, the Boards of the JCRA and OUR should comprise the same people, who in practice would operate as a single Board, while administering two separate sets of laws.
c) Once the Board has been established that that part of Resolution XIV 1 (f), Billet d'Etat X, 2006 related to the establishment of an Audit and Remuneration Committee should be rescinded and the Audit and Remuneration Committee shall be abolished.

13. That the States direct the drafting of the appropriate amendments to the legislation.

Yours faithfully

C S McNulty Bauer
Minister

M Lainé
Deputy Minister

R Matthews
R Sillars
M Storey
States Members

P Mills
Non States Member

REGULATORY POLICY INSTITUTE

Review of Guernsey's utility regulatory regime

A report for Commerce and Employment prepared by:

Professor George Yarrow & Dr Christopher Decker

15 October 2010

Contents

Summary

i. This report constitutes our assessment of Guernsey's utility regulatory system as applied to the regulation of electricity, post and telecoms, and it includes recommendations for change to improve the framework and conduct of regulation. Although initially triggered by issues noted in the April 2010 Requête, the scope of the Review has broadened to take account of other structural, policy and institutional factors. We consider this broadening desirable, as any assessment of the effectiveness of a regulatory regime requires an examination not just of the regulator, but also of the broader policy and institutional structure of government within which regulation operates.

ii. We have taken it as axiomatic in conducting the Review that Guernsey folk are much the same in their nature as folk everywhere else, and that any general differences in conduct and performance are to be ascribed to differences in context (those things that make Guernsey different). Among the factors that we considered particularly relevant were: the small size of the relevant markets; the structure of government in Guernsey; public ownership of Guernsey Post and Guernsey Electricity; corporate governance in the commercialised public sector; prospects for cooperation with Jersey; and Guernsey's save-to-spend policy.

iii. Although Guernsey's system of utility regulation is broadly similar to that developed in the United Kingdom, the system of formal regulation is operated at a scale much smaller than is typically observed in other jurisdictions. We examine, as a preliminary exercise, the question of whether the size of the economy is such that regulatory success is unlikely. We conclude that regulation can work in a small economy such as Guernsey, but that, precisely because of its size, issues such as the scope and proportionality of regulatory activity are of critical importance. In this respect, we suggest that regulatory arrangements be built around a regulatory style that we have termed 'doing a limited number of biggish things well', but which might alternatively be called an approach based on 'limited regulation'.

iv. We then consider issues surrounding the appropriate objectives for the regulatory system in Guernsey, which brings us to questions of competition and public monopoly. On competition, we conclude (contrary to the view put to us by some

parties) that the scope for competition on the Island – and in the regulated sectors, including electricity – is greater than is generally assumed. While Guernsey's size means the intensity of competition may not be as vigorous as in larger economies, the possibility of challenge through competitive entry can still be a powerful inducement to better performance in many sectors and industries (including the regulated sectors).

v. On questions of monopoly we note that where utilities remain in full public ownership (such as is the case for Guernsey Electricity and Guernsey Post) this tends, on average, to dull the managerial incentives for improving performance over time and requires a very activist shareholder to counteract the effect of this. In this respect, we find significant limitations in relation to the current governance arrangements for the publicly owned electricity and post monopolies in Guernsey. In particular, we note that the States guidance (to the shareholder) envisages a broad shareholder role which involves the resolution of trade-offs between price levels and financial returns; which is not the approach envisaged under the standard 'independent regulation' way of doing things. In addition, we consider there to be a serious design issue with the application of price-cap regulation to these publicly owned monopolies. In particular, we question whether fixing prices will create the same desirable incentives for cost reduction in the commercialised entities as it does in private companies. We conclude that there may be more effective means of achieving the relevant public policy objectives (than simple price-cap regulation of public enterprises).

vi. Turning to the specific sectors, our assessment is that the regulatory system has worked effectively in telecoms, and has been particularly effective in allowing for new entry, and in creating a general environment of trust and professionalism. Our recommendations in this area are that the current regulatory structure is maintained, and the approach be tilted further towards the gradual withdrawal of formal price controls as competition develops. We also consider there to be considerable merit in proposals to allow for greater harmonisation with the regulatory framework in Jersey. An important implication of our assessment is that there is an on-going role for the Office of Utility Regulation (OUR) in the telecoms sector, and that, in consequence, the OUR's role in regulating postal services and in electricity should be considered on an incremental basis.

vii. In post, it is our assessment that the regulatory system has not performed effectively. We conjecture that this is the result of a combination of factors including the application of the standard price control approach, the weaknesses of the broader governance and oversight arrangements, and the absence of any second-opinion expert review panel ('an adjudication panel') which could deal with issues as and when they arise. Our major specific recommendation in post is that issues surrounding the USO be addressed as a priority.

viii. Our assessment in electricity is that the regulatory system has failed in some key respects, including in relation to fairly standard regulatory matters such as the treatment of the issue of cost-pass through in the price control. In our view, an appropriately designed and constituted adjudication panel might have been able to deal with these issues swiftly and decisively. However, there are also deeper issues in electricity relating to the ownership and governance arrangements. For this reason we consider that the approach of sticking with the current regulatory model may not resolve the underlying problems, and that more radical change may be necessary. In this respect, we canvassed a number of possibilities including: the full or partial privatisation of GE; a more active shareholder function; a shift toward a more 'adjudicative' (as opposed to 'activist') role for regulation in price setting arrangements; and the possibility of moving toward a 'regulation by exception' arrangement. Each of these proposals has merits as well as drawbacks associated with it. That said, our own conclusion is that a more adjudicative approach to regulation is most likely to provide a good fit with the Guernsey system of government. Separately, we suggest that the States give serious consideration to the adoption of a clear and stable formal energy policy in order to avoid the instability caused by potentially significant changes in policy preferences, which has the potential to have a negative effect on the effectiveness of regulation going forward.

ix. Finally, in addition to the specific recommendations in each of the sectors, we set out more general recommendations to improve the regulatory system in Guernsey. Among these are:

- That an adjudication panel be established, to be called (and remunerated) on an 'as needed' basis, to provide an authoritative second opinion on disputed matters and adjudicate on disagreements between the regulated companies and the OUR.

- The States consider again the suitability of the current governance arrangements for the commercialised utilities, particularly the role of the non-executive directors and T&R as shareholder. In particular, we consider there to be merit in the proposal for the creation a 'shareholder resource', preferably in cooperation with Jersey, responsible for engaging with the utilities on financial matters and holding them to account in terms of its performance against its plans and shareholder objectives.

- That a formal institutional mechanism or process be developed to enhance the accountability of the OUR, and permit a review of its activities on a regular basis.

- That, as already contemplated, competition laws should be established in Guernsey, but that further thought be given to the issue of appropriately adjusting 'standard' thresholds relating to market shares, so that those thresholds better reflect the realities of competition in a small market.

"Mankind are so much the same, in all times and places, that history informs us of nothing new or strange in this particular. Its chief use is only to discover the constant and universal principles of human nature, by showing men in all varieties of circumstances and situations, and furnishing us with materials from which we may form our observations and become acquainted with the regular springs of human action and behaviour. These records of wars, intrigues, factions, and revolutions, are so many collections of experiments, by which the politician or moral philosopher fixes the principles of his science, in the same manner as the physician or natural philosopher becomes acquainted with the nature of plants, minerals, and other external objects, by the experiments which he forms concerning them."

David Hume, *An Enquiry Concerning Human Understanding*, 1748.

1. Introduction

1.1 Terms of reference

We have been appointed by the Commerce and Employment Department (C&E) in the States of Guernsey to undertake a review of Guernsey's utility regulatory regime.

The objectives of the study/exercise are those set out in the C&E's invitation to tender (ITT):

- To review the States of Guernsey's existing objectives for the regulation of electricity, post and telecoms, with particular reference to the liberalisation of the post and electricity markets;

- To assess the effectiveness, and appropriateness, of Guernsey's regulatory regime in delivering these objectives;

- In light of these findings to identify and assess options capable of achieving the States objectives; and

- To provide evidence based recommendations for the C&E to take to the States of Deliberation which will ensure that Guernsey has a form of regulation that meets the present and future needs of the States of Guernsey, consumers and the Guernsey economy.

The objectives of the review described in the terms of reference are rather broader than the issues that were the principal focus of the April 2010 Requête, which has triggered the subsequent process. We consider this broadening of the scope of the review to be desirable, and note that it might, in fact, have been impossible to undertake a satisfactory assessment on a narrowly defined basis. This is because the effective functioning of a regulatory system depends upon the interactions among a number of 'structural' factors, including the legal, public policy and institutional frameworks in which regulation occurs/operates. Without studying these interactions, it may be impossible to diagnose the sources of any problems that are discovered, and hence impossible sensibly to discuss remedial actions.

1.2 Attributes of good regulatory frameworks

A number of general principles or attributes have been linked to good regulatory frameworks in work undertaken or sponsored by bodies such as the World Bank and the OECD, aimed at examining whether a particular jurisdiction's infrastructure regulatory regime is *designed* in a way that is likely to foster good decisions and outcomes.[1]

Among the most important of the attributes identified in such work as being significant for good regulatory practice are the following:

- ***The independent regulator as benchmark:*** There is widespread agreement that infrastructure regulators should be independent from the regulated entities and, as far as possible, from government influence. Regulatory independence is conducive to greater neutrality and objectivity in regulatory decision making, which tends to contribute to greater confidence and greater market participation by all those who might have dealings with the utilities concerned. One argument is that the establishment of an independent regulator helps improve a potential trade off between market and government 'failures'; the central market failure problem being monopoly, and the central government policy failure being opportunism, or unstable/volatile political objectives. In short, establishment of an independent regulator is seen as a commitment by the government that decisions on allowed prices will be determined chiefly by economic, rather than by political, factors.

[1] See, for example, the World Bank's *Handbook for Evaluating Infrastructure Regulatory Systems* (2006), as well as material presented in the Bank's working paper *Regulatory Effectiveness and the Empirical Impact of Variations in Regulatory Governance* (2005).

- ***Clarity in the framework of roles, objectives and responsibilities:*** Alongside the need for regulatory independence is a need for clarity in the framework of regulatory roles, objectives and responsibilities. It is typically the case that regulated utilities will have dealings with more than one branch of government, and clarity is important at an institutional level in order to help avoid unnecessary conflicts and duplication of functions among the various parties. In addition, clarity on these points helps avoid policy confusions that might send uncertain signals to capital markets and other stakeholders.

- ***Completeness in rules and targeting:*** In addition to being clear, good regulatory governance arrangements should be 'complete' insofar as those subject to regulation are made aware of the principles, guidelines, and objectives that will be pursued in carrying out regulatory activities, and are also made aware of expectations concerning their own responsibilities, as well as the potential consequences of failing to discharge those responsibilities.

- ***Stakeholder participation:*** Participation and consultation are generally seen as conducive to good, analytic decision making, as well as providing information on issues such as the acceptability of different policies to the various stakeholder groups. In addition, consultation and participation serve to promote confidence in the regulatory system and ensure its legitimacy. Formal rights of participation are, however, generally considered insufficient of themselves. In practice, participation must be *meaningful.* In this respect, there needs to be ample opportunity for all affected parties who wish to participate to do so, at a time and in a form that allow regulators to take submissions properly into account before rendering a decision in regulatory proceedings.

- ***Transparency:*** Transparency implies openness of the regulatory process and regulatory decisions to stakeholders, so that both the process of decision making and the substantive evidence, reasoning and judgments are visible and comprehensible. Transparent processes and decisions serve to increase confidence in the regulatory system, and to impose organisational and intellectual disciplines on regulators that potentially contribute to the making of better decisions. Proxies for transparency in regulatory processes include: public hearings, a public record of submissions, public access to decisions, and an annual report of activities including a

financial audit. In relation to the substance of regulatory decisions, any key principles and methodologies on which major regulatory decisions are made should be clearly set out in advance in appropriate documents. Various institutional safeguards aimed at achieving transparency in regulatory decisions have been suggested. These include: making all documents and information used for decision available for public inspection; ensuring the procedures by which, and criteria upon which, decisions are made are known in advance and made publicly available; establishing criteria relating to how written decisions are presented including requirements for: a clear statement of the decision, a description and analysis of all evidence taken into consideration, a summary of the views offered by participants to the proceedings, and finally, a discussion of the underlying rationale for the decision.

- ***Predictability and consistency:*** A good regulatory system should provide reasonable, although not absolute, certainty as to the principles and rules that will be followed within the overall regulatory framework. In this respect, good decision-making draws an acceptable balance between predictability and consistency on one hand, and flexibility and discretion on the other.[2] As economic regulation can involve interventions that affect existing property rights, it is important that the uncertainty attached to regulatory decision making is limited as far as is possible without overly fettering the regulator's discretion to make the most appropriate decision.

- ***Proportionality:*** Regulatory interventions should be proportionate to the problem that the regulator is addressing. In particular, it can be argued that, as a general matter of principle, intervention should be the minimum necessary to remedy the problem identified, and should be undertaken only if the likely benefits outweigh the expected economic and social costs. Any enforcement action should be in proportion to the risk, with penalties proportionate to the harm done. Similarly, compliance obligations should be affordable to those regulated.

- ***Accountability:*** Independence does not imply that the regulator is not accountable. It follows that, in order to ensure that the regulator is accountable for her/his conduct, and for how he/she implements policies, there should be procedures in

[2] Guidance on regulatory uncertainty is itself not always clear. What matters to investors, for example, is not that policy is set in stone and unchangeable. In fact, that would tend to lead to poor regulation, which could damage utility performance in the longer run. Rather, what matters is that capital markets (say) can predict how regulatory decisions will respond to changing circumstances (e.g. how the Bank of England's Monetary Policy Committee might react to changing information about inflation, unemployment, the sterling exchange rate, etc.)

place to scrutinise the regulator's performance in light of the relevant objectives. Such procedures commonly include publication of decisions, and the ability to appeal the regulator's decision in some cases. Consultative bodies of consumers, industry representatives and/or others are ways of seeking to ensure meaningful public participation, which enhances the accountability of the regulator.

- ***Appeals:*** It is generally recommended that all regulatory decisions should be subject to *final* right of appeal to an impartial or independent, legally designated court or tribunal, in which the following issues can be addressed: has the regulator acted beyond its legal authority?; has the regulator followed appropriate procedural requirements?; has the regulator acted arbitrarily, unreasonably or disproportionately?; and how did the regulator approach the evidence and submissions before it? The ability to appeal decisions is an important guarantor of both transparency and accountability, and this arguably helps improve the quality of regulatory decisions (i.e. by acting as a form of regulatory quality control). In addition, the prospect of an appeal helps keep regulators 'on their toes', both in relation to the processes followed and the substantive decisions made. Alongside any formal appeals mechanisms it is sometimes suggested that other non-traditional, means of challenging regulatory decisions, such as the use of an Ombudsman or specialist tribunals or panels, can be effective.

We mention these attributes here, not because they provide a checklist or scorecard by which we can assess Guernsey's regulatory regime, but rather to highlight the point that for regulation to work effectively it is often the case that a number of 'pieces of the puzzle' must be present and connected. In particular, when assessing the effectiveness of a regulatory regime, it is necessary to look beyond the activities of the regulator: consideration must also be given to the broader institutional structure of government within which regulation operates.

1.3 Do these general factors apply to the context of Guernsey?

We take it as axiomatic that Guernsey folk are much the same in their nature as folk everywhere else, and that any general differences in conduct and performance are to be ascribed to differences in context (those things that make Guernsey different). In this, we simply follow the founding fathers of political economy (see the David Hume quotation at the beginning of this review), and the generally accepted legal wisdom that: *"Context is everything: circumstances alter cases."*

Among the factors that we consider particularly relevant to the Guernsey context, and therefore which we consider and discuss throughout the review, are the following:

- The small size of the relevant markets.
- The structure of government in Guernsey.
- Public ownership of Guernsey Post and Guernsey Electricity.
- Corporate governance in the commercialised public sector.
- Prospects for cooperation with Jersey.
- Guernsey's save-to-spend policy.

Before examining each of these factors in detail, however, this report considers (in sections 2 to 4) three sets of preliminary issues:

- First, we examine the question of whether the size of the relevant markets in Guernsey is so small that, even if all other factors were favourable, independent regulation could never realistically be expected to succeed. We consider this question before any others because, if small market size alone were likely to preclude success, there would be little point in further assessment. As our subsequent discussions indicate, we did not reach such a conclusion, but we nevertheless set out our reasoning on the issue, because the asking and answering of this relatively simple question points to some of the characteristics of regulatory arrangements that, in our view, are necessary for the achievement of successful outcomes in Guernsey.

- The second preliminary exercise relates to the characteristics of competition. We found in our consultations for this Review that there are some fairly widespread misunderstandings about the nature of competition and its likely effects in sectors such as telecoms, postal services and electricity. This is unsurprising, since words like 'monopoly' have subtly different meanings when used in different contexts, some of which are more technical than others. The word can be, and is, used to describe: supply by a single seller (from the original Greek), supply by a single seller that faces no competitive threats (i.e. cannot be displaced), and supply by an enterprise with a large market share and an ability to have a significant influence on market prices. Though the label applied may be the same, each of these 'monopolies' is different from the others, and can be expected to exhibit different

behavioural patterns. Accordingly, we have sought to clarify some of the relevant economic concepts, and reasoning, relevant to the assessment of competition, in the hope that this may help facilitate a better public discourse, not only on the regulatory issues covered in this Review, but also in relation to the possible future development of competition law on the island.

- Our third preliminary exercise relates to the implications of public ownership for the conduct of independent regulation. We single this issue out because of its particular significance for the matters that we have been asked to consider; and because that significance has already been identified in an earlier document produced by Professor Stephen Littlechild for Guernsey Electricity. Accordingly, we judged that it would be helpful to set out the general challenges posed for independent regulation by public ownership, ahead of looking at how the issues crystallize in the specific Guernsey context.

The later sections of the Review (sections 5 to 7) comprise evaluations of the current regulatory framework, and its performance, in the three sectors currently subject to sectoral regulation – telecoms, postal services, and electricity – together, in section 8, with suggestions and recommendations on reforms that might help improve policy effectiveness in relation to regulation and competition on Guernsey.

1.4 Approach to the review and the materials examined

An important aspect of this Review was an extensive consultation process, the purpose of which was to build up our understanding of the specific issues, and the specific contexts, of utility regulation on Guernsey. As part of this process we met with the following parties and representatives:

- A large number of States' Members, including the signatories to the Requête as well as other Members.
- Commerce and Employment Board Members and Department staff.
- Treasury and Resources Board Members and Department staff.
- The States Chief Minister.
- The States Chief Economist.
- The Office of Utility Regulation.
- The Jersey Competition and Regulatory Authority.
- Cable & Wireless Guernsey.

- Guernsey Electricity.
- Guernsey Post.
- Guernsey Gas.
- ClearMobitel.
- Airtel Vodafone.
- Hub Europe.
- Citipost DSA.
- The Bulk Mailers Association.
- Representatives of the Communications Workers Union.
- Consumer representatives, including Postwatch.
- The Guernsey Reform Group.

In some cases, we met with relevant bodies and organisations on more than one occasion, and also talked with past, as well as current, employees. In order to facilitate open discussion, all of the meetings were conducted on a confidential basis. We have, therefore, not attributed any statements in what follows to any particular individual or organisation. Generally speaking, the consultation meetings were highly informative, and we are grateful for the atmosphere of openness and frankness in which the great majority of the meetings were conducted.

Our assessment of the performance of the regulatory system across the individual sectors (electricity, post, telecoms) draws upon the general themes of these discussions and the other materials we have examined. However, in reviewing the performance of the regulatory system, we have also focussed our attention and analysis on the examination of a small number of important 'episodes' or specific issues (such as the reserved area dispute in post, or the cost-pass through issue in electricity) that we consider likely to be particularly informative about the operation of regulation in the sector concerned. We consider there to be a number of advantages in adopting this approach. As a matter of methodology, this type of forensic analysis of specific, but important, issues/episodes can be revealing in terms of providing deeper insights into how such problems arise in the first place, and how they are then dealt with/addressed within the broader regulatory and institutional system.[3] In addition, by applying this approach across the sectors we are able to look for any patterns

[3] The approach of tracking back from very specific problems/issues to the root causes, is not dissimilar (albeit in a very different context) to that entertainingly described by The Times columnist Matthew Parris in an article concerned, in his own terminology as 'Keyhole Diagnostics'.
< http://www.timesonline.co.uk/tol/comment/columnists/matthew_parris/article5679226.ece>

or recurring issues across the different sectors which can help to identify underlying issues and problems beyond that of the specific issue/episode examined.

Alongside the consultations and meetings, we collected and assessed a wide range of materials and evidence in the course of this Review, including the following:

- The April 2010 Requête, and related correspondence between the Commerce and Employment Department and Treasury and Resources Department;
- Past reviews and materials, including earlier studies by the National Audit Office (NAO) and Europe Economics, a Report by Professor Stephen Littlechild for Guernsey Electricity in 2006, a Report on electricity issues for the Office of Utility Regulation by Sir Ian Byatt, Chris Bolt and Professor David Newbery in 2006, a provisional Report on utility regulation by Guernsey's Chief Economist;
- Written submissions, documents and letters on specific regulatory issues/matters provided by companies, consumer representatives, Deputies and individuals;
- Various presentations made by regulated companies and individuals;
- Publicly available documents relating to previous regulatory decisions, including not only those of the Office of Utility Regulation but also those published by other States' departments;
- Documents relating to company and financial performance for the regulated companies in Guernsey;
- Material and reports published by the OUR since its inception in 2001;
- The Regulation of Utilities (Bailiwick of Guernsey) Law 2001, The Post Office (Bailiwick of Guernsey) Law 2001, The Electricity (Guernsey) Law 2001; The Telecommunications (Bailiwick of Guernsey) Law, 2001, and related directions in accordance with these pieces of legislation.

We have also had regard to more general materials on regulation, including material produced by other regulatory agencies, regulated companies in other jurisdictions, and material on approaches to regulatory assessments produced by bodies such the World Bank and the OECD.

2. Regulation in a small economy

The system of utility regulation adopted in Guernsey is broadly similar to that developed in the United Kingdom in the 1980s and 1990s. It is most similar to that currently operating in Northern Ireland, in that a single regulatory office is responsible for unrelated sectors.[4] While this approach of combining the regulation of different sectors (post, electricity and telecoms) into a single regulatory office differs from that used in the UK (excluding Northern Ireland), it is not uncommon; and similar institutional structures can be found in countries such as the Netherlands, New Zealand, Germany and Australia.[5]

On the other hand, there can be no doubt that the States are operating a system of formal regulation at a scale much lower than is typically observed in other jurisdictions that followed broadly similar paths. This raises the immediate question: is the size of the economy simply so small that success is unlikely? Using an analogy from the theory of evolution (a not uncommon source of analogies in economics): *is this type of animal destined for extinction in this type of environment?*

As an initial approach to this question, we have considered the proportionality between the costs and potential benefits of the current regulatory arrangements in Guernsey. We use *potential* benefits because, even if actual benefits were found to be below costs, if it were possible to improve performance by incremental reforms without abandoning the main features of the system, it would be sensible to consider those reforms first, before considering the 'extinction option'.

Put another way, we have looked first at the question: *can it work?* This is to be distinguished from the questions: *has it worked?,* or *Is it working?*

2.1 Costs

The costs with which we are concerned can be divided into:

- The costs of the Office of Utility Regulation (OUR).

[4] In Northern Ireland the Utility Regulator is responsible for electricity, gas, water (telecoms is regulated by Ofcom). In Guernsey, the OUR is responsible for telecoms, electricity and post.

[5] In the Netherlands, rail and energy are combined with competition regulation as separate chambers of the NMa. In Australia, competition and regulation of all telecoms, post, energy are generally combined within a single authority. In Germany, post, rail, energy and telecoms are regulated by the Federal Network Agency.

- The compliance costs incurred as a result of OUR activity.

In each case, we are concerned only with the costs that are borne by Guernsey residents (the significance of this point is explained below).

OUR costs

Table 1 below presents estimates of the costs of the OUR in Guernsey and of regulatory agencies in other jurisdictions. It shows that in 2008 the total OUR costs were just over £758,100, and that this represents a cost of £126,353 per employee, or £12.28 per resident of Guernsey. Two interesting observations can be made from this table. First, the cost per employee for the OUR is broadly similar, if not slightly lower, than the costs per employee at comparable agencies in Jersey, Ireland and the UK (although not Germany). Second, the estimates are consistent with the existence of significant 'scale economies' in regulation; with the exception of the Jersey comparison, as the population gets larger the cost of regulation per capita falls.

Table 1: Cost of regulatory agencies in other jurisdictions - 2008 (£)

	FTE Staff	Budget (£)	Cost per staff member (£)	Cost per capita (£)
Guernsey				
OUR Guernsey (post, telecoms, electricity)	6	758,118	126,353	12.28
Jersey				
JCRA (competition and telecoms)	9	1,154,220	128,247	12.57
Ireland				
CER (energy)	68	8,610,785	126,629	1.95
Comreg (post and telecoms)	113	17,878,181	158,214	4.04
	181	*26,488,966*	*146,348*	*5.99*
United Kingdom (excluding N.I for energy)				
Ofgem (energy)	302	39,907,000	132,142	0.67
Ofcom (telecoms)	810	138,611,000	171,125	2.34
Postcomm (post)	66	9,159,000	139,619	0.15
	1178	*187,677,000*	*159,372*	*3.17*
Germany				
Federal Network Agency (post, telecoms, rail, energy)	2500	123,269,629	49,308	1.50

Source: Annual reports and resource statements

In reviewing these costs, it is important to recall that not all of them are necessarily borne by Guernsey residents.[6] This is because the OUR derives its incomes from licence fees and, while the licence fees levied on Guernsey Post and Guernsey Electricity can be expected to be recovered by those state-owned enterprises from residents, either as customers or as taxpayers, this is not necessarily the case in relation to the telecoms companies.

In telecoms there are private shareholders (and a non-Guernsey, public owner in the case of Jersey Telecom), and there is an element of competition among providers. In such circumstances, there is no guarantee that the companies can recover 100% of licence costs, and it might well be that, in effect, (non-Guernsey) shareholders bear some of the burden of the licence fees.[7] In this context, it is relevant to note that more than 60% of the licence fees received by the OUR are derived from the telecoms sector (table 2).

A detailed consideration of the size of this effect is beyond the scope of this Report, but we think that, as a rough approximation, the cost-to-Guernsey of the OUR may be a little lower than the OUR accounts would suggest.

Table 2: Licence fees (£)

	2002	2003	2004	2005	2006	2007	2008
Guernsey Electricity	165,000	180,000	180,000	180,000	180,000	120,000	80,000
Guernsey Post	120,000	120,000	120,000	180,000	180,000	120,000	80,000
Telecoms companies	447,381	493,886	552,671	589,850	863,745	495,935	369,837
Total	**732,381**	**793,886**	**852,671**	**949850**	**1,223,745**	**735,935**	**529,837**
Telcoms as a % of total	*61%*	*62%*	*65%*	*62%*	*71%*	*67%*	*70%*

Source: Annual reports

[6] Although the OUR is financed by licence fees, to the extent to which those licence fees are not fully translated into higher prices, shareholder returns will be lower. In the case of electricity and post this can potentially have a negative effect on Guernsey taxpayers. Where the consequences of regulatory decisions may have effects via impacts on prices (consumer impacts) or via impacts on profitability (which affect the fiscal position, and hence taxpayers), we refer simply to effects on 'Guernsey residents', to encompass both.

[7] This is an example of the general issue of the *incidence* of a tax. For example, corporation tax is levied on company profits, but that doesn't mean that it is borne by shareholders: most of it might be passed on to customers in the form of higher prices.

Compliance costs

As is widely recognised in the Guernsey debates on regulation, the direct costs of a regulatory agency such as the OUR is only one side of the costs associated with regulation. Compliance costs – by which we mean the resource costs (including costs of staff time) incurred by regulated companies in responding to the activities of the OUR – are also a highly relevant factor in any assessment of the costs and benefits of a regulatory regime.

Compliance costs depend heavily on the style of regulation, as well as on the relative efficiency of the business being regulated. Regulators require information on which to base assessments, but, for the most part, this should be similar to management information already available for the running of an efficient business. There are some additional requirements – for example, the need, under regulation, to keep track of the regulatory asset base or to prepare regulatory accounts – but, on the whole, once systems have been set up, these should be fairly straightforward accounting exercises. In practice, compliance costs may often be greater than the minimum required, and when this occurs it is to be counted as a regulatory inefficiency. Such 'excess' costs are not relevant for the exercise here – *can it work?* – but will be considered later when we ask *has it worked?*

During the course of our Review, a range of estimates of compliance costs associated with the regulatory regime were suggested to us. These included estimates up to an annual cost of £1 million for some companies.[8] We note that in 2005 the NAO recorded annual estimates of compliance costs (excluding licence fees) of £40,000 for Guernsey Post and £500,000 for Guernsey Electricity (although it expressed caution when interpreting the latter number).[9] We asked parties if they could provide us with any further evidence in relation to these estimates, which some did, but, in the time available, we were unable to verify these amounts.[10] We do think, however, that the relatively low figure recorded by the NAO for Guernsey Post indicates the sort of compliance cost level that is achievable when things are working well.

[8] In its 2010 Annual Report, Guernsey Post stated that *"[T]he costs of dealing with the regulator this year was close to £1m*". < http://www.guernseypost.com/index.php/download_file/-/view/441>

[9] National Audit Office *Review of Commercialisation and Regulation in the States of Guernsey* September 2005, paras [2.39] for Guernsey Post; and [3.51] for Guernsey Electricity.

[10] Part of the difficulty associated with verifying these estimates is in distinguishing information reporting that is directly caused by regulation, from that which would be required for other purposes.

Overall costs of efficient regulation

Given that some regulatory costs are likely be borne by telecoms shareholders, but that there will always be some level of compliance costs even when the informational demands of regulation are light, we are of the view that the overall costs-to-Guernsey of efficient regulation at around the current scale and scope of such activity should be fairly close to the actual outlays on the OUR, that is around £750,000 - £800,000 per annum. As indicated above, this implies a cost-per-resident of around £12.15 - £12.96 per head per annum.

2.2 Potential benefits of independent regulation

The costs of regulation need to be set against the potential benefits of the type of regulatory arrangements established on Guernsey. Again we stress *potential* benefits, since the focus for the moment is on the question *can it work?*

One way of approaching this question is to ask how big the reductions in costs of the utilities (ie: the efficiency benefits) attributable to regulatory activity would need to be to offset the costs of regulation. That is, what would the cost-savings associated with higher productivity or efficiency improvements in the utilities need to be to offset the costs associated with the regulatory regime.

There are a number of points to bear in mind in undertaking this mini-exercise:

- In telecoms, a large part of the benefits of regulation may come from product and service innovations (e.g. increases in broadband speed), not reduced costs. The existence of benefits attributable to regulation in telecoms is, from experience in other jurisdictions, most likely to occur via effects on new entry. Regulatory agencies around the world have tended to be helpful in removing barriers to entry, facilitating innovations from new entrants, and stimulating incumbents to greater innovative efforts in response to the new competition. Guernsey appears to be no different in this regard.[11]

[11] While it may be argued that there are limited prospects for another major operator in Guernsey, the point is a more general one (discussed in the following section) which is that one of the benefits of competition, and of effective competition policy, is that it generates continuing incentives for all involved, including incumbents and other operators alike, to improve their performance so as to reduce the risk of being *displaced* by another operator. That is, a new entrant may seek to take over from an incumbent supplier, not to co-exist with the incumbent.

- If we separate out telecoms from post and electricity for the purposes of the proportionality tests, and if it is found that an independent regulator passes these tests for telecoms (even if telecoms were to become the only sector regulated by the OUR), then the relevant costs to be taken into account for the assessment of postal and electricity regulation will be *incremental* regulatory costs: given the existence of a regulator responsible for telecoms, the question of interest is whether or not there can potentially be a case for adding postal and electricity regulation to telecoms regulation.

- Large slices of costs in the postal and electricity sectors will be 'non-controllable', and it is appropriate to exclude these for the purposes of the calculations. For example, if utility costs were £50m and regulation cost £1m, it might be said that a 2% reduction in utility costs is required to offset the regulatory burden. However, if only 50% of the costs are controllable by management of these firms, the relevant threshold for cost performance reduction is 4%. In postal services, management has very limited influence on Royal Mail costs; and in electricity, management has only limited control over fuel costs and wholesale energy prices (i.e. the price of wholesale power imported via the interconnectors to France).

Particularly given the scope for efficiency gains suggested by experience in other jurisdictions when utilities are privatised or commercialised, and then regulated, we think that it is not at all infeasible that the levels of cost reduction (to recover the applicable licence fees) detailed in table 3 below could be achieved. Further, if efficient compliance costs are broadly similar in scale to the licence fees – so that the total cost of regulation is double the applicable licence fee – we think the required levels of cost reduction attributable to regulation would still be within a range that an effective regulator could achieve.

There is then a further question of whether, once any obvious cost improvements have been made, there is a continuing case for independent regulation. That is, might it be that the current arrangements are desirable on a transitional, but not a permanent, basis?

Such might be the case if efficiencies, once driven out the system, stayed out. However, particularly in a changing economic environments where 'efficiency frontiers' are liable to

change, constant attention is likely to be required to maintain performance at close to best practice levels. The search for efficiency is, therefore, typically never-ending.

Table 3: GE and GP licence fees as a % of costs and revenue - 2007 and 2008 (£)

	Guernsey Electricity		Guernsey Post*	
	2007	**2008**	**2007**	**2008**
Licence fee (£)	120,000	80,000	120,000	80,000
Controllable costs (£)	20,611,000	21,735,000	12,041,000	12,403,000
Licence fee as % of controllable costs	**0.58%**	**0.37%**	**1.00%**	**0.65%**
Turnover (£)	33,070,000	38,661,000	31,209,000	36,982,000
Licence fee as % of turnover	**0.36%**	**0.21%**	**0.38%**	**0.22%**

* Guernsey Post's controllable costs are based on those listed at note 2 of the 2008 financial statements and include: Staff costs, Auditors' renumeration, loss on disposal of fixed assets and depreciation.

Source: Annual reports

2.3 Implications and conclusions

Our first, broad conclusion is that, *notwithstanding the small size of the Guernsey economy and the existence of economies of scale in regulatory activity, the underlying parameters do not imply that successful, independent regulation cannot work.*

However, perhaps a more interesting implication that flows from these basic assessments concerns the *nature* of proportionate regulation in Guernsey. Since the per capita cost of regulation is almost four times greater than in the UK then, at least when considering expansions or contractions in regulatory activity, and holding all other things equal, the regulatory performance standard required to justify incremental expenditure will, in per capita terms, likely be several times higher than in the UK.

In our view, this suggests that:

- It would be unreasonable for a Guernsey regulator to try to cover a similar range of issues at similar levels of detail to, say, a regulator such as Ofgem. More marginal, less productive, activities should rationally be shed.

- The appropriate regulatory style might be characterised as: seeking to do a limited number of biggish things well.

In later sections of this report, when we turn to assessing how regulation has been implemented across the different sectors, we will refer to the second of these points as the 'LNBTW' test/criterion.

The relevant intuition for this test/criterion is already to be found in Guernsey political discourse, in the form of the notion of light handed or light touch regulation. We are not particularly attracted by this term (light touch regulation), because it can be misleading, and strongly prefer the notion of 'limited regulation'.

The reasoning here can be explained by a political analogy. Guernsey may be proud of the fact that it has smaller, more limited government than in neighbouring European jurisdictions, but it would not, we think, refer to this as light-touch government. 'Light touch government' might give the impression that everything that government did was done in a similar laid back way; and might communicate to a violent criminal in London that, if caught in the act in St Peter Port, the hand of the law would be much lighter than in London. We hope that would be a misapprehension.

The point is simply that, on some (big) issues, a regulator may need to be tough, even while pursuing a highly limited and very focused agenda. The idea of doing a limited number of biggish things well seems to us to better capture what is required to translate the potential for worthwhile regulation into an actuality.

To summarise, and in response to the question posed at the start of this section (C*an regulation work in a small economy such as Guernsey*?) our assessment is a positive one. However, we would qualify that statement by noting that, precisely because of the small size of the economy, issues such as the scale and proportionality of the regulatory framework, and the regulator's application of that framework, become critically important. For this reason, *we suggest that the regulatory arrangements should be built around the notion of 'limited regulation'.*

3. The scope for competition

During the course of our discussions on Guernsey, it was put to us by several parties that there was:

- No scope for competition in the electricity sector.

- Relatively limited scope for competition more generally on the island, as compared with larger economies.

We believe that the first of these views is wrong (for the reasons discussed in section 7 below), and that the second, whilst correct in thinking that small market size can have a dampening effect on the strength of competition, may be based on an exaggerated view of the quantitative significance of the effect. That is, competition can still be vigorous in a small market, whilst not being quite as vigorous as it might be if there were more at stake (i.e. more business to win).

These things matter – i.e. it is important for policy makers to have clear sight of what competition can and can't do – because prospects for competition should affect the conduct of regulatory policies: price regulation, for example, is generally introduced where competition is inevitably absent. Further, if Guernsey is to follow Jersey (and most of the rest of the world) in introducing competition law, it will be important that such law is enforced in a proportionate way that is sensitive to the island's contexts.[12] Failures of understanding about the nature of competition at the outset would greatly increase the risks of disproportionate enforcement.

3.1 What is competition?

The technical definition in economics (and economic policy) of the process of competition is no different from the dictionary definition: *competition is rivalry*. In the situations of interest, the relevant rivalry is generally that for the business of the customer/consumer; but, in thinking about competition, sporting analogies can sometimes be helpful (provided that the right analogy is used!).

[12] In this respect, we note the States Resolution of 10 July 2009 (and the earlier report of Commerce and Employment of 29 May 2009) in relation to proposals for mergers and acquisitions regulation, as well as the July 2006 States Resolution in relation to the development of enabling legislation incorporating measures to address anti-competitive arrangements and abuses of a dominant position.

The standard reasoning as to why competition is important is that it provides consumers with choice. If a consumer is dissatisfied with the price or the quality/performance of a particular or product, they can switch to other suppliers.

Over the long haul, however, it is the contribution of competition to rising living standards that is the primary benefit. This comes about because competitive processes are, by a long mile, much better at discovery and innovation that any other system of economic organisation known to man.

The incentive effects of competition include both carrots and sticks, but it is the sticks that are perhaps the more distinctive properties. It is often said that 'necessity is the mother of invention', and competition creates the necessities. If rivals are introducing new, superior technologies and products, then it becomes necessary for business survival to do likewise. Crucially, the pressure of necessity is universal, as Adam Smith put it:

> *Monopoly, besides, is a great enemy to good management, which can never be universally established but in consequence of that free and universal competition which forces everybody to have recourse to it for the sake of self-defence.*[13]

Competition is likely to have its greatest payoffs where economic conditions are dynamic; where the world is changing; where conditions are uncertain, and there is more to be learned/discovered; where adaptation to new circumstances is required. As we understand it, commercialisation and privatisation began in Guernsey because of these types of perceptions in relation to the telecoms sector. In this sense, the policy developments made obvious sense in the light of the underlying economics.

In contrast, and as noted, there does not appear to be a similar recognition of the role of competition in electricity, even though the sector is, at the global level, in the early stages of what is likely to be a protracted and uncertain technological revolution, on account of pressing environmental issues. We will return to this point later.

[13] A Smith *The Wealth of Nations* in W Letwin (ed) (Everyman's Library London 1975) page 91.

3.2 Assessing competition

In a broad sense, the intensity of competition in a market is a measure of how sensitive an enterprise or business's prospects are to its performance, *relative to rivals*, in serving customers. In competitive markets, prospects and returns are highly geared to relative performance; in less competitive markets the gearing is weaker.

Competition and regulatory agencies have developed a number of techniques and measures to assess the strength of competition, and it is perhaps unfortunate that the easiest to understand and measure, namely market shares, tends to be given undue prominence. Specifically, high market shares are often interpreted, uncritically, as a sign of lack of competitive pressures. They may be, but they may not be. Indeed, particularly in small markets, they are frequently *not* an indicator of absence of competition – a point that generally gets lost in economics textbooks, but that is highly relevant in the Guernsey context.

The critical issue is related to the ability of others to challenge the existing suppliers, including challenges by potential rivals who are not yet established in the market. This ability to challenge by potential entrants is measured by the height of 'barriers to entry' into the market, which many economic theorists would put at the top of their list of indicators of strengths/weaknesses in competitive pressures (but which, unfortunately, being harder to measure than market shares, is an indicator not typically favoured by those wanting simple results).

We will refer to a market in which there are low or modest barriers to entry as an 'open market', and distinguish it from a closed market where entry barriers are insuperable. Consider, for example, 'the only shop in the village'. The shop has 100% of the local market, but it is unlikely to be free of competitive pressures – it may, in fact, be on the margin of existence. It can lose business by customers 'shopping in different markets', eg. in a supermarket relatively distant from the local market; and, if it is inefficient, charges high prices, and offers poor service, it may be vulnerable to someone setting up in competition. One possible result of such a development is a price war, with the inefficient shop closing-down after a time. Even though this returns the village to having a single shop, competition has potentially achieved a lot:

- A less efficient enterprise has been displaced by a more efficient enterprise, capable of better serving customers.

- Much more important, the process of competition generates continuing incentives for all involved, incumbents and potential entrants alike, to improve their performance (the threat of displacement is ever present, even though actual competitors are not).

For an analogy, consider Tiger Woods, who is ranked number one in the world golf listings. There can only be one number one, and Mr Woods has, at the time of writing this review, 100% of that slot. He may not have by the time of the reading of this review. There is constant challenge here, and if it were the case that Mr Mickelson took over the berth and held it for a while, no-one would claim that, because there is still only one number one, that there is no competitive pressure. Quite obviously, the competitive pressures at the top of the tree are persistent and strong, and serve the customers (golf fans) well.

All of these points suggest to us that while it is obviously the case that, in relation to the supply of some products or services, and given Guernsey's size, the intensity of competition may not be as vigorous as it would be in larger economies, it is nevertheless the case that possibility of challenge through competitive entry can be still be a powerful inducement to better performance in many sectors and industries.

We hope that these points will be recalled when the States come to implement a mergers policy for Guernsey; since there is an obvious risk that market share thresholds, developed for larger economies and markets, may be mechanistically and inappropriately 'copied in' from larger jurisdictions. We have seen copies of the May 2009 Commerce and Employment report, and Dr Michal Gal's recommendations in her February 2008 report, and are not convinced that the proposals as they stand obviate the risk of setting inappropriate thresholds.

4. Public ownership

Another theme that emerged from our consultations was the suggestion that many of the perceived problems associated with the regulatory regime could be traced back to the fact that Guernsey Post and Guernsey Electricity remain in public ownership.

In section 8 we explore this issue in greater depth in the context of discussing possible ways forward. However, we think it is useful, at this early stage, to outline some of the more general challenges posed for independent regulation in circumstances where utilities are in public ownership.

4.1 'Closed monopoly' in general

The public ownership of utilities has, in many jurisdictions, typically been associated with statutory monopoly. That is, legislation has prevented entry and challenge to incumbents from competitors, and thereby created a closed market with only one supplier for a particular product or service.

This can be contrasted with an open market, where even sole suppliers can be under strong competitive pressures, including from the threat of entry (see discussion above). In a closed market, there are no immediate rivals and competitive pressures are therefore necessarily weak.

Closed, *privately owned* monopolies, if unregulated, can be expected to exhibit two tendencies *on average*:

- For any given level of costs, they will tend to set high prices, in order to increase profits.

- 'Sleepiness', meaning that they are likely to have higher costs and be less active in product and process innovation, etc. Although they have carrots – financial returns are likely to be higher if performance is better – they do not face the existential threat of being driven out of business or of being severely reduced in their circumstances in the event that performance is poor. There is no *necessity* for managerial performance, particularly in relation to innovation, to be good.

We emphasise 'on average' because there tends to be a greater variance in the performances of closed monopolies than of competitive enterprises. Good performance is not a necessity for survival of closed monopolies, so there can be a tail end of very poorly performing enterprises that are able, because of the lack of alternatives for consumers, to continue operations for many years. On the other hand, in some cases, the remaining incentives are sufficient to induce very good performance indeed, and closed monopolies can in some cases even outshine comparable, competitive brethren (e.g. because they can avoid some of the distractions that competition may bring).

We can summarise these points by saying that, for suppliers in competitive markets, good performance is a matter of necessity, whereas, for closed monopolies, it is a matter of choice.

4.2 Publicly owned monopolies

Managerial incentives in publicly owned monopolies tend to be weaker than in private monopolies, because not only are the existential sticks missing, but the carrots tend also to be weaker: profit seeking is typically not the driving motivation of the owner, and indeed the owners' objectives may be fuzzy/unclear and unstable over time (being influenced by the shifting sands of the relevant politics).

Sir Peter Parker (as he then was), a distinguished and highly experienced industrialist said, of becoming Chairman of British Rail, that it was the first job he had taken on in his lifetime in which he did not know, from one year to the next, what might be counted as 'success'. (We note in passing that fuzziness and instabilities in political preferences also have implications for the corporate governance of publicly owned enterprises – a point that will be developed later – but here we focus on the direct effects on managerial incentives).

There are two consequences of the dulled managerial incentives:

- Publicly owned monopolies do not typically set prices that are high in relation to existing costs. The more frequent tendency is for prices to be set such that profit margins for the enterprise as a whole are lower than normal (although, on a disaggregated basis, some margins may be very high, and some highly negative, reflecting the fact that pricing often reflects political preferences for cross-subsidisation – see our later discussion of the universal service obligation in postal services).

- Publicly owned monopolies tend, on average, to be even 'sleepier' than their privately owned counterparts. That is, they tend not to be active in identifying and driving out cost inefficiencies, and at the same time, are typically less active in innovative activity because the incentives to undertake such actions are generally weak.

Again we stress 'on average'. Weak incentives can give public sector management discretion to pursue different types of business *strategies*, and, in some cases, the discretion has been used to deliver excellent performance. The risks of 'strategic car crashes' and of excessively high costs are, however, much less closely contained, and it is the eventuation of some of those risks that is the chief cause of the low average performance of public enterprise.

4.3 Implications of public ownership for the regulatory model

This brings us to the implications for Guernsey's regulatory model of the fact that two of the utilities in Guernsey remain in public ownership. As has been pointed out by a number of participants in the Guernsey debate, RPI-X(+Y) price control was designed for the regulation of private monopolies, not public monopolies.[14]

The RPI-X(+Y) approach is intended to work as follows:[15]

- Like all forms of price control, a central aim is to prevent prices being raised to excessively high levels in relation to costs. In this way, consumers can be said to be protected against the exploitation of market power.

[14] In very general terms, this form of price control involves the regulator setting a maximum allowable average price (or revenue) path for a set of relevant services for a specified period, which to some degree is independent of the actual costs associated with the provision of those services.

In standard RPI-X approaches, for example, prices are indexed to movements in *non-controllable* changes in the rate of inflation (RPI) and an assumed rate of productive efficiency growth (X). In other implementations, such as that adopted in some sectors in Guernsey, elements of costs deemed to be beyond the influence of the supplier (ie: non-controllable, such as fuel cost changes) can also be incorporated into price changes through a +Y factor, where Y in the change in these costs over the relevant period..

[15] These are the positive aspects of the approach. Like all forms of price controls, the RPI-X(+Y) approach also has disadvantages and limitations. To give an example, in the simple approach there are only weak incentives to improve product quality, if such improvement would cost money: it would not be possible to reflect the increased quality in higher prices. Indeed the incentives are to degrade quality if that would save costs.

- By predetermining prices for a period of several years (i.e. putting the average price level beyond the control of the regulated company), any reduction in operating costs accrues as increased profit to the firm. Assuming that there are profit-seeking pressures on managers from shareholders, managers will have reasonably strong incentives to seek reductions in operating expenditure.

As discussed, however, public monopoly does not usually tend to lead to high margins on average (so the problem-to-be-corrected identified in the first bullet point is unlikely to be a major problem to begin with). And, while excessive cost is a potentially serious issue, it is far from immediately obvious that fixing prices is a good way to encourage cost reduction for a publicly owned monopoly. The thing that links them (i.e.: that links prices to cost reductions) in the case of private monopoly – the profit seeking pressures emanating from shareholders – is typically not there in the case of public monopoly.

It is, of course, possible to go some way, within a public ownership structure, to require those in government responsible for supervising the financial performance of the relevant enterprises to behave 'more like' private shareholders or investors. This, in effect, is the approach taken by State Aid policy in the European Union, which is motivated by a desire to ensure that public investment in enterprises is not used by Member States to distort competition in the internal market. It is not, however, the approach that has been taken in Guernsey.

The States Trading Ordinance 2001 specifies that the States may give guidance as to how the shareholder role is to be exercised, but the legislation states that such guidance can be "only of a general nature", and the relevant committee simply has to "have regard to" the guidance, which means that there is no requirement that guidance should always be followed. More importantly, in relation to the crucial issues of prices and costs, the guidance issued by the States in connection with Guernsey Electricity, first to the Advisory and Finance Committee, and later to Treasury and Resources, says that:

"Financial performance targets for Guernsey Electricity Limited shall be set so as to:

1) *deliver improved efficiency in fulfilling the requirements of the Public Supply Obligation imposed under the regulatory regime whilst drawing a balance between seeking a commercial return on the resources employed and the effect on the community of any increase in charges which may result; and*

2) *achieve as soon as is practicable an appropriate commercial return on the resources employed in the provision of other services."*

The guidance concerning Guernsey Post has been identical, save that the reference to the 'Public Supply Obligation' is replaced by a reference to the 'Universal Service Obligation'.

The key point is that the guidance explicitly envisages a shareholder role that includes the resolution of trade-offs between consumer interests in lower price levels and the potential fiscal burdens that might be caused by prices that are below commercial levels. Whilst this is the traditional approach taken toward publicly owned enterprises, it is <u>not</u> the approach envisaged under the 'independent regulation' way of doing things. The latter works on the basis that shareholders and managers seek higher financial returns, and that the regulator seeks to establish incentives that channel that drive toward cost reduction and performance improvement, rather than toward excessive prices, by setting price caps. The independent regulation 'model' therefore envisages the trade-off between the benefits of lower prices to consumers and the disbenefits of lower financial returns being settled via the interaction between regulator and enterprise management (acting for a financially motivated shareholder), not via a political judgment of the shareholder.

In effect, given the guidance, Guernsey has been operating with two, different, incompatible regulatory philosophies. In this light, it is not surprising that there has been some unnecessary confusion and conflict at times, at least in postal services and electricity. Indeed, it might even be argued that it is a credit to the pragmatism of those involved that things have not been significantly worse.

In the Guernsey context, any leverage that a regulator might seek to exert in relation to promoting cost reductions by means of fixing prices is further eroded by the States' 'save to spend' policy. Whilst we understand that this policy is not a completely rigid constraint on the financial freedom of commercialised public enterprises, in that borrowing is potentially permitted where it can be shown to lead to a future income stream that is more than capable of remunerating such external capital, the fact is that both Guernsey Post (GP) and Guernsey Electricity (GE) have, over time, built up significant financial reserves, so as to be able to finance investment when the appropriate time comes for major, new capital expenditures.

The availability for such financial reserves to managements means that, in the event that revenues do fall short of costs in a particular year, it is unlikely that this will lead to any very

immediate, strong pressures to improve performance. Not only is there no equivalent to the threat of bankruptcy that faces privately owned companies when performance deteriorates, but also there is a source of finance that can be automatically drawn upon to cover the losses. At worst, there will be need for some explanation to Treasury and Resources (T&R) that funds for future investment are a bit lower than projected; but since the consequences of any shortfall might not be felt for many years, it is unlikely that T&R would regard this as a major matter, requiring urgent attention.

Since recourse to save-to-spend reserves by enterprise managements could be impeded by a more activist, shareholder approach to financial matters – for example, by T&R insisting on ring-fencing of the funds, or by requiring that the funds are paid over to T&R for safe keeping – the underlying issues here are just another aspect of the current shape of the shareholder role in the Guernsey arrangements; and, as indicated by the guidance cited above, that role is not currently in tune with the role envisaged for independent regulation.

We conclude, therefore, that there is a serious design issue in relation to the application of price-cap regulation to publicly owned monopolies in Guernsey. Although there is no shortage of examples of such regulation being used in other jurisdictions – postal services and rail networks in the UK, water supply in Scotland, electricity transmission and distribution networks in Australia and New Zealand, airport regulation in the Republic of Ireland – we conjecture that what success there has been is associated with a very narrow shareholder role that focuses on achieving higher financial returns, and that avoids shareholder involvement with other aspects of public policy. Since it is usually harder to motivate public officials to take such a narrow, financial approach, than it is to motivate private investors who have more direct stakes in the financial outcomes, *prima facie* it is possible that there will exist more effective means of achieving the relevant public policy objectives (than price-cap regulation of public enterprises). We will return to this point later.

5. The position in relation to telecoms

In the following three sections we turn our attention to examining the three sectors that are subject of this review: telecoms, post and electricity. We consider telecoms first, because the issues that arise in that sector are distinct from those in post and electricity, for the following reasons among others:

- The incumbent telephone operator, Cable and Wireless Guernsey (CWG) is privately owned, and so the points identified above about the application of the RPI-X price control to public monopolies do not apply. Rather, the fixing of prices by a regulator should be expected to encourage managers, via shareholder influence, to seek to reduce costs to increase profitability.

- There is competition in the provision of telecommunications services, particularly for mobile services, with both large and small operators working on the island.

- As a consequence of competition it appears that the scope of formal price control is dwindling, and that the OUR is clearly moving in the direction of shifting the emphasis toward an *ex post* regulatory framework. In this respect, there appears to be a fairly clear role for a regulator in terms of interconnection rate determinations, and in access adjudications more generally.

- There are no issues related to the States' policy of 'save to spend' in the telecoms sector.

5.1 Assessment of current arrangements

In discussions held with various stakeholders, the overarching impression of the regulation, and performance, of the telecoms sector was generally positive. Although there were one or two recurring concerns raised by some parties regarding specific issues – such as that broadband prices appear to be higher than they should be; and historical issues such as the underlying motivations for, and financial benefits from, the initial privatisation of Guernsey Telecom – the general perception was that regulation 'worked' in relation to telecoms.

Among the reasons put to us for why this may be the case was the following:

- The fact that CWG was a private concern;

- The effect of new entrants on the behaviour and conduct of CWG, which, together with regulation, acted as a 'dual pressure' on CWG;

- The specific characteristics of the sector, particularly rapid technological change which is seen to lend itself more readily to new entry and the development of competition via product and process innovation, and the fact that (unlike say the postal sector) telecoms tends to be capital rather than labour intensive.

Alongside these factors, it was put to us on more than one occasion that the generally positive performance of telecoms could, in part, be attributed to the regulatory framework and to the conduct of regulation in the sector. Indeed, almost all of the parties we spoke to who worked in the sector made favourable comparisons between the OUR's approach to regulation and the approaches to be found in other, small jurisdictions, including Jersey. Specifically, it was noted that entry into the market in Guernsey was relatively unproblematic, as compared to other jurisdictions. Moreover, it was put to us that there have been significant efficiency savings following the privatisation of CWG, and that staff numbers had reduced by over a third without any perceived reduction in quality of service.

Terms such as 'competent', 'diligent' and 'constructive' were used when describing the OUR, and almost all of the respondents we spoke to involved in telecoms did not wish to see the regulatory function withdrawn from this area. Indeed, the opposite view attracted much more support: a number of respondents argued for an expansion of the regulatory remit and powers, and, in particular, some parties argued that there was a pressing requirement for competition law in the sector. There was also a perception by those close to the sector that the relationship between OUR and CWG had matured in recent years, and that the environment now was one in which the different parties (OUR, CWG and entrants) can work together in reasonably constructive ways, notwithstanding the tensions that naturally exist among competing enterprises.

Despite this generally positive perception of the regulatory arrangements in the telecoms sector, it was also put to us that there were still areas of activity that offered scope for improvement. Specifically, some respondents voiced concern about the current approach to

the development of next-generation networks on the island, and in particular, the role of the regulator in facilitating that process. In addition, it was suggested that there are some unresolved issues relating to the Universal Services Obligation (although this was suggested to be more of a public policy issue than a matter for the OUR).

Other points of criticism put to us during the course of our discussions about the OUR's approach and processes, included the following:

- decisions in some key areas were too slow;
- it was sometimes difficult to know when the OUR would reach a decision or issue guidance;
- there was a tendency for the OUR to use external consultants, who did not fully appreciate the Guernsey context;
- models used in financial determinations were not as transparent and clear as they could be;
- parties were not given sufficient time to respond to information requests; and
- there has been a tendency, particularly in the past, for the OUR sometimes to use public relations announcements to argue their case against particular companies.

We are not in a position to assess the merits of these claims on a point by point basis; and we note them in passing chiefly insofar as they reflect views of some of those who are close to the operation of the regulatory system in telecoms. Having had the pleasure/pain of listening to extensive commentaries on regulatory performance in other jurisdictions, however, we did not come away from the meetings with any impression that the regulatory performance weaknesses mentioned were in any sense out of the ordinary. Regulated companies views of regulation are not dissimilar to farmers' views of the weather, and sailors' views of the sea: there is an ever-present recognition that livings have to be made in environments that are not the best of all possible worlds. If anything surprised us in the discussions relating to telecoms, it was the general tendency, on a balance of effects basis, to view the OUR in a favourable light.

The doing a limited number of biggish things well ('LNBTW') test

It is our general assessment that the regulatory framework in the telecoms sector, and the application of that framework by the OUR, pass the LNBTW test. There are a number of factors underlying this conclusion, but in particular, we find that the most important tasks of a regulator in this sector – setting CWG's price control; determining fixed interconnection and access rates and mobile termination rates – appear to be performed to a good standard. Moreover, the regulatory framework appears to have adapted well to the introduction of new competition in the market. Finally, we note, as a general observation that the conduct of regulation in the telecoms sector appears to operate in a constructive environment, for which credit is appropriately due to all participants.

Nevertheless, as in other jurisdictions, a number of important challenges lie ahead for the States and for the regulatory framework in telecoms. Most important among these will be the development of an appropriate policy and regulatory approach with respect to the roll-out of new technologies and next-generation network infrastructure. In this respect we note that the most important 'big thing' for the regulatory framework will be to ensure that the access arrangements are such as to keep markets open to new participants and new ideas (ie: to keep entry barriers down).

5.2 Alternatives to the current arrangements

We have considered possible alternatives to the current regulatory arrangements and whether these may improve the effectiveness of the performance of the telecoms sector in Guernsey. The key point here is that, under alternative proposals, the basic, 'big thing' functions would still have to be addressed, even if the current independent regulatory structure were abolished. Moreover, no alternative way of performing the functions appears to offer material benefits relative to current arrangements. We therefore see no immediate benefits, and some costs, from abolition of the OUR.

There are, however, two adaptations to the current structure which open up possibilities for reducing the regulatory burden in the sector, to a modest extent. First, there could be an acceleration of the current trend toward deregulation of prices. In common with other jurisdictions, the scope of *ex ante* price capping has been reduced over time; and the transition to *ex post* supervision of prices, where the regulator only intervenes in price setting (and other non-price matters) if a complaint is made by a customer or a competitor, could be completed, particularly if Guernsey were to introduce competition law. A

framework of competition law would provide a formal mechanism by which parties could seek to persuade the regulator to investigate particular issues as and when they arise. Such a shift to a competition-law focus over a transitional period could also be consistent with movements toward closer harmonisation with Jersey on regulatory and competition matters (see further below).

While such a possibility appears, in principle, to have merit, we would caution that telecoms disputes, and in particular competition law matters in this sector, can very quickly become litigious areas. We note, for example, that a very large proportion of cases heard before the UK Competition Appeal Tribunal involve issues relating to telecommunications.

It goes without saying that increased litigation in an economy as small as Guernsey's could be very bad news for residents, and that there are therefore potentially high payoffs from developing arrangements for market supervision that minimise recourse to the courts. We therefore strongly recommend the introduction of 'fast-track' arrangements for obtaining second opinions in the event of disputes between companies and regulators. We will consider this later in discussion of appeals procedures in postal services and electricity, but note here that (a) similar reasoning seems to have led, in Guernsey, to the establishment of an appeals tribunal as part of the initial regulatory and commercialisation policy, and (b) the approach appears to have fallen out of favour with the States, possibly influenced by an early and costly conflict between CWG and the OUR. As already indicated, however, subsequent regulatory relationships have been much more satisfactory, and the initial dispute may simply have been the result of early adjustments to a new regime, rather of defects to the regulatory model itself.

The second alternative to the current structure that we have considered is the possibility of closer ties and greater cooperation with the Jersey Competition and Regulation Authority (JCRA). There appears to be widespread recognition in Guernsey of the benefits of closer co-operation with Jersey, and of a pan-island regulatory approach in the sector. This is not just a question of reducing costs, though that is clearly a factor, but also reflects the fact that the regulators in the two islands are, for the most part, dealing with the same companies, who operate on both islands, which face similar issues. There is therefore likely to be considerable benefits in greater coordination of approaches.

At the same time, it is recognised that the underlying regulatory architecture in the two islands is different: the Guernsey approach is based on the Regulation Law with no

competition law in place, while the Jersey approach is based principally on competition law. Deeper cooperation between the two regulators will, to be effective, likely require significant convergence of (currently) divergent policies, and is therefore likely to involve much more than simply sharing administrative resources.

5.3 Conclusions and implications

On the basis of the above assessment, we conclude that the current regulatory structure and arrangements for the regulation of telecoms in Guernsey should be maintained, but that the regulatory framework should be adapted as and when necessary to facilitate greater co-ordination with Jersey.

We endorse the current OUR approach, which contemplates the gradual withdrawal of formal price controls as competition develops further, and a transition in the regulatory approach toward monitoring and *ex post* interventions where necessary. In our view, the transition could be accelerated in the event that the States decide to introduce a competition law. Such a law could also accelerate the development of cooperation with Jersey, although the States will need to think carefully about the precise content of such a competition law, since there will be aspects of it – such as the way in which market shares are interpreted for enforcement purposes – which will need to be fine tuned to reflect the small size of the economy, at least if disproportionate enforcement is to be avoided.

In the interim we consider that the primary aims of the regulatory framework in telecoms should be to focus on keeping entry open to new competitors, which is of particular importance given the rate of innovation and technological change in the sector, and on ensuring that a low-cost dispute resolution process is established. Finally, subject to the provisos made, we see considerable merit in exploring the potential for the fuller harmonisation of the regulatory functions with Jersey.

Implications for post and electricity

Our conclusions in relation to telecoms have immediate and important implications for evaluation of the future role of the OUR in the postal and electricity sectors. Specifically, given our conclusion that the OUR has positive, on-going functions to perform in regulating the telecoms sector, any on-going role for the OUR in regulating electricity and post should properly be considered on an incremental basis.

This means that it is not appropriate to argue that if, say, supervision of GP and GE were taken back within government in some way or another, the OUR could be closed and considerable cost savings made. If the OUR is retained as the telecoms regulator, the savings available would only arise from the cost reductions achievable by shedding the OUR's functions in postal services and electricity. As Table 1 indicates, the bulk of OUR's revenues, and, by implication, its costs, are associated with telecoms regulation. The cost savings achievable from shedding postal and electricity responsibilities probably therefore amount to no more than about £100,000 for each sector. These are not trivial sums in a small community, but neither could they be classified as major savings.

Even modestly successful regulatory arrangements should be able to contribute value added that could justify such expenditures, and so the central questions in postal services and electricity are to do with whether the framework is fit for purpose, and whether, in fact, independent regulation adds any value at all, in a context of public ownership.

6. Post

In reviewing the postal services sector, we have identified a number of major issues surrounding the operation and regulation of Guernsey Post (GP) over the recent past, including:

- Declining mail volumes, which have called into question the sustainability of the Universal Service Obligation (USO), at least at current service levels. This is a not a Guernsey specific issue, and we note the difficulties faced by Royal Mail in the UK, and the recent proposals in Jersey to substantially reduce the number of deliveries and collections each week.

- An attempted diversification by GP into banking which failed at considerable cost to Guernsey residents as owners and, to the extent that there is any subsequent effect on prices, as customers.

- A costly court case, resulting from an appeal by GP against an OUR decision to significantly reduce the scope of the reserved area (i.e. those GP services that are protected from competition from other postal operators). The issues at stake were closely related to the perceived threats to the existing level of local services (deliveries and collections) that might follow if new entrants took substantial business from GP and reduced GP's ability to finance loss-making local services.

- Competitive developments in the bulk mailing sector, including the entry of new competitive bulk mail providers, and the emergence of possible issues relating to the low value consignment relief exemption in the UK which could impact on the ability of new entrants to compete in the market.

- Changes in terms of trading between GP and Royal Mail, resulting in a re-alignment in tariffs for mail deliveries to the UK.

- The existence of a substantial GP pension fund deficit.

The issues related to the pension fund deficit (which are common to many postal operators) are beyond the scope of this report – although we note the extra financial pressure that it implies – but we consider each of the other issues in the discussion that follows.

The USO is necessarily a key plank of postal services policy, and it is the issue that can be expected to be of greatest concern to the people of Guernsey. Although the USO is set by the States not the regulator (the States give directions to the regulator on the relevant matters), it is nevertheless an issue that had a substantial influence on the recent dispute between GP and the OUR, which has cost Guernsey residents a significant sum in legal costs. For these reasons, we begin our review of postal services regulation in Guernsey with a brief discussion of the nature of universal service in the sector; and we state at the outset our general conclusion that, *if the universal service obligation can be put on a more sustainable basis for the future, postal services regulation will be greatly simplified, and will be unlikely to lead again to the kinds of problems that have been witnessed recently.*

6.1 The universal service obligation (USO)

Traditionally, local postal services have been provided by public or private-but-regulated monopolies on terms that involve heavy cross-subsidisation. There is generally a single price for letter collection and delivery (sometimes called a 'postalised' price), irrespective of the fact that delivery and collections costs may vary significantly with location. Some customers pay prices for services that are significantly in excess of the costs of providing the relevant services, and the resulting profits are used to supply other customers at prices that are significantly below the costs of providing the services. Directions of cross-subsidy flows include, for example:

- From services in densely populated areas to services to and from remote rural areas.
- From bulk mail customers to household-to-household letters.

For these arrangements to be viable, there must be sufficient net income from the profitable traffic to support the unprofitable services. The sources of net income (sometimes called economic rents) have traditionally been secured by granting post offices protected/closed monopoly positions. In the absence of competition, postal operators could charge prices for some services which were substantially above costs. In contrast, if unrestricted competition had been allowed, it would have driven prices towards costs, and the sources of net income would have tended to dry up. Moreover, new entrants could be

expected to target highly profitable services first, since, for these services, it would be possible to undercut the incumbent's prices by margins large enough to get customers to switch their business, yet still make a profit.

The world is changing, however, and this traditional type of arrangement is coming under pressure, more or less everywhere, from two types of developments:

- First, there has been an increasing tendency for governments, unimpressed by the efficiency performances of incumbent operators, to open up parts of the market to competition, in an attempt to introduce greater incentives for enhanced performance. Given the political popularity of universal postal services – like the sight of policemen/policewomen on the street, the regular postal round appears to have social value over and above the immediate service actually provided[16] – governments have typically been cautious about opening postal markets to competition. The aim has been to strike a balance; so as to achieve the greatest benefits from the stimulating effects of competition without fundamentally undermining the USO. In the dispute between GP and the OUR described above (now resolved), GP was of the view that the OUR had gone too far with market opening, whereas the OUR was of the view that GP's reserved area was greater than necessary for an efficient operator to be able to sustain the USO.

- Second, and far more threatening to incumbent postal operators than the controlled contraction of the protected/reserved areas, has been the loss of business to electronic communications systems. These substitutable methods of communicating mean that basic postal services (e.g. small letters) are no longer a monopoly, and that governments are increasingly incapable of protecting them from competition. GP is, in reality, *competing* with electronic communications and, in broad terms, is losing local business (at what currently is a relatively rapid rate). This is the existential threat that all competition brings, and it cannot be avoided. However, it does have very obvious implications for the universal service, and for public policy toward the USO.

[16] There are also narrower, economic arguments why the economic benefits of universal service might not be fully reflected in postal revenues from sales of stamps. For example, if a service is withdrawn, the loss to the average consumer is not the value of stamps that might be purchased in, say, a given year, but the amount that the consumer would have been willing to pay to send letters, which will typically be higher.

If the USO is to be maintained at some prescribed level that is loss making, what is required in these circumstances (of erosion of monopoly) is an alternative source of finance to cover the losses.[17] This could be general taxation, but more usually it is via the establishment of a universal service fund (USF), which derives income from a levy on postal services, whoever is the provider, outside the reserved area.

If the business of providers outside of the reserved area is subject to significant rates of erosion, for example because of competition from electronic mail, this may be no more than a temporary holding operation. However, bulk mail comprises substantial levels of delivery of physical objects (DVDs, small electronic components, etc.) for which electronic communication is not such a good substitute as it is for letters, bills, bank statements, etc. The funding source may therefore prove more durable, although this is a matter that obviously needs to be kept under review.

What is wrong with the current USO arrangements?

As required by our terms of reference, we have considered in some detail the evidence that has been put before us in relation to regulatory problems of the recent past in the postal services sector; and we will discuss some of that material later in this section. It appears to us, however, that, notwithstanding the detail, there is a major policy problem that needs to be addressed, ahead of all other issues.

The problem is easily stated, and has at least three aspects:

- the current level of universal service in Guernsey is unsustainable under current funding arrangements because of falling volumes,[18]

- under potentially superior funding arrangements, retention the current level of universal service might still be the preferred option of Guernsey residents, and

[17] As just indicated, we do not take the view that all loss-making services should be closed down. Particularly where there is an element of collective choice, services may have social and symbolic functions beyond the immediate service that is paid for (e.g. the collection and delivery of a particular letter), and may yield economic benefits over and above what is measured by stamp purchases. It is a matter for the relevant communities to decide whether the service is worth the costs of subsidisation, most appropriately via the political system.

[18] We note that the OUR examined the issue in 2006, but volumes have fallen considerably since then and appear set to fall further.

- current regulatory arrangements are failing to give Guernsey residents and States Deputies clear sight of the costs of alternative levels of universal service provision, and hence impeding their ability to make informed decisions on the matter.

A way forward: a universal service fund

Given the above points, we suggest the following way forward, to put the universal service obligation on a more sustainable basis:

i. The OUR should be given a primary duty to assist in ensuring that States Deputies and the public are informed about the costs of providing different levels of universal local services on the island, so that the scope of the USO can be determined from time to time on an informed basis.

ii. GP should, as a matter or priority, prepare estimates of the efficient costs of providing universal service over a range of alternative standards: six days a week collections/deliveries: five days a week collections/deliveries (i.e. not Saturdays); three days a week collections/deliveries; etc.

iii. These costing estimates should be submitted to the OUR for review, and the OUR should set out its views, subject to a standard consultation exercise with all parties.

iv. GP should estimate the financial losses that it would incur in providing the different service levels for a predetermined time period, such as three years (which will require a pricing as well as a cost assessment); and hence indicate the funding requirement necessary to provide the different, defined service levels.

v. The OUR should set out its views on the same.

vi. If agreement between GP and OUR is reached, the amount of funding required to sustain the USO at varying levels is sent to the States of Deliberation, for decision by Deputies as to the level of service that should be provided, taking account of the costs and perceived broader social/community benefits.

vii. The OUR should then determine an *ad valorem* levy on relevant services estimated to be sufficient to raise the necessary level of funding, with an adjustment mechanism for forecasting errors, calculated, say, on a quarterly basis.

viii. If agreement is not reached between GP and the OUR on the funding levels, the issue would be resolved by resort to a specially convened expert adjudication panel (about which see further below).

ix. The written views of the expert panel on the requisite funding level would then go to State Deputies, who would make their decision on the service level and the associated funding level, before asking the OUR to determine an *ad valorem* levy at a rate that could be expected to provide the necessary finance.

Under these arrangements:

- The determination of the reserved area should not be particularly controversial, since its shrinkage would simply imply a wider base on which the USO levy would be applied (the problem at the moment is simply that a contraction of the reserved area necessarily eats into the funding base for the USO). Indeed the reserved area could, in principle, be abolished entirely, yet GP would still be able to sustain the level of service decided by the States.

- The substantive issues that are currently addressed via price controls would be addressed more directly and transparently, via the process set out above. Once the USO funding level has been determined, GP could be left free to set its own prices, constrained by (a) the competition from electronic media at the small letter end of the market, (b) other postal operators for bulk mail, (c) the knowledge that, if it collected significantly more revenue than projected at the USO determination, it could expect to receive lower funding levels when the USO and its funding is reset.

We think these measures would simultaneously:

- Address the issues likely to be of greatest concern to the Guernsey public (the provision of local postal services, and the costs thereof);

- Achieve this in a way that is least restrictive of competition; and

- Allow for a substantial measure of deregulation (the OUR would, under these recommendations, no longer actively fix GP's prices).

The last of these aspects may appear radical, but it does no more than recognise that postal services compete with electronic communications systems. We believe that the OUR recognises this reality and would, in any event, seek to move toward deregulation of prices in future years. Our proposals can, therefore, be seen as serving to accelerate, and better manage, an existing path of evolution for postal services on Guernsey.

6.2 Assessment of current arrangements

The operation of the regulatory framework in postal services was clearly recognised as an area of tension and dispute among the different parties we spoke to. Some parties were of the view that the regulatory approach in this area had been effective in reducing what were perceived to be excessive cost levels/overheads of Guernsey Post (GP), and that recent problems could be attributed to sustained efforts of the OUR to 'break the back' of GP's excessive costs, and to improve productivity.

Other, differing views were also put to us. Among these were that the regulatory framework was rigid and inflexible; that the regulatory burden on companies was significantly disproportionate and too intrusive; and that the regulatory approach was, at times, accusatorial and adversarial. There was also a perception by more than one party we spoke to that regulation had become a vehicle to advance the interests of the bulk mailers.

Among the mixture of points made, there were two specific claims made about the OUR's approach in postal services that attracted particular interest because they resonated with points made in our discussions in relation to telecoms and electricity. The first was that the approach of the OUR tended toward heavy-handedness and was disproportionate, particularly in relation to amounts and types of information requested; and that certain OUR staff had, in the past, sometimes been brusque and dogmatic about issues, which had, at least in part, contributed to the deterioration of the relationship between the OUR and GP. The second claim was that the OUR had, in the past, relied heavily on the use of external consultants to undertake the efficiency reviews, and that the selected consultants tended to bring with them a specific conception of 'efficiency' and how things should be done, and

that they worked to detailed 'models' that were not appropriately adjusted to the circumstances of GP.

There are two general issues here:

- It is an old saying in regulation that, notwithstanding the technical nature of many aspects of the tasks, "people matter". All regulatory agencies are, therefore, susceptible to variations in performance as personnel change. The OUR has a small staff, and is therefore more vulnerable to these effects than would be a larger regulatory agency. In a larger agency, it is only personnel changes at the top level of the organisation that are liable to have significant and immediate implications, but, in a small agency, replacement of more or less any member of staff can have such effects. From our own experience, whilst the quality of recruits to regulatory agencies is generally high, no organisation is fully protected against the occasional lazy person, or (and usually a bigger risk to effective regulation) the occasional zealot. Our proposals in relation to the establishment of an expert adjudication panel discussed below are designed to mitigate the effects of the occasional hiccup in this regard.

- Outside consultants often come with their own preferred approaches and 'technologies', which may have been developed for enterprises very different in size to GP (and GE and CWG). Consultants can sometimes work with old 'technologies'. In the economic field at least, there is often a tendency for consultants to develop a relatively standardised product, since this is easier to sell to multiple clients. Particularly when economic conditions are changing, this can lead to disjunctions between modelling and reality. Precisely because there are a number of features of the Guernsey circumstances that are distinctive, such 'standardised' approaches are best avoided. In future, we recommend that OUR thinks more carefully about its use of outside consultants, although we note that our proposals in relation to (a) deregulation of prices and (b) the establishment of an expert adjudication panel, should mitigate any tendency toward 'standardisation of assessment'.

Given the diversity of views expressed, we judged it unwise to rely too heavily on our general discussions with interested parties in seeking to gain an understanding of the relevant issues. We therefore examined two specific issues/episodes, which appeared

capable of providing deeper insights into the application of the broader regulatory and policy framework in post: the diversification episode, and the reserved area dispute.

The diversification episode

Almost without exception, a topic which arose at meetings we had on the island concerned the implications of the recent strategic initiatives of GP to diversify its activities into financial services, particularly the failed initiative to start a savings bank. Various costs associated with this initiative have been put to us, which are generally in the vicinity of £700,000 to £800,000. On all accounts, however, it is agreed that the diversification episode was a costly failure for GP, and the costs would inevitably fall, in one way or another, on Guernsey residents.

While this issue does not immediately relate to the regulatory framework, or the OUR, it does, we think, highlight broader questions about the adequacy and appropriateness of the current corporate governance arrangements of GP, and in particular: the role of T&R as shareholder; the functions and powers of non executives directors; and the interactions between management, the T&R as shareholder, and other departments of the States of Guernsey, notably C&E. These issues are important as they relate to Guernsey Electricity as well as GP.

We explored these matters in our discussions on Guernsey, and heard a number of views. These ranged from a perception that non-executive directors did an adequate job given their other time commitments and relatively low levels of remuneration, and that they were the best available on the island given the small pool of potential candidates, to the opposite view: that the non-executive directors were completely ineffectual; that there were 'Old Boys' influences at work in the appointment of non-executive directors; and that in practice it was 'remarkable how quickly non-executive directors went native'.

As regards the role of T&R as shareholder, again we heard different views. On the one hand, it was put to us by some that T&R's position as shareholder puts it between 'a rock and a hard place', and that it necessarily has to take a low-key role with respect to the boards of GE and GP, so as to not interfere, and to not be seen to interfere, too actively in the management of these commercialised enterprises. However, the alternative view was also suggested: that the management of the commercialised entities had, in the past, seen

T&R as a mechanism to voice their disapproval of the regulator, and maintain a campaign against the regulatory system.

Notwithstanding these points, the almost unanimous view of the people we spoke to was that the shareholder function was a fairly low priority for T&R, whose interests lay in broader concerns about the island's economy and taxation system. As one respondent succinctly put it, the main interest of T&R in the commercialised utilities was one of ensuring that the 'post was delivered and the lights were on', and that it was not particularly concerned with other aspects of GP's and GE's commercial operations, provided that they were not significantly loss making.

After consideration of the issues, our first conclusion is that, for reasons adumbrated in Section 4 of this Review, public ownership raises particular challenges for the co-ordination of the roles of shareholder and regulator. Traditionally, public ownership has been used as a form of regulation, with ownership and regulatory functions bundled together. Separation of the roles requires an appropriate division of labour between the two functions, and clarity as to what that division of labour, and associated division of responsibilities, should be. We do not think that existing arrangements on Guernsey exhibit such clarity. Without reform, there is no guarantee that episodes like the savings bank episode will not be repeated (and this applies to electricity as well as postal services). Indeed, given the observed, almost world-wide propensity of the managements of commercialised and privatised utilities to diversify, it might be said that such outcomes are positively likely to occur again in the future.

The reluctance of T&R to get heavily involved in supervising the business strategies of commercialised, public enterprises is fully understandable: it is not an area of public policy in which a Treasury or Finance department of government would normally have particular expertise, or seek to get involved. T&R truly does have bigger fish to fry, particularly in the current economic climate.

This, however, leaves some activities of the boards of public enterprises largely unsupervised, at least in circumstances where the roles of non-executive directors are not re-defined to encompass supervisory functions (such as might occur in two-tier board structures).

Lack of supervision of non-regulated activities is, in Guernsey's case, compounded by the point made earlier, that, under public ownership, the price-capping powers of a regulator are a much weaker instrument for influencing cost levels than they would be if enterprise managements were under stronger pressures from outside interest groups (shareholders, debt-holders) to increase profitability by reducing costs.

These points, then, serve to highlight the inadequacy of existing arrangements for performance of the shareholder's or investor's role in overseeing and influencing the Board. In a sense, commercialisation has been only half accomplished. The management of GP and GE have been afforded the freedoms usually enjoyed by commercial managements, but they have not been subject to the normal disciplines and constraints. One of those normal constraints is competition, for which regulation is a surrogate when competition is infeasible. The other is pressure from owners/investors to improve financial performance, and that external pressure is largely missing under full public ownership.

For the avoidance of doubt, whilst it is clearly the case that the missing pressure (in postal services and electricity, but not in telecoms) could be introduced via the introduction of private capital, we are not suggesting that privatisation, or allowing GP and GE access to debt markets, is the only way of completing the commercialisation process. We simply conclude that something is missing from the Guernsey model, and that, if the States do not act to fill the void, the kind of risk that is illustrated by the savings bank diversification plans of GP will likely continue to eventuate.

We also appreciate that, whilst the context is one in which political Deputies may be reluctant to be too involved in the oversight of the commercialised boards, it is nevertheless the case that, in normal circumstances, we would expect to see shareholders, and other investors, taking a more active and questioning role in matters of general business strategy. A considerable amount of analytic resources is typically deployed, on behalf of investors (whether directly, or indirectly), in understanding what the managements of publicly listed companies are up to, in order to be able to value the shares.

It appears to us that one implication of the inadequacies in current corporate governance arrangements is that the OUR has, in effect, been invited to 'step-in' and perform some of the oversight functions that would ordinarily have been performed by the non-executive directors of the board, or by the shareholder. Put differently, the 'gap' in oversight of the operations of the commercialised entities has effectively put the OUR in a position where it

represents the only form of external challenge to the management of the commercialised entities, rather than being only one of two, major sources of challenges to, and constraints on, enterprise managements.

Given the earlier criticisms of the OUR for being over-intrusive in its approach, we conjecture that one possible causal factor here may be the weakness of external shareholder pressures, and hence a tendency to substitute regulatory solutions for those absent pressures. That is, the OUR may have done too much because government has done too little.

Although this may be a situation that can have certain attractions – politicians can avoid difficult decisions to resolve awkward and unwanted trade-offs, and criticism can be offloaded on to a (conveniently unelected) regulator – it is not a situation that can be expected to work well for consumers and taxpayers over the longer term. Our general recommendation on these matters is therefore that policy should be rebalanced, toward stronger corporate governance focused on improving enterprise performance coupled with more limited regulation.

The reserved area dispute

As noted earlier, issues surrounding the scope of the reserved area were one of the triggers for the Requête, and were the central issue of dispute in the recent legal proceedings in the Royal Court. If the proposals discussed above relating to the introduction of a USO fund were adopted, we are of the view that this issue should not arise again.

Nevertheless we consider the reserved area dispute to be worth discussing here because it has led us to a more general conclusion: that, far from being simpler, regulation in a small governmental system is, in many ways, more complex than in a large system, most conspicuously because of the entanglement of other issues, and of personalities, with regulatory processes and decisions. The theme for this sub-section of the Review might, therefore, be said to be *"A prophet is not without honour, save in his own country, and in his own house."* (St Matthew, 13:57)

To repeat an earlier point, it is a standard view in the study of regulation that 'people matter'. Major regulatory reforms happen because of the personality and drive of a particular regulator; and dysfunctionalities can develop because of personality clashes

between individuals. Most importantly, issues can become entangled: information from other contexts can be wrongly imported into decision making where that information is not relevant at best, and misleading at worst.

On reflection, we think these general tendencies are rather more pronounced in small systems for reasons which now appear to us obvious, but which were less obvious before our discussions. The discussions were focused on technical matters, but we encountered a not inconsiderable amount of gossip as well.

On the technical side of the restricted area dispute, we found that there was a degree of 'suddeness' in the final decisions of the OUR on the reserved area issues, in the sense that earlier documents did not prepare the reader very well for what was to come. We also found that, particularly given the points above about competition from electronic mail, the OUR's information gathering was more intensive than we would have expected.

In relation to the latter (information gathering point), we conjecture that in this particular case:

- Personalities may have played a role.
- The use of an outside consultant resource may not have helped as it should.

In relation to the 'suddenness' of the decision eventually made, we conjecture that this may have been triggered by an element of frustration on the part of the OUR. As noted above, the regulatory model being applied was not designed for publicly owned enterprises: OUR was chiefly interested in squeezing inefficiencies out of GP, but the chief instrument available, price control, does not work directly on costs in a publicly owned monopoly. At the same time, GP's management appears to have formed an impression that the OUR could get nothing right, which is implausible in the light of telecoms experience, and hence indicative of other factors at work. The lack of GP's progress on certain matters seems to have caused the OUR to lose patience.

The inherent limitations of the standard regulatory model when applied to a public enterprise such as GP, subject to weak, external financial pressures, particularly when coupled with personality issues, appears to us have been a major contributing factor to the tensions surrounding the reserved area dispute. A further exacerbating factor may have

been the States' save-to-spend policy, which further reduced the leverage on cost cutting from price setting (see section 4 above).

Overall, we conclude that, on this occasion, the regulatory system cannot be said to have passed the LNBTW test; particularly when account is taken of the costs of the court case.

6.3 Alternatives to the current arrangements

The preceding discussion has highlighted an important possible alternative to the current regulatory arrangements – in the form of the establishment of a USO funding mechanism – which should allow for deregulation of prices, and, at the same time, help avoid costly and protracted disputes about the reserved area in the future. However, we have also outlined other weaknesses of the current regulatory framework, which include: the governance and oversight arrangements for the commercialised entities and the effects of dysfunctional relationships on the operation of the regulatory system. Unlike the USO funding proposal, the recommendations set out below are potentially relevant to the electricity sector, as well as to post.

Governance issues

We (like the National Audit Office, and others before) have considered some of the issues surrounding the governance arrangements for the commercialised utilities, particularly the role of the non-executive directors and the role of T&R as shareholder. As a general observation, we do not think there is an obvious 'off the shelf' alternative structure which could improve upon the current arrangements, although there may be ways of reforming the current structure to allow for greater scrutiny and oversight. This suggests that there may be value in considering some more radical options, as well as the more incremental recommendations set out below.

As regards the non-executive directors, we suggest that it may be important to focus not only on the process of appointment (to make sure that potential talent can be drawn from a bigger pool), but also on the criteria that are applied when considering the merits of different candidates. In terms of the appointments process, our understanding from discussions about the current arrangements is that potential appointees are proposed by the companies and that there is very little challenge to, or scrutiny of, the appointments that are proposed by the executive management. Slightly contrary to the view we cited

earlier, to the effect that non-executives quickly go native, this process may be biased toward appointments who are native to begin with.

In terms of the criteria applied when reviewing the suitability of potential applicants for non-executive director roles of the commercialised entities, we conjecture, from our discussions, that while some very able people have been appointed to the boards in this capacity, they have not necessarily been people with the right, or desirable, qualities to perform the role effectively. Ideally, the States should give general guidance on policy/strategic matters, and what is therefore more likely wanted in non-executive directors, are people who have Scrooge like characteristics when it comes to making use of other peoples' money, coupled with the inclinations of investigative journalists in relation to some of the things they might be told by executive management. These characteristics may not necessarily be highly correlated with past business success.

In relation to ways of enlivening the role of the shareholder, a number of alternative possibilities were put to us. One general alternative, which we discuss in detail below in relation to GE, is to privatise the commercialised entities. While we recognise that this is a possibility that has merit, we are not in a position to assess the feasibility, or likelihood, of this happening in relation to GP (or GE); this is firmly a matter for the States and we do not enter into a further discussion here.

Other alternatives put to us included the suggestion that the role of shareholder might be transferred to the Commerce and Employment department, or to another States department. This suggestion is not a new one, and we note that, in the original plans for commercialisation, there was a similar debate about whether the shareholder function should be performed by the Advisory and Finance Committee or the Board of Industry. The case for C&E to assume the role is now, as then, based on the argument that C&E would be able to afford the role greater attention, and that it is generally consistent with the broad skills and mandate of that department. While this alternative may have merit, we note that, under the current structure, T&R has expressed concern that its shareholder role is at risk of being politicised, and that it may consequently become too active in its dealings with the commercialised entities. General experience of regulation indicates that this is a serious risk – in the relevant literature it is referred to as 'regulatory capture' – and we do not see how shifting the shareholder function to another department would alleviate this concern.

More radically, it was put to us that the role of shareholder of the commercialised entities might be more effectively performed outside of the immediate political structure, particularly given that its focus should be on improving the *financial* performance of the relevant enterprise. We understand, for example, that the States of Jersey are in the process of considering the feasibility of a 'shareholder resource' in relation to its public enterprises, aimed at providing better definition of the role, and greater coherence in its execution. Specifically, it is our understanding that such an approach is intended to create a 'buffer' between the Ministers and the Boards of the utilities, and would involve the establishment of a dedicated, professional capability within the Treasury department, responsible for engaging with the each utility and holding it to account in terms of its performance against its plans and shareholder objectives. We have not been able to investigate this in great detail, but recommend that this option be examined further, particularly given that there appears to be general support on the island for greater harmonisation with Jersey (the two Islands might usefully share a common shareholder resource).

Mitigating the effects of dysfunctional relationships

A view that we share with the previous reviews of regulation in Guernsey, and one that featured in almost all of our discussions, is that relationships in the regulatory sphere in Guernsey can quickly become personal and fraught. Whilst many of the technical issues addressed by regulatory policy might be considered to be 'as dull as dishwater', personality issues are not: the local media have, in their own words, noted that regulatory 'spats' make for 'entertaining news copy'.[19] Unfortunately, too much news copy can undermine trust between the parties, reduce the scope for informal dialogue and communication, and potentially be of detriment to the broader regulatory framework (and the Guernsey consumer).

One suggestion put to us to assist in the mitigation of the effects of rogue personalities and dysfunctional relationships, which we have considered carefully, is that the OUR move to a Commission system, similar to that used in Jersey for its competition law authority, and used by many regulatory agencies elsewhere. We have experienced these alternative approaches in operation in the UK and in other jurisdictions, and are not convinced this would help. Commissions do tend to de-personalise things a little, but by no means completely. Commissions can also be less innovative, in classic committee ways, which can be a disadvantage in sectors subject to major change, where good regulation needs to adapt

[19] Guernsey Press 'Opinion' 5 April 2010.

quickly to changing technologies and market environments. Crucially, in a small system, it is likely to be more significantly more costly than feasible alternatives, at least if Commissioners are expected to do significant work rather than simply be ornaments.

The approach we would favour to deal with substantive matters of disagreement between the OUR and the companies it regulates would be to introduce a mechanism that provides for the taking of a second opinion on disputed matters into the institutional architecture. Specifically, our proposal is to constitute a small expert panel on standby, to be called (and remunerated) on an 'as needed' basis, to adjudicate on disagreements between the regulated companies and the OUR ('an adjudication panel'). The decisions/opinions of the panel would have no formal standing in law, but they would be written down and would gain authority from the standing and experience of their authors.[20] If, in the event, the OUR did not accept the recommendations of the Panel, it would be required to explain its reasoning for the rejection in writing. The expectation would be that decisions/opinions of the panel would be accepted by the Regulator, not least because they could used in court proceedings in the event of any formal appeal. Rejection of a panel's opinion coupled with a subsequent adverse decision from the Royal Court could be expected, with reasonably high probability, to be terminal for the career of a regulator, in the Channel Islands at least.

In relation to this proposal, we note the following:

- In our conversations on the island we found widespread support for the idea that a more informal (than recourse to the Royal Court), first instance, disputes resolution process should be put in place.

- Support was based on the reasoning that the ability to obtain an authoritative second opinion on disputed matters can provide for a quick, relatively inexpensive and focused way of resolving specific matters as and when they arise.

- A similar, though not identical, arrangement to what we have in mind was proposed by Ofgem in GB in 2000 in relation to proposals for reforms to the supervision arrangements for wholesale electricity markets, though they were not introduced at the time and were subsequently overtaken by developments, including wider reforms in competition law.

[20] Depending upon the preferred approach the States might also consider directing the OUR to have the 'utmost regard' to the views of the panel.

- The Aviation Appeals Panel (AAP) in the Republic of Ireland is another, similar but not identical, example of the approach. The AAP is constituted as and when needed to hear 'appeals' by interested parties against decisions of the airports regulator, whose major task is to set price caps for (the publicly owned) Dublin Airport. The AAP's decisions are not legally binding on the regulator, who is simply required to reconsider the relevant matters, but this can be enough to settle matters without recourse to the High Court in Dublin.

- The proposed arrangements are also not entirely dissimilar to an approach already employed successfully in Guernsey. In 2006, an Independent Expert Panel was appointed by the OUR to consider issues relating to the valuation of the initial assets of GE, a difficult and potentially highly contentious issue at the time. The Panel was characterised by the distinction and experience of its members – Sir Ian Byatt, Chris Bolt, and Professor David Newbery – and the (not unrelated) brevity and crispness of its reasoning and recommendations. This report was praised by most parties, including parties from different sides of the arguments, and appears to have produced generally acceptable outcomes.

6.4 Conclusions and implications

We have found that the current regulatory structure and arrangements for the postal sector have not performed effectively in the recent past; (more importantly) are not fully adapted to handle future challenges, particularly the erosion of the current sources of funding for the USO; and are in need of reform.

Looking forward, the priority is to address the issues surrounding the USO. The current objectives of the OUR are not structured so as to give this issue top priority, and, in any case, we are of the view that it is a matter chiefly for the States, not for devolved regulation, since it raises issues of, in effect, taxing some postal services (or, in the alternative, to raise general taxation) to subsidise other postal services. Tax and spend policies are matters for parliaments, not for regulators, although the latter may be afforded a role in implementation of decided policy.

We have outlined one possible method of approaching the issues, based upon funding the USO from a levy on all postal service providers, and not just GP; which, in our view, should be the preferred approach. It would likely have a number of immediate benefits, including:

- It should prevent issues like the reserved area dispute arising again in the future, at least with anything like the level of significance that the recently settled dispute acquired.

- Once the USO funding level has been determined, the role for the OUR could shift away from a determinative role in price setting (where things have not gone well) to tasks that are more to do with ensuring fair competition, advising on the USO, and dealing with implementation issues in regard to the USO. Specifically, GP's prices could be deregulated (although they would, of course, be subject to guidance from the shareholder).

Even allowing for the effects of such changes in the regulatory arrangements for postal services – which we consider would be significant – there will still remain issues regarding the adequacy of the governance and management oversight arrangements for GP. As explained, while some of these issues are not of direct relevance to the regulatory regime (such as implications of the diversification/savings bank episode), to the extent that the regulator is required to assume, by default, a role that should be performed either by the non-executive directors of GP, or by the shareholder, they can become relevant. We will pick up on these points in more detail in the next section in the context of GE.

7. Electricity

Despite the fact that the electricity sector has not been subject to the same level of market and technological change as the telecoms and postal sectors, we have found it to be the most difficult sector to assess in terms of the impacts of the regulatory regime, and also the most challenging in terms of proposing practical alternative ways forward.

There are, in our view, a number of reasons for why the issues in this sector are so difficult, but one factor that seems of particular relevance is that the disputes between the incumbent provider, GE, and and the regulator, have been sustained, at relatively high intensity over a long period. This is different from telecoms, where there was a major dispute following privatisation, but there has been a long, 'quieter' period since, and also from postal services, where, despite disagreements stretching some way back, things only came to the boil relatively recently.

Indeed, from the evidence we have seen, GE has questioned the legitimacy of the OUR more or less from the beginning, and, whatever the merits of the arguments on each side, it is somewhat extraordinary that one part of a system of government – and GE is a state-owned enterprise – can, for so long a period, openly challenge the legitimacy of another part of the system of government, without the matter being resolved by the government itself.

We suspect that the history has deeply affected the relationships between all parties, and, perhaps more importantly, has affected the implementation of regulation to such a degree that important issues have not, and are not being, addressed in cool-headed and informed ways. Whilst it appears, from the materials we have seen, that the relationship between the OUR and GE improved for a short period following the NAO Report, after the States instructed the parties to get along better, the wheels quickly came off again. We consider why this may have been the case in some detail below.

As a preliminary point, we state our view that GE's concerns about the regulatory arrangements were not, in our view, spurious. In this respect, we recognise, in particular, GE's reliance on views expressed in 2006 by Professor Stephen Littlechild (one of the original architects of the UK regulatory model) to the effect that the standard RPI-X regulatory arrangements are not well designed for public ownership, and are inappropriate in the small-island context of Guernsey. While we have discussed the small economy issue in Section 2 (and disagree with the general proportion that regulation cannot be made to work

in a small economy -- for example, because of our findings in relation to telecoms), our conclusion here follows from the reasoning set out in section 4 above: in particular, we think that the standard price control model lacks leverage in providing incentives for cost reduction in the public ownership context, and that the problem is exacerbated in the Guernsey context by the absence of a performance-focused exercise of the shareholder function, and by the softening of cost-reduction incentives caused by the 'save to spend' policy.

We note, however, that Professor Littlechild's main proposal was that the supervision and oversight of GE's activities be transferred from the OUR to T&R. For the reasons already discussed in the previous section in the context of GP, we consider there to be fundamental corporate governance issues that put serious question marks against such an alternative in the specific Guernsey context. In any event, it is our understanding that T&R made it clear that they did not want to assume such a role when the matter was considered in 2006/7, and that that view was widely supported among Deputies. In the course of our discussions we found no evidence to suggest that the policy position has materially changed since that time, and we have therefore not considered the proposal further.

This history appears, to us, to provide another illustration of the problematic shareholder role: the current position appears to be 'pass the parcel' on enterprise governance issues. As in relation to postal services, one of our general conclusions from the history of commercialisation in the electricity sector is that, to the extent that the OUR may have been over-active relative to the 'light handed' regulation anticipated by at least some Deputies at the time of the establishment of the OUR, one of the principal causes appears to be that other parts of government have been under-active in taking responsibilities. In the American idiom, the OUR has been left 'batting cleanup'. As stated earlier, the OUR might have done less, if others had done more.

That is, however, largely a matter of history now; and of more importance is the future. GE has continued to press for a change in the form of the supervision arrangements which has been rejected in the past, and which, from our discussions, does not attract significant support today. There is an element of Groundhog Day about this: and the position is surely unsustainable and a resolution of the issues is called for. This is perhaps the biggest single issue that we have encountered in the course of this Review.

7.1 General issues in the electricity sector

Before presenting our assessment of the performance of the regulatory regime, we outline some of the broader contextual issues that appear to be shaping the way in which regulation has operated, and which, we believe, are going to become more important in the future.

The States energy policy

It is not for an independent regulator, such as the OUR, to determine matters in relation to security of supply and the environment. These are clearly questions of energy policy, and responsibility appropriately lies with the States.

Nevertheless, it is our view that, while a clear demarcation in roles and responsibilities between the States and the regulator is appropriate, it is also the case that the regulatory framework, as applied to the energy sector in Guernsey, would benefit from a clear and stable articulation of a coherent energy policy for Guernsey. In this way, the more technical decisions could be better adjusted to contribute to public policy objectives in an efficient way.

There was considerable ambiguity evident in our discussions regarding the status of any energy policy in the States. Our understanding is that, while an Energy Policy Report was prepared in 2008 and tabled to the States of Deliberation, it was simply formally noted at that time, and it was said that further work identified in that report was to be pursued. No subsequent, major statement on the relevant matters has been drawn to our attention, and, in this sense, we have been unable to locate a formal energy policy for the States.

In our view, this is not a clear and stable framework within which regulatory policy can be expected to operate. It is beyond the scope of our remit to comment in-depth on the substance of any energy policy, but we note simply that the continuing lack of clarity can be expected to have a negative effect on the effectiveness of regulation going forward.

Indeed, the absence of a settled energy policy could fundamentally undermine both independent regulation of the sector and its efficient management. Major lessons of the UK experience with nationalised industries, and the subsequent experience of independent regulation, are that:

- Volatile and unstable political preferences made effective management of the industries extremely difficult to achieve (here we refer again to the statement of Sir Peter Parker noted in section 4 about what constitutes 'success' in such a context).

- Independent regulation was, among other things, intended to reduce the influence of these instabilities on commercial decisions, and it has generally succeeded where such 'de-politicisation' has proved feasible and durable.

The significance of these points in relation to electricity regulation cannot easily be understated. Today, energy policy is driven to a very large extent by environmental considerations. Hence, for so long as there is not a settled viewed on environmental matters within a jurisdiction, and for so long as policy tomorrow may be different from policy today, and different again from policy yesterday, instabilities in political preferences will continue to exist and, given the high significance attached to the environmental issues, can be expected to undermine independent regulation and good management alike (e.g. major investment projects will tend to become snagged up in what are really disputes about unsettled aspects of energy policy).

Competition

As noted in section 3, we were surprised at the extent to which those we spoke to viewed competition as largely inconsequential in the electricity sector, and as likely to remain so. We do not agree with this consensus for a number of reasons, including:

- There is latent competition in generation between on-island generation (GE generation) and generation in France (by EDF). If, as is the case in the UK, there were greater separation among the various activities that comprise GE – generation, distribution, supply, goods retailing, and systems operation – GE supply/distribution would need to purchase its power from one of the competing generators. This could be (the separated) GE generation on-island, EDF via the undersea cable, other continental generators, or other generators located on Jersey. It may even include small scale distributed generation on Guernsey.

- For the future there is the possibility of developing new generation technologies such as tidal/marine power.

- There is potential competition in reserve generating capacity. The current security of supply policy requires all imported electricity, and then some, to be backed up by Guernsey generating capacity. As Byatt, Newbery and Bolt noted in their expert report for OUR in 2006, this implies that electricity generation on Guernsey is very capital intensive – large amounts of capital are required to generate relatively small amounts of electricity – which contributes to higher costs.

  It is our understanding that some back-up capacity already exists on-island, for example, back-up capacity owned by CWG (for its servers), by the Princess Elizabeth hospital, etc. Since it exists for the same purposes as GE's back up plant (to operate in the event of a disruption to supplies from normal sources) this capacity should be remunerated on a broadly equivalent basis to GE's own reserve capacity, so that there can be at least some competition in this area. This would be likely to reduce costs, and could potentially lead to some innovative, alternative ways of achieving security of supply objectives.

- Finally, when a micro-generation unit is installed in a property, the owner effectively becomes a self-supplier, in competition with GE at the supply level. More generally, the development of load/demand management can serve to reduce demand for supply from GE, and also possibly contribute to that demand becoming more price-sensitive. Such developments have similar effects on GE to the effects of a competitor (who steals business, and makes business more sensitive to pricing).

For reasons explained earlier, we expect competition issues generally to become more important in the future, unless the development is prevented by inappropriate energy policy. Our view then is that energy policy and regulatory/competition policy should work together to promote the kinds of innovations and adaptations that will be required in the future.

Save to spend, cost cutting incentives and investment programmes

There are a number of well-recognised issues surrounding the States' 'save to spend' policy for the commercialised utilities, and the impacts such a policy may have on the incentives of the commercialised companies. The conservatism underlying the policy appears to have its roots in general fiscal policy, and we understand that there can be exceptions to this general

policy in funding projects that will create an income stream (we would conjecture that some investment in electricity systems could fall into this category).

What appears to be less widely recognised, however, is that the States' 'save to spend' policy reflects a particular intergenerational trade-off, and this raises questions about intergenerational equity. More specifically, one effect of the policy's application in the electricity sector is that *current* electricity consumers are, in effect, paying for assets that will only be used by *future* electricity consumers. This violates one of the ancient principles of government provision, called the 'benefits principle', which suggests that payments (sometimes in the form of taxation) should reflect, at least to some extent, the benefits received from the government services.

We appreciate from our discussions that there is a reluctance to allow the commercialised entities to borrow any funds at all. However, we agree with others who have reviewed aspects of public policy in Guernsey in thinking that this may be too extreme an approach, and note that a policy of fiscal conservatism can still be maintained, as a matter of States policy, by placing a fairly restrictive upper limit on the gearing of the commercialised entity. An immediate effect of allowing borrowing to some degree is that some of the capital costs associated with the new assets will be transferred to those who will benefit from their use. There are also likely to be potential benefits for the regulatory regime in allowing GE (and GP) to borrow. The availability of cash reserves, accumulated for future investment, means that the budget constraints on GE management are softer than would otherwise be the case, and as discussed earlier, this further weakens leverage on costs that might come from fixing prices. Put differently, one possible effect of the save to spend policy is that it reduces the incentives for GE and GP to focus on cost cutting measures. Moreover, it can potentially reduce incentives to produce robust and well justified 'business cases' to underpin their proposed investment plans

In any event, it is unclear to us how adequate the reserves built up under the policy might be in practice. In electricity, for example, there are currently significant investment requirements, but the cash balances have not been built up to the extent necessary to fully finance GE's forward looking programme. As a consequence, it is likely that prices will have to increase significantly in order to address these future capital investment requirements. Table 4 for example, shows that over the next ten years the amount of annual forecast capital expenditure is expected to increase by 100%, and that in 2016/17 the forecast capital expenditure *in that year alone* will be 86% of the closing save to spend balance.

Table 4: GE's save to spend and capital expenditure forecasts - 2007/08 to 2016/17 (£M)

	Save to Spend closing balance (£M)	Forecast capital expenditure (£M)	Forecast capex as a % of save to spend balance
2007/08	18.5	6.0	32%
2008/09	21.5	4.5	21%
2009/10	27.0	2.5	9%
2010/11	28.5	7.0	25%
2011/12	25.5	9.5	37%
2012/13	25.5	6.5	25%
2013/14	24.0	8.0	33%
2014/15	22.5	8.5	38%
2015/16	18.0	11.0	61%
2016/17	14.0	12.0	86%
Net change 2007/8 to 2016/17	**-4.5**	**6.0**	
% change	*-24%*	*100%*	

Source: Broad estimates based on figure 6.1 of GE Price Control Final Decision February 2007

7.2 Assessment of current arrangements

It was the general perception of those that we spoke to that the regulatory framework as applied in electricity had failed in the time since commercialisation. Of course, views differed widely as to sources or causes of the failure, but the general perception was one that things hadn't quite operated as they should have.

Some parties put to us that it was not the regulatory approach or framework that was inadequate, but the intransigence of GE, and its failure to recognise the legitimacy of the OUR. More specifically it was argued that GE had, for many years, seen itself as operating autonomously and in some respects outside the control of the States.

Perhaps unsurprisingly the opposite view was also put to us: the source of difficulties in the sector was an over-active and intrusive regulatory approach which was disproportionate, and did not clearly assign roles and responsibilities. Other more specific issues put to us included: that the OUR did not effectively communicate its longer term work programme; that the OUR sought to constantly second-guess GE's strategic and investment plans; and

that particular personalities made the relationship between GE and the OUR unnecessarily adversarial.

As noted above, more fundamental issues have also been suggested for the perceived failures of the regulatory regime in electricity, in particular: that the regulatory model has been inappropriate and the size of the market has not lent itself to the type of regulatory framework adopted.

Consistent with our approach in the earlier sections we have not sought not assess the individual merits of these various claims, but have used them to try to detect patterns that might help to us to identify the underlying issues and problems. In electricity, the discussions have led us to consider three specific matters, which we suspected might provide insights into the workings of the Guernsey regulatory system: two episodes involving the determination of the pass-through of changes in certain cost elements, and an issue concerning the structures of electricity tariffs.

Perhaps the most contentious matter in the relationship between the OUR and GE in recent years has been the issue of cost-pass through. In simple terms, the relevant questions have concerned whether, how, and when, GE is allowed, under its current price control settlement, to recover the costs associated with significant increases in (a) allowed fuel costs incurred in operating its own generating sets on the island and (b) the costs of electricity it purchases from EDF via the undersea cable. The matter raises issues of both process and substance.

It should be said at once that the rationale for a cost pass-through mechanism is not a matter of dispute. Under the standard price-cap model of regulation, it is normal to recognise a distinction between those costs over which a utility has a reasonable degree of control, and those over which it does not. In the case of GE, the latter category would include changes in fuel costs that are the result of changes in world prices of oil and its derivates, and also the cost of electricity purchases from EDF (where, although GE might be in a position to negotiate slightly better or worse terms, it cannot reasonably be expected to be able to avoid major swings in continental market prices for bulk electricity).

Where non-controllable costs are a significant fraction of total costs (as they are for GE), the resulting pricing formula is usually said to be of the RPI-X+Y type, where Y denotes the changes in the non-controllable costs that are allowed to be passed through, automatically

into retail prices. This formula was first used for British Gas in 1986, so we are not dealing with anything very innovative; and the fact that it can be expressed algebraically is an indication that the pass-through calculations are, or should be, formulaic and mechanistic.

Cost pass through: episode I

In terms of process, we have reviewed the timing and content of the consultations on the cost pass-through mechanism when it was first proposed to be introduced, and the final decision itself, in early 2007. We have also reviewed exchanges between the OUR and GE on this issue. In this respect, we were struck by correspondence from the OUR to GE, only days before the publication of the final price control decision, in which various alternative options for dealing with pass through costs were identified. This reveals that the precise details of the proposed pass-through mechanism were quite ambiguous and vague, even right at the very end of the price review process. This is highly abnormal relative to conventional practice. We would have expected to see clarity and precision on this issue, which, as the later evidence shows, relates to very major influences on the electricity prices paid by consumers. It is precisely to deal with technical tasks such as this that regulatory specialists are appointed, and the task in question was not a particularly challenging one intellectually.

An equally, if not, more important issue is the substantive form of the final pass-through mechanism adopted in the price control. A useful comparison when thinking about how a pass-through mechanism should operate is a long-term commercial contract. In such contracts, is not uncommon for provision to be made for various unforeseen changes in those variables which can be expected to have the most material impacts on the commercial value of the contractual arrangements. Thus, for example, long-term energy supply contracts typically contain various types of indexation provisions, which link the price paid to movements in measurable indices (such as the RPI, the producer prices index, oil price indices, gas price indices, bulk power price indices, coal price indices, and so on). The terms of the contracts will typically define precisely what indices are to be used, and how they are to be used in calculating contract prices. Ambiguity here can be expected to lead only to costly contractual disputes later, and, wherever realistically possible, it tends to be carefully avoided.

The cost-pass through mechanism adopted in the GE price control contained avoidable ambiguities, largely because it was not specified at a requisite level of detail. While the OUR

decision document did present worked examples of how the pass-through mechanism *could* work, it lacked precision, and the language implied that there would be later, discretionary choices (for the regulator to take) in relation to some of the elements of how cost pass through would work. This was highly non-standard.

We necessarily conclude that fault in determining the flawed, final form of the pass-through mechanism rests with both parties. While the OUR proposed the mechanism, GE accepted its form in accepting the final decision. However, we would qualify this assessment by noting that the extent of fault of GE is partly mitigated by a number of factors: the process by which the pass-through mechanism was proposed; an understandable reluctance to use the 'nuclear option' of appealing this decision to the Royal Court; and finally, the fact GE was under general instructions from its shareholder to cooperate with the OUR following the NAO Report.

Irrespective of the relative balance of fault, our conclusion is that, in this episode, the regulatory system failed the LNBTW test.

Cost pass through: episode II

Unfortunately, the failure of the regulatory system in the cost-pass through decision appears to have had significant and on-going effects. Lack of precision in the decision meant that there was ambiguity in how, if at all, changes in the sterling/euro exchange rate should be reflected in prices.

Again, we think that there should have been no substantive issue in resolving the ambiguity, once it became clear that it was a significant issue. To the extent that GE's fuel input costs and its bulk electricity purchase costs, *measured in sterling*, changed in consequence of exchange rate movements, such changes should be allowed as a cost-pass through item.

In the event, the OUR interpreted its final decision as meaning that the sterling/euro rate should be held fixed, at the value shown in its 'examples of calculations' around the time of the decision. On this interpretation, GE has been exposed to the full risk of variations between the actual euro/sterling exchange rate and the exchange rate used in the calculation examples. The issue became a very major one because of the subsequent, substantial movements in the sterling/euro rate, and was exacerbated by another provision

of the final price control decision, to the effect that changes in non-controllable costs could only be passed through after a lag of two years.

The cost-pass through element of the price control formula formed the basis of numerous exchanges between GE to the OUR, over a period of more than a year, during which GE requested a re-examination and adjustment of the pass-through mechanism to correct for this exchange rate exposure. In response to these requests, the OUR's general position was that, if GE wanted to adjust the pass-through mechanism it would be necessary to re-open the full price control decision.

The OUR's position on re-opening the price control decision was in line with normal practice in the conduct of regulation, which is designed to prevent cherry picking by regulated companies. That is, if a particular aspect of a price control settlement turned out to be unfavourable to the regulated company, but other aspects turned out to be more favourable than expected, there is obvious merit in preventing the regulatee from being able to insist on only the unfavourable development being reassessed. In this case, therefore, we think that GE should simply have asked for a full re-opening of the price cap (even though there was only one issue that it wanted resolved), and that it can be faulted for not so doing. It is perhaps indicative of a lack of trust that it did not do so, perhaps expecting that this would lead to a very major regulatory exercise, with its attendant costs. However, lack of trust can be self-fulfilling, and the amounts of money potentially at stake would have still justified the costs of an extensive exercise.

On the other side of the fence, it should have been clear to the OUR that there was an ambiguity in the final decision, that this was a major weakness, and that the matter should be cleared up in an administratively efficient manner. Without in any way abandoning the formal (and correct position) that a re-opening of a price control necessarily meant that any issue could be considered, OUR could have indicated to GE that, in the circumstances, it could see that the exchange rate issue was of a special kind – relating as it did to imprecision and ambiguity in the final decision – and that, in the event of a re-opening of the decision, that is where regulatory effort would be expended. Again, we think that it may indicative of a failed relationship that such simple steps were not taken.

Instead, after further correspondence on this matter, the OUR appears to have launched an investigation of GE's approach to the treatment of foreign exchange costs, and in particular its approach to hedging. As far we can discern, the OUR may at this point have taken the

view that that GE was aware, or should have been aware, of its exposure to the sterling/euro exchange rate, and that it should have taken measures to protect itself from risks of exchange rate fluctuations. If that was the case, our view is that it amounts to compounding error with error.

There is nothing inherently inefficient in a regulated company deciding not to hedge its exchange rate risk, or deciding to hedge it only partially (in whatever proportion it chooses). A hedge is a bet on future exchange rate movements: making the bet will cost something, and, at the time of making it, there will be prospects of losses as well as gains. The fact that GE would have done better to hedge is wisdom gained only with hindsight: there was no way that this could have been known at the time of the decision.

There is no reason for GE to think that it had any particular expertise in currency trading, so it unsurprising for us to learn that GE had not developed sophisticated hedging strategies. More generally, in a small economy, it might be considered more appropriate and effective for exchange rate hedging decisions to be the responsibility of a central treasury function, as it often is in large commercial companies running a range of different businesses.

We conclude that this second cost-pass through episode, encompassing the responses to ambiguity in the earlier decision, involves both a reluctance to act expediently to correct a previous mistake and regulatory over-reach (an unwarranted interest in currency trading), and for these reasons amounts to another failure of the LNBTW test.

Price structures

A third issue that featured in our discussions, and which appears to be an area of on-going complaint by Guernsey Gas about the regulatory system in electricity, is that the price structures that are set under GE's price control arrangements are anti-competitive. More specifically, the complaint is that some of the tariff levels established under GE's price control settlement are effectively below costs, and that this is having the effect of limiting the ability of alternative fuel providers (e.g Guernsey Gas) to compete effectively in the market.

This kind of problem can arise when tariff structures comprise fixed and variable parts, where the variable part is related to the number of kWhs consumed in the relevant period. When, as has been the case over recent years, higher electricity prices have been driven by

increases in electricity generation costs, retail prices, to be cost reflective, should pass through the higher costs into the variable part of the tariff, rather than the fixed part. If this is not done, parts of the tariff structure can move out of line with costs, and some prices may even fall below costs.

Our interest in this matter is that it is, in effect, a complaint that would ordinarily be investigated and considered under competition law in other jurisdictions (eg: under predatory/below cost pricing provisions). There is no such law presently in Guernsey, and while the matter has been investigated in the context of a breach of GE's licence conditions by the OUR, we would argue that this is not the appropriate mechanism by which to consider complaints of this type. In particular, there is a potential conflict of interest in any investigation of this type, since the OUR will typically have previously approved the contested price structures for GE in its price control decision.

We recognise, however, that the specific procedural difficulties associated with the OUR hearing and investigating a complaint about a decision that it was involved in would remain (and may even increase) should the OUR assume competition law powers, at least if current price control arrangements are maintained. This is one, further reason why it may be advantageous to move away from *ex ante* price capping by the OUR, and toward a regulatory style based more on *ex post* assessments, consistent with the general approach adopted in the enforcement of competition law. Then, even if the OUR retained regulatory powers to approve or to not approve particular price proposals, a regulatory decision to approve could always be qualified by the statement that it was based on the reasonableness of prices on average, and that it was the responsibility of the enterprise itself to ensure that the details of the price structure were compliant with competition law.

7.3 Alternatives to the current arrangements

One of the puzzling questions we have wrestled with in reviewing the utility regulatory regime in Guernsey, particularly as applied in electricity, is why the recommendations of the National Audit Office do not appear to have worked. This result is especially perplexing as, following the publication of the NAO report, and following the directions given by the shareholder to GE, there appear to have been genuine efforts on both sides to improve the working relationships and to avoid the pitfalls of the past.

We have come to the conclusion that one reason for the NAO's recommendations falling flat in electricity may be that the NAO's overall assessment of arrangements in that sector (that the model of commercialisation and regulation adopted was appropriate for Guernsey, and that it was principally a matter of getting the model to operate effectively) may have been overly optimistic given the broader governmental/policy structure in Guernsey.

Here we refer to all of the points made previously regarding the appropriateness of the standard RPI-X (+ Y) price control framework to commercialised, publicly owned entities; the impacts of the States' save-to-spend policy on the incentives of the commercialised companies; and the inherent weaknesses and tensions in the framework of governance and accountability for the commercialised entities, particularly the lack of an activist shareholder interest in financial performance. Given that all of these aspects of the policy structure continued unchanged, it is perhaps unsurprising that the underlying issues remain.

For these reasons, we have concluded that the approach of sticking rigidly with the current model, and focusing on how to get it operate more effectively, may not be sufficient to resolve the underlying problems and move matters forward. Against this background, we have therefore considered a range of broader alternatives that may address the underlying and recurring problems in the sector.

An adjudication panel

The biggest glitch in the regulatory system in electricity in the time since the NAO report appears to us to have been the cost past through episodes discussed above. In our view, these are clear examples of the types of issues that an expert panel – such as a small adjudication panel of the type described above – could have dealt with expeditiously. In this context, we note that, at a technical level, the cost-pass through issues were much simpler in form than the issues that the OUR asked Byatt, Bolt and Newbery to opine on, which concerned asset valuations, and that expert report appears to have been a great success.

Specifically, once it became clear that the ambiguity surrounding the treatment of the sterling/euro exchange rate was a serious commercial issue, an experienced expert (or experts) could have been asked to give an opinion on an appropriate way to resolve the ambiguity. This would have been akin to an arbitration process in relation to a commercial contract – and we note that regulatory price control decisions have a number of features in common with longer-term commercial contracts – and we have little doubt that the matter

could have been dealt with quickly and authoritatively, within a matter of days or a relatively small number of weeks, at modest cost.

Had such a mechanism been in place at the time, we think that there is at least a good chance that the smoother relationship between the OUR and GE which, to the credit of both sides, appeared to have developed following the NAO Report and the States directions, would have been sustained. We are encouraged in this belief by views, expressed to us in our discussions on Guernsey, that such a mechanism would also likely have helped in the postal sector.

We have one residual puzzle concerning the use of appeals panels on Guernsey, which follows from the fact that we have been unable in our discussions to obtain a satisfactory account of why the States moved in the opposite policy direction, when the original Utility Appeals Tribunal (UAT) was abolished. The directional movement appears somewhat odd given the conclusions of previous reviews, which endorsed the value of an appeals function short of the Royal Court (albeit subject to the proviso that costs should be significantly lowered from those incurred as a result of the Tribunal's early outing in the CWG case), and given that the majority of those we met with took the view that, in principle, such an approach should work.

A number of reasons were suggested to us for why the UAT was not viewed as successful. Among these were that: the UAT was established at the same time as it heard its first appeal, leading to delay and muddle; the high costs and procedural issues associated with the CWG appeal; a concern that the operation of the UAT would lead to the introduction of concepts from the EU and UK into Guernsey law; and more general concerns about the status and role of such a body under Guernsey law.

These matters touch on broader questions of the appropriate design of any adjudication panel, and we note in this respect that there are many forms that such panels can take in practice. Our recommendation is based on our observation of what has worked in Guernsey (the Byatt, Bolt and Newbery panel), and is designed to avoid the pitfalls implied by the list of weaknesses in the UAT set out in the previous paragraph. To repeat earlier points, its main features would be that it would:

- Comprise a small panel of experienced authorities in regulation, to be called on an 'as needed' basis.

- Its views would not be determinative: they would have no immediate legal force.

- Its views would, however, be reasoned and written down, and would derive authority from the professional standing of its members.

- If the OUR subsequently rejected any or all of the panel's recommendations, it would be required to write down, with full reasoning, why it had done so.

- All documents would be available in any subsequent litigation.

As a final observation we note that, in some of our discussions on the possibility of introducing 'second opinion' or adjudication panel, it was sometimes suggested that this type of arrangement would simply introduce greater costs to the regulatory system. Whilst this is undoubtedly true assuming that all other things are equal, the whole point of the proposal is that it would change those 'other things', possibly in quite fundamental ways. For example:

- What is clear from recent months is that the costs of appealing decisions to the Royal Court appear to be an order of magnitude greater than those that might be expected to be associated with an adjudication panel of the type outlined. If an expedited dispute resolution process economises on such outcomes, it will save considerable sums of money for Guernsey residents.

- Although it was used by GP, the Royal Court option is, precisely because of its high costs, perceived by some as a kind of 'nuclear option', and this may discourage appeals where appeals are warranted. The Court option was not taken by GE, and, as explained above, the result has been a long, festering and unnecessary dispute, that must, when the time devoted by both sides to the issue is taken into account, have been considerably more costly than early resolution via an expedited adjudication panel would have been.

- For reasons explained earlier, we are not convinced that the use of outside consultants to assist the OUR has generally been anywhere close to as productive as the report of the three regulatory grandees (Byatt, Bolt and Newberry). With an expert panel as the fallback, OUR might be encouraged to rely more on the

development of its own in-house skills, which are likely to be more closely tuned to the Guernsey context, and rely less on outside reports. In doing this, it would know that when mistakes are made – as they inevitably will be when difficult issues are being addressed and resources are limited – they are reasonably likely to be corrected in a low key way. And using consultants less would obviously cost less.

- We suspect that, in practice, the expert adjudication panel would not be much used. The very fact of the existence of the safety net, can be expected to lead to better, more confident, less defensive decision making all round.

Ownership and governance issues

For the reasons stated, we believe that some of the worst regulatory episodes experienced in the electricity sector could have been avoided had an appropriate second-opinion, adjudication panel existed. Nevertheless, even in the event of the creation of such a panel, which we strongly recommend, other fundamental difficulties associated with the regulatory framework will still need to be addressed. In particular, we have in mind the difficulty of trying to influence GE's costs via standard price controls in the presence of a relatively inactive shareholder and a save to spend policy.

We consider that these difficulties are likely to remain more of a problem in electricity than in post in the future. As discussed in section 6, the postal sector is experiencing pressure from other forms of competition – bulk mailers and electronic mail – which could be expected to create natural incentives for cost reduction. Moreover, the enduring regulatory issue in postal services in the future is likely to be a fairly narrow one: determining and managing the level of the USO. All of these factors suggest the prospect for substantial deregulation in the future, and scope for the regulatory system to become more limited and focused.

In electricity, however, potential future policy issues are as broad as they are long, not least because of the priority given nowadays to environmental concerns. One way or another, the relevant matters can be expected to figure prominently in the States policy making for many years to come.

It is in this context that we have considered a number of different proposals for reform of the ownership and governance arrangements in relation to GE, some of which have been

raised before and others which were put to us during our meetings. These possibilities include:

- ***The full or partial privatisation of GE:*** As noted in relation to GP, the question of whether to fully or partly privatise the commercialised entities is one for the States to determine, and here we simply note some of the economic trade-offs involved. The first of these is that an immediate advantage of privatisation would likely be new, more focused corporate governance arrangements for GE. There would be a more activist, investor interest in enterprise performance.

  Such a move would also likely mean that the existing regulatory model adopted in Guernsey would be more effective, as both the management and shareholders should have a stronger natural incentive to ensure that costs were reduced below the price levels set in the price control under these arrangements.

  Privatisation would also address problematic issues associated with the States' save to spend policy. Even a part-privatisation of GE may be sufficient to reap some of these benefits, and to address the dulling of incentives associated with the save to spend policy. This might involve capital being raised by issuing a limited number of shares to the private sector, or issuing company debt instruments. More radically, and in line with international trends, consideration might be given to selling the generating assets of GE to a private company, or these assets could possibly be privatised via a management buy-out; whilst keeping the distribution and supply activities of GE within public ownership. Such partial divestment could be facilitated by the striking of a long term contract between the divested generation business and the GE distribution and supply business.

  However, being two-handed economists, we make two further observations on privatisation in the Guernsey context. The first is that, while privatisation might be expected to improve the operation of the standard regulatory model, it would be a strange logic to seek to change the context to suit the model, rather than the other way around (adapting the model to the context). If, therefore, the privatisation option is to be evaluated, it should properly be evaluated against a reformed, public sector approach; not the existing arrangements, which, for all the reasons set out above seem to us to require a number of adjustments if they are to work more effectively.

The second observation is that, while privatisation may lead to better regulatory relationships – insofar as shareholders insist that management has a good working relationship with the regulator – it is very far from being a panacea for all problems. There are numerous examples of where private, powerful monopolies have failed to recognise the legitimacy of independent oversight, and have sought to wage war to undermine their authority.

- ***A much more (financially) activist shareholder.*** A second possibility, working within the existing commercialisation arrangements, is to introduce a more financially active shareholder function. This possibility was already discussed in the context of GP, and we note again that, while this proposal may address some of the governance problems identified, it will not, on its own, address some of the other fundamental issues with the regulatory framework (e.g: it may have done little to help with the cost pass-through disputes, which have been such a major issue in electricity).

- ***'Adjudicative' price control procedures*** A third alternative, which we consider worthy of further investigation, is shifting the regulatory arrangements toward what can be termed a more 'adjudicative', and less activist, style of price control. By this we mean that the regulatory regime for electricity moves away from the existing *ex ante* price control framework, where OUR is active in setting a price cap, and shifts to one where prices are, in effect, determined by GE, but are subject to possible regulatory challenge.

  Under this approach, GE would bring forward proposals to the OUR when it wanted to change an existing pricing formula or agreement, and would be expected to supply, with the proposal, the relevant business case. The business case would, of course, be expected to contain details of projected future cost, and of cost efficiencies that could be achieved. To provide comfort that prices might be reduced in periods of falling costs, the arrangements could also provide for the OUR to require that GE come forward with proposals for pricing changes, in the event that the regulator had reasonable grounds for suspecting that prices had become excessive.

The procedure might then be along the following lines:

i. The default position would be that GE could go ahead with the changes if not challenged within a period of two months from the time of providing the OUR with the proposals and supporting documentation.

ii. If the OUR does wish to challenge, it would have two months to make a counter proposal.

iii. The OUR could consult and buy in any other resources to assist in this process, and it would be required to give reasons for its decision.

iv. There might be a period of, say, one month, during which OUR and GE would have an opportunity to seek comprise. If agreement is reached, the process stops there.

v. If no agreement is reached, the matter would go to the expert panel, who might be required to give their own assessment within, say, two months. If OUR and GE agree on this, the process stops there.

vi. In the event of disagreement, the three proposals (GE, OUR, experts) go to the shareholder, who chooses one.

Although there is potential political involvement here, it would only occur at the end stage, when other avenues have been closed off. Moreover, it is a 'passive' decision in the sense that T&R would choose one of three existing alternatives: it would not need to be pro-active in developing policy.

- ***'Deregulation' - Jersey style*** Another alternative put to us is for the regulatory arrangements for electricity to be modelled on those adopted in Jersey, and in this respect, it was suggested that Jersey electricity operated under a 'regulation by exception' regime. As it was explained, this arrangement means that Jersey electricity is effectively 'deregulated' (i.e.: not subject to any form of price control) but that it can be called upon to justify why it is charging its services in a particular way, or in circumstances where it is seeking to increase prices.

While such an approach seems attractive in terms of reducing the regulatory burden, it does not adequately address questions of appropriate oversight and governance arrangements. Specifically, given our discussions above regarding the weaknesses in current governance arrangements for the commercialised entities, particularly the shareholder function, we cannot be confident that there would be sufficient oversight and influence over the costs of GE under this type of arrangement. In this respect, we note that there is one important difference between Jersey electricity and GE: Jersey electricity is partly privatised and is in fact listed on the London Stock Exchange. As noted earlier, ordinarily it would be expected that private shareholders would place constant pressure on Jersey Electricity's management to ensure that costs are as low as possible (allowing for quality of service issues) in order to obtain the highest level of profits. No such pressure exists in the case of GE.

7.4 Conclusions and implications

Our examination of the electricity sector has been a lengthy one, which reflects the complexity of some of the issues that are raised by the regulatory arrangements in that sector. The general conclusion from our assessment is that the regulatory system in this area is need of significant reform; a conclusion that should not come as a great surprise to anyone familiar with the sector.

We have sought to identify the issues which we consider to have contributed to the poor performance of the regulatory system in this area. We will not repeat the points here, but emphasise the conclusion that some of the worst episodes could have been avoided had an appropriately designed expert adjudication panel existed.

For the future, we fear that instructing the parties to get along, as was done following the NAO Report, is unlikely to be an effective solution (even allowing for recent changes in management), and that more fundamental changes to the ownership, regulatory and governance arrangements may need to be considered.

Apart from strongly recommending the establishment of an expert adjudication panel, to be called on as and when required, our own recommendations would be to:

- Explore with Jersey the possibility of establishing a joint resource to better fulfil the shareholder role in relation to maintaining pressure on enterprise managements in relation to financial performance.

- Move to the suggested adjudicative style of regulation. In this context, we note again the similarity between the regulatory pricing arrangements and a long-term electricity supply contract, with suitable indexation provisions; and from this draw the conclusion that, with a well crafted initial pricing formula, price assessment exercises may only be required on a rather infrequent basis. We also note that such arrangements would represent a move toward the Jersey arrangement, and might provide a basis for eventual harmonisation of the two regulatory regimes (i.e. Jersey might converge on the new Guernsey system).

- Finally, we suggest that the States give serious consideration to the adoption of a formal energy policy to provide a clear and stable framework within which regulatory policy can be expected to operate. As noted, the instability caused by potentially significant changes in policy preferences has the potential to undermine independent regulation, and have a negative effect on the effectiveness of regulation going forward.

8. Summary of findings and recommendations

The States of Guernsey have followed an international trend by introducing an independent regulatory regime to oversee the operations of newly privatised and commercialised utilities. However, there are a number of contextual factors that potentially differentiate it from experience elsewhere. Among the most important of these are: the small scale of the relevant markets; Guernsey's structure of government; the approach to corporate governance for the commercialised utilities; and the States' 'save to spend' policy.

We considered the impact of the small scale of the economy on the prospects for an independent regulatory regime and concluded that this should not necessarily, in and of itself, imply that independent regulator is necessarily disproportionate. However, we also concluded that because of the small scale of the economy, it was of considerable importance that the regulator adopt a style that was proportionate – what we termed doing a 'limited number of biggish things well', but which might alternatively be called an approach based on 'limited regulation'.

This brought us to questions of competition and monopoly, which relate directly to the objectives of the regulatory regime. Contrary to the view put to us by some parties, we concluded that the scope for competition on the Island – and in the regulated sectors, including electricity – is greater than is generally assumed. Recognising that, given Guernsey's size, the intensity of competition may not be as vigorous as in larger economies, the possibility of challenge through competitive entry can nevertheless still be a powerful inducement in many sectors and industries (including the regulated sectors).

All of this suggested that, in principle, a framework based around an independent regulator who adopted a proportionate and limited regulatory approach, and who provided for the possibility of competition where competition was feasible, should be able to ensure that the benefits of regulation exceed the costs.

In practice, however, while it appears that regulation has been relatively effective in the telecoms sector (which suggests on-going role for the OUR) it does not appear to have had as much success in the postal and electricity sectors. There are a number of possible reasons for this:

- Both post and electricity are commercialised but remain in full States ownership. This type of structure tends, on average, to dull the managerial incentives for improving performance over time; and it requires a very activist shareholder or activist shareholder representative, focused on financial matters, to counteract this. In Guernsey, it is, in our view, unrealistic to expect T&R to fulfil such a role. In addition, there is a serious design issue associated with the application of the standard price-cap regulation approach to the commercialised entities. In particular, it is not immediately obvious that fixing prices will create the same desirable incentives for cost reduction in commercialised entities as it does in private companies.

- Although we heard many conflicting views about the OUR's conduct in implementing the regulatory framework, which we are not in a position to assess on a point by point basis, we noted some similarities across sectors in a few of the comments made. These included concerns about: the OUR's lack of forward agenda, particularly the absence of forward work plans; that the OUR's use of external consultants was problematic, and that the consultants did not take adequate account of the specific Guernsey context; that there was an over-reliance on detailed models, which imposed a disproportionate burden on companies to produce information which 'fitted the model'; and that the style of some OUR staff was, at times, unnecessarily adversarial and dogmatic.

- At the same time, however, it was put to us that the scope of the OUR's activities has broadened in the postal and electricity sectors because of an effective failure of other aspects of governance and oversight within the system of government on the island. Specifically, it was suggested that there was a 'gap' left by the failure of other bodies and institutional arrangements to oversee the operations of the commercialised entities, and that, as a consequence, the OUR represented the only form of external challenge to the management of the commercialised entities.

These points have led us to our recommendations for the future of Guernsey's utility regulatory regime, which encompass both general, structural recommendations for the design of the regulatory and institutional framework, and more specific recommendations for each of the sectors examined.

8.1 Sector Specific Recommendations

- The regulatory regime in telecoms appears to have generally 'worked', and to have been effective in allowing for new entry, and in creating a general environment of trust and professionalism (sees section 5). Given this, our recommendations are that the current regulatory structure be maintained, and the approach be tilted towards the gradual withdrawal of formal price controls as competition develops (which we believe is the current OUR approach). The primary aim of the regulatory framework in this sector should be keeping entry open to new competitors, which is of particular importance given the rate of innovation and technological change in the sector. We consider there to be considerable merit in proposals to allow for greater harmonisation with the regulatory framework in Jersey, and that this issue should be explored further.

  A consequence of these points is that we continue to see an on-going and important role for the OUR in the telecoms sector, which implies that the OUR's on-going role in regulating postal services and in electricity should be considered on an incremental basis.

- In post, the regulatory system has not, in our view, performed effectively, and we conjecture that this is the result of a combination of factors including the application of the standard price control approach, the weaknesses of the broader governance and oversight arrangements, and the absence of any second-opinion review panel which could deal with issues as and when they arise (see section 6). We discuss our recommendations to address these issues in detail below. However, our major recommendation in post is that issues surrounding the USO be addressed as a priority. This will likely make feasible the deregulation of GP's prices.

- Electricity has proven the most difficult case for us to assess in terms of the impacts of the regulatory regime, and in proposing practical alternative ways forward (see section 7). Our assessment is that recent episodes indicate that the regulatory arrangements have failed in some key respects. Again, we consider that an appropriately designed and constituted adjudicatory panel might have been able to deal with these issues swiftly and decisively, and we repeat our recommendation that such a panel be established. However, there are deeper issues in electricity relating to the ownership and governance arrangements. We suspect that the

approach of sticking with the current model, and focussing on how to get it to operate more effectively, may not resolve the underlying problems associated with the regulatory/institutional framework. More radical changes may be necessary. In this respect, we canvassed a number of possibilities including: the full or partial privatisation of GE; a more active shareholder function; a shift toward a more adjudicative style price control arrangement; and the possibility of 'deregulating' GE and moving toward a 'regulation by exception' arrangement. All of these proposals have merits, and there are benefits and drawbacks associated with each of them. That said, our own conclusion is that a more adjudicative, less activist, style of regulation, more closely in tune with approaches to the enforcement of competition law, is most likely to provide a good fit with the Guernsey system of government.

As a final comment on electricity, we suggest that the States give serious consideration to the adoption of a clear and stable formal energy policy in order to avoid the instability caused by potential changes in policy preferences, which has the potential to have a negative effect on the effectiveness of regulation going forward.

8.2 General Recommendations

- The States establish a mechanism for getting an authoritative second opinion on disputed matters. While there are many possibilities, our preferred approach would be to assemble an adjudication panel, to be called (and remunerated) on an 'as needed' basis, to adjudicate on disagreements between the regulated companies and the OUR. Allowing for an authoritative second opinion on disputed matters, can provide for a quick, relatively inexpensive and focused assessment of specific matters as and when they arise, and we are of the view that this could have been sufficient to avoid some of most costly disputes that have arisen in the postal and electricity sectors in recent years.

- There is a pressing need to consider again the suitability of the current governance arrangements for the commercialised utilities, particularly the role of the non-executive directors and T&R as shareholder. There are various possibilities here including partial or full privatisation, or the transfer of the shareholder function from T&R to another department. One option that we consider has merit and should be explored further is the creation a 'shareholder resource' within the Treasury department, preferably in cooperation with Jersey, responsible for engaging with the

utilities on financial matters and holding them to account in terms of its performance against its plans and shareholder objectives.

- A question that recurred throughout many of our meetings was; *who is overseeing the regulator?* A comment expressed by a number of parties we spoke to was that, while they did not necessarily think that the OUR was doing a poor job, they were concerned that there was not a formal institutional mechanism or process through which they could pose questions to the OUR, or gain a better understanding of its general approach to implementing its objectives. Some respondents suggested that, as a result of this, the media, and OUR press releases, had become the main forum for understanding, and forming an opinion, about the regulatory system.

  In other jurisdictions there are numerous ways in which a regulatory authority is called to account for its actions, including through appeals of specific decisions; but also through regular and periodic questioning by members of parliament under the select committee process. While there is a formal appeals process in Guernsey to the Royal Court, it is clearly considered a 'nuclear option' by many parties, and therefore does not appear to represent an effective constraint on the regulator's behaviour. Similarly, while we understand that the OUR is under the auspices of C&E, it is unclear the extent to which this mechanism can be expected to provide any formal oversight of its activities and decisions. Accordingly, a further general recommendation is that thought be given to possible ways, and forums in which, the OUR might be called to publicly account for its activities on a regular basis.

- Finally, we are strongly supportive of the introduction of competition law in Guernsey, provided only that care is taken to adjust 'standard' thresholds relating to market shares towards the realities of competition in a small market. Competition law enforcement is, at its best, more adjudicative in style than it is 'activist', and it tends to rest more on *ex post* than on *ex ante* assessments. Given that our recommendations point toward a less activist, and more *ex post* style of regulation, and hence to a form of regulation that is, in fact, much closer to competition law enforcement, we are of the view that our recommendations should assist in the harmonisation of regulatory and competition policies. Further, since Jersey relies chiefly on a competition law approach, the recommendations should assist with any future policy harmonisation between the Islands.

List of abbreviations

AAP	Aviation Appeals Panel (Ireland)
C&E	Commerce and Employment Department
CER	Commission for Energy Regulation (Ireland)
Comreg	Commission for Communications Regulation (Ireland)
CWG	Cable & Wireless Guernsey
EDF	Électricité de France
EU	European Union
GE	Guernsey Electricity
GP	Guernsey Post
JCRA	Jersey Competition and Regulation Authority
LNBTW	The 'limited number of biggish things well' test/criterion
NAO	National Audit Office
OECD	Organisation for Economic Co-operation and Development
OFGEM	Office of Gas and Electricity Markets
OFCOM	Office of Communications
OUR	Office of Utility Regulation
POSTCOMM	Postal Services Commission
T&R	Treasury and Resources Department
UAT	Utility Appeals Tribunal
UK	The United Kingdom of Great Britain and Northern Ireland
USO	Universal Service Obligation

APPENDIX 2

Regulatory Policy Institute
2 Market Street
Oxford OX1 1ET
UNITED KINGDOM

28 February 2011

Deputy Carla McNulty Bauer
Minister
Commerce and Employment Department
Raymond Falla House
Longue Rue
St Martin
Guernsey GY1 6AF

Dear Deputy McNulty Bauer,

Comments on responses to RPI Review of Guernsey's Utility Regulation

You have requested that we prepare a brief letter responding to some of the more substantive points that have been raised in the submissions on our recent report reviewing Guernsey's Utility Regime.

In particular, you have asked us to comment on the following points:

(i) The suggestion that consideration be given to the introduction of a Universal Service Fund (USF) in post;

(ii) Possible reforms to the governance arrangements for Guernsey Electricity and Guernsey Post;

(iii) The introduction of an adjudication panel across all sectors.

We comment on each of these points briefly below in turn.

The Universal Service Fund

In our report we identified what we consider to be a major policy problem that needed to be addressed in the postal sector, and that was that the current level of universal service in Guernsey is unsustainable under current funding arrangements because of falling volumes (because of competition with electronic mail). Accordingly, as part of our recommendations, we suggested a possible way forward to put the universal service obligation on a more sustainable basis.

In a nutshell, the suggestion was in two stages. In the first stage, we suggested that Guernsey Post and the OUR should work together to develop agreed

estimates of the efficient costs associated different levels of universal service (five days a week collections/deliveries versus three days a week collections/deliveries etc.). These estimates should then be put to the States of Deliberation, for decision by Deputies as to the level of service that should be provided, taking account of the costs and perceived broader social/community benefits.

In the second stage, once a level of USO was agreed by the States, we suggested that consideration be given to the establishment of a universal service fund (USF), which would derive income from an *ad valorem* levy on postal services, whoever is the provider, outside the reserved area. The levy should be such that it is sufficient to raise the necessary level of funding, with an adjustment mechanism for forecasting errors, calculated, say, on a quarterly basis.

For the avoidance of doubt on this point, we conceived of the USF as being a deficit fund in so far as it would be set so as to recover any deficit associated with the provision of universal services. That is, if the cost of the USO was estimated at £2 million, and GP's revenue (from postage paid in the reserved area) is £1 million, the USF would be set so as to recover the deficit of £1 million from operators in the activities outside the reserved area.

Some of the responses to our report questioned the feasibility of such an approach. Specifically, two substantive concerns were raised:

> (1) That the universal service fund approach does not appear to have been tried elsewhere in the postal sector; and
>
> (2) That the introduction of a levy to fund the USO on businesses outside the reserved area may reduce entry into these activities, and deter bulk mailing companies from setting up on the Island.

As regards the first point, while it is correct that the adoption of a USF-type approach is not common in the postal sector, it is nevertheless a very common approach to recovering funding for universal services costs in the telecoms sectors in many jurisdictions.

More importantly, however, we don’t think that this should be a decisive factor in determining the merits of such a proposal. As noted in our report, Guernsey operates a system of regulation that is very close to the frontier of what can work given the small size of the economy. A consequence of this is that it is neither sensible nor appropriate to simply seek to ‘cut and paste’ the regulatory approaches adopted in other, much larger economies (and it is arguably this tendency that may have contributed to some of the historical problems with regulation on the Island). In short, given that Guernsey is at the frontier of what is possible, the regulatory framework needs to be adaptive and innovative when it has to be, and proposals for change

should be assessed on the basis of whether they are the right solution for a very small system of regulation (rather than simply whether they have been adopted elsewhere).

In relation to the second point, this is largely an empirical question. We did seek as part of our review to investigate this question, and the responses received did not appear to suggest that the introduction of such a levy would, of itself, deter entry or lead to businesses deciding to leave the Island. However, this, of course, depends on the size of the levy, and we recognize that no-one likes to pay more.

The central issue here, from the States perspective, relates to the most effective way of recovering any commercial losses associated with the USO, at whatever level it is set. The disadvantages of current arrangements are that (a) the implicit tax base is shrinking quite rapidly, (b) without an alternative financing mechanism, not only do USO issues get unduly entangled with competition issues, but postal services on the Island will likely come to be provided at sub-optimally low levels.

We have proposed the establishment of the USF, on the basis that this will allow for the USO costs to be recovered across a potentially larger base (i.e. all postal service provision, not just provision within the shrinking, reserved area). This is not the only way of addressing the underlying problems, however, and an obvious alternative is to recover the any losses associated with the preferred level of USO via general taxation.

Ultimately, the consideration of possible methods for funding the USO is a matter for the States (and not, we think, for the OUR, by default, through the determination of the reserved area). We do not think there are any easy answers in this area, and it is a question many jurisdictions are grappling with at the moment. To repeat what we have said in our report, the logic underlying our proposal was to seek to recover the costs associated with the USO across as wide a base of postal service provision as possible; and the USF should be interpreted in that light.

The corporate governance arrangements and shareholder function

One of the conclusions of our report was that the current corporate governance arrangements, and existing arrangements for the performance of the shareholder or investor role in overseeing and influencing the boards of the commercialized entities, were inadequate. Specifically, we noted that something appeared to be missing from the Guernsey model, and that, if the States do not act to fill the void, the kind of risk that was illustrated by the savings bank diversification plans of GP will likely continue to occur. Moreover, we suggested that one of the reasons why the OUR may be perceived to be so activist in relation to GE and GP was that it had, in effect, been invited to ‘step-in’ and perform some of the oversight functions that would ordinarily have been performed by the non-executive directors of the board, or by the shareholder.

One of the options that we recommended to address this problem was that the States consider the creation a 'shareholder resource' within the Treasury department, preferably in cooperation with Jersey, which would be responsible for engaging with the utilities on financial matters and holding them to account in terms of its performance against their plans and shareholder objectives.

Some responses to our report endorsed our assessment of the current problems with the governance arrangements for GP and GE and recommendations for change, while others were not persuaded. While we accept that defining what successful governance arrangements looks like for commercialised state-owned enterprises is a difficult task given the potential for conflict between the various objectives that such organisations are typically asked to perform (be commercial, but at the same time serve the community's interest), we nevertheless think that it is possible to identify where such arrangements appear not to be working; or, to put it more bluntly, where they are failing.

It was against this standard that we examined the arrangements in Guernsey, and for the reasons given in the report found them wanting in key respects. The evidence we cited in support of this assessment included the recent costly and failed attempt of GP to diversify into banking, and the persistence of issues in the electricity sector which appear, in part, to reflect the fact that certain bodies have been under-active in taking responsibility for overseeing the financial performance and business strategy of GE.

We expressly note in our report that we can fully understand the reluctance of T&R as shareholder to get heavily involved in supervising the business strategies of commercialised, public enterprises. For the avoidance of doubt on this point, we are not suggesting in the report that T&R should become involved in the operational, or day-to-day, activities of the business. This we agree would be inappropriate.

However, we do consider there to be a need for the shareholder (or some other body, such as a shareholder function) to be activist on a very narrow range of issues; namely those relating to financial performance and longer-term business strategy. Broadly speaking, under these arrangements, the shareholder's focus would be on scrutinizing and overseeing the financial performance of the commercialized entities to make sure they are operating efficiently, while the OUR would be focused on ensuring that consumer's interests are represented and protected.

In the absence of some clarification of who is responsible for what within government, there is an obvious risk that the managements of public enterprises will be given different and incompatible objectives by different parts of government. This

is clearly not conducive to better management, and we draw attention to the views of Sir Peter Parker, one time Chairman of British Rail, on this point.

Finally, we note that in some submissions a concern was raised that the proposed shareholder function would prove to be expensive, adding to the cost of the regulatory system. While the precise costs of such a function will obviously depend on how it is implemented – and our own view is that avoiding duplication in functions (which currently exists between shareholders and regulator) should not be costly – it is appropriate, when evaluating such a proposal, to also take account of the potential cost savings of greater clarity in roles and responsibilities within government.

An adjudication panel

A key recommendation of our review was that an adjudication panel be established, on the ground that this was a potentially inexpensive way to avoid some of most costly disputes that have arisen in the postal and electricity sectors in recent years. While some responses to our report were strongly in favour of such a panel being established, others were not convinced.

To be clear on this point, our conception of the adjudication panel is one that principally provides an authoritative second opinion on disputed matters on a 'as needed' basis. The Panel is not intended to be a permanent, standing body, and it was not proposed that its decisions be legally binding. As such we do not necessarily see it requiring the involvement of long-drawn out legal processes. In short, we are *not* suggesting that the Utilities Appeal Tribunal be revived.

Rather, our proposal is perhaps best conceived of as a form of mediation or arbitration (closer to the work of the Centre for Effective Dispute Resolution) which is convened on an *ad hoc* basis to resolve technical disputes between the firms and the OUR as and when they arise. Specifically, we are thinking of a body that can provide a quick, relatively inexpensive, and focused assessment of specific matters of contention (a second pair of eyes).

Our view remains that this would be a proportionate way forward, at least if Guernsey is to retain an independent regulatory office or authority. Sectors such as telecoms and electricity raise highly technical issues, and a small regulatory organization inevitably has limited capacity compared with its much larger brethren.

Our belief that such a proposal could work well is that regulation in Guernsey has already benefited from something similar in spirit – the appointment in 2006 of an Independent Expert Panel (IEP) to consider issues relating to the valuation of the initial assets of GE, which was a difficult and potentially highly contentious issue at

the time. As we note in our report the work of the IEP was praised by most parties, including parties from different sides of the arguments, and appears to have produced generally acceptable outcomes. Similar types of expert panels are a feature of regulatory arrangements in other jurisdictions; such as the Aviation Appeals Tribunal in Ireland, which is convened on an as-needs basis and where the experts are given a maximum limit of three months to report on any issues raised.

For the avoidance of doubt, we do not see the adjudication panel and the establishment of an OUR board as being similar things. The adjudication panel is, in our view, a technically focused expert body that would be convened to address specific, relatively technical matters in an independent and impartial way, as they arise (like as the cost-pass through issue in electricity, or matters relating to the valuation of assets such as the Independent Expert Panel considered). A regulatory board is a regulator by another name; and a second pair of eyes from within a given organization is very different from a second pair of eyes from outside the organization (unless 'got at' via the appointment process!). Boards and Commissions can also be expensive, not only because of higher administrative costs but also because they tend, in practice, to be associated with higher frequencies of appeals to the courts (which, as we have pointed out, is incredibly expensive on a per capita basis in a small economy).

In contrast, what we have proposed is a quick, cheaper form of dispute resolution. Although non-binding, the opinion of an authoritative panel should help avoid unnecessary recourse to the courts, precisely because an authoritative opinion would tend to have influence in the event that a matter did go to the courts. It could also substitute to some extent for sub-contracted consultancy work on technical issues, to the benefit of both OUR and enterprise budgets.

We hope that the above points help to clarify the understanding of the assessment and recommendations in our report. We would be pleased to speak to any Deputies or other interested parties regarding any aspect of our proposals if they wish to contact us.

Yours sincerely,

George Yarrow/Chris Decker

APPENDIX 3

List of responses to the RPI report " Review of Guernsey's utility regulatory regime"

Office of Utility Regulation

Office of Utility Regulation: Audit, risk and Remuneration Committee

Jersey Competition Regulatory Authority – Non-executive Directors

Treasury and Resources Department

Cable and Wireless Guernsey Limited

Guernsey Post

Postwatch

Guernsey Electricity

Jersey Electricity

International Energy Group (Guernsey Gas)

Brookfield Asset Management Limited (Guernsey Gas)

APPENDIX 4

JCRA Non-executive directors

Mark Boleat was appointed Chairman of the Jersey Competition Regulatory Authority with effect from 21 April 2010. He has extensive experience in the regulatory field. He was a member of the Gibraltar Financial Services Commission from 2000 to 2009, he established the regulatory regime for claims management companies under the Compensation Act 2006 and for one year was formally the Claims Management Regulator, and in December 2009 he was appointed a member of the British Government's Regulatory Policy Committee. His book *An Agenda for Better Regulation* was published by the Policy Exchange in January 2010.

Mark Boleat holds a portfolio of other positions including Deputy Chairman of the Policy & Resources Committee and Chairman of the Markets Committee of the City of London, a Director and Chairman of the Audit Committee of the Travelers Insurance Company and Chairman of the Association of Labour Providers. He has held a number of other positions in the commercial, public and charitable sectors.

Robert Foster was appointed a Non-Executive Director of the JCRA in August 2004 and was re-appointed in August 2007 and August 2010. He is a Commissioner of the National Lottery Commission, and Chair of the Project Board overseeing the introduction of the next operator licence. He is also a Non-Executive Director, and Vice-Chair, of King's College Hospital NHS Trust in London, and a member of the Advisory Council of a venture capital company, Oxford Capital Partners. He was Chief Executive of the UK Competition Commission from 2000 to 2004. He is a Chartered Engineer and was previously an engineering manager in the electronics and telecommunications industries, then a senior civil servant in the Cabinet Office and Department of Trade and Industry responsible for innovation policy.

Dr Philip Marsden is Director of the Competition Law Forum and Senior Research Fellow of the British Institute of International and Comparative Law. He is a competition lawyer with a particular interest in abuse of dominance, consumer welfare, innovation incentives and international competition issues. Philip is also a Non-executive Director on the Board of the UK Office of Fair Trading and Visiting Professor at the College of Europe, Bruges, teaching the core LL.M. competition course. He has authored several books and articles, and is also co-founder and General Editor of the European Competition Journal. Previously Philip practiced competition law in Toronto, Tokyo and London, advising firms in the retail, software and mobile telephony sectors and still acts as an advisor and expert witness in these and other areas. His doctorate is from the University of Oxford, Faculty of Law, focusing on trade and competition issues.

Richard Povey was appointed a Non-Executive Director of the JCRA in May 2005 and was re-appointed in May 2008. He has extensive industry experience, particularly in the petrochemical, mechanical and electrical engineering, and telecommunications sectors. He held a number of senior management positions in Swire Pacific Ltd in both Hong Kong and Taiwan between 1979 and 1996. Since 1996, he has held non-executive positions for various fund management and industrial companies. He is currently a Non-Executive Director of Opsec Security Group plc and Henderson Far East Income Ltd.

APPENDIX 5

DRAFTING OF LEGISLATION – PRIORITY RATING SCHEME

STATES REPORT ON THE REVIEW OF UTILITY REGULATION

Criteria

Criterion 1 – Need for legislation

The present structure and procedures of economic Regulation of the States-owned utilities (Guernsey Electricity and Guernsey Post) in Guernsey has been contentious for a period of time, resulting at times in conflict between the OUR and management of both Guernsey Electricity and Guernsey Post, beyond that which could normally be expected in carrying out the Regulation function. The situation came to a head in 2009/2010 in respect of proposals from the OUR to amend Guernsey Post's exclusive area, resulting in a Requête that was approved by the States in April 2010. As a result of the Requête, a review of utility regulation in Guernsey was commissioned from the Regulatory Policy Institute which was published in October 2010. The review was put out for consultation and following a full and detailed evaluation of the responses the Commerce and Employment Department is recommending a package of proposals which, if implemented, it believes will result in a significant improvement to the current arrangements.

Under the current Regulation of Utilities Law, some of the Recommendations can be implemented through States' Directions, but others will require minor amendments to primary and secondary legislation.

Criterion 2 – Funding

The OUR's costs in respect of economic Regulation are met by licence fees, so there will be no requirement for additional funding from General Revenue in order to implement the proposals.

Criterion 3 – Risks and benefits associated with enacting/not enacting the legislation

Failure to amend the legislation will mean that the recent difficulties with the operation of economic Regulation in Guernsey will be likely to continue, and in particular the benefits of amending the current structure of the OUR and increased co-ordination with the Jersey Competition Regulatory Authority will not be obtained. The principle benefit of the proposals is to achieve a model of regulation of States-owned utilities which is better adapted

to the Island's status as a small market economy. This cannot be achieved without some, albeit minor, amendments to the current legislation.

Criterion 4 – Estimated Drafting Time

The Law Officers estimate that the aggregate time in drafting the amendments will be a maximum of two weeks, including review by interested parties. There will also be a need for staff time to review and comment on the amendments, but this should not take more than a maximum of two days.

(NB The Treasury and Resources Department have identified no resource implications in this Report)

(NB The Policy Council is broadly supportive of this Report's package of measures but recognise that individual Members have specific concerns which they may raise in the September States Meeting.)

The States are asked to decide:-

XIV.- Whether, after consideration of the Report dated 8th July, 2011, of the Commerce and Employment Department, they are of the opinion:-

1. To direct the Director General of Utility Regulation, by Ordinance, to follow the six principles for economic regulation set out in paragraph 5.11 of this Report and to take them into account in performing his statutory duties.

2. To direct the Director General of Utility Regulation, by Ordinance, to prepare a Memorandum of Understanding setting out formally the approach, process, practice and procedure, objectives, deliverables and measurements of success for future regulation of each States-owned utility, as described in paragraphs 5.14 and 5.15 of this Report.

3. To direct the Treasury and Resources Department as shareholder, acting as their representative, to follow the six principles of corporate governance set out in paragraph 6.6 of this Report and to take them into account in performing the shareholder representative role.

4. That paragraph 4 of the States Guidance to Shareholders with respect to Guernsey Electricity, and paragraph 2 with respect to Guernsey Post be amended to read as appropriate:

    a) Deliver improved efficiency in fulfilling the requirements of the Public/Universal Supply Obligation imposed under the regulatory regime

    b) Achieve as soon as practicable an appropriate commercial return on the resources employed in the provision of services.

5. To direct that the "shareholder resource" concept be explored by the Policy Council's External Relations Group in its ongoing dialogue with Jersey and that the Policy Council bring a Report before the States by the end of September 2012.

6. That the review of the powers, duties, mandates, and effectiveness of the Scrutiny and Public Accounts Committees referred to in paragraph 7.11 should include consideration of the most appropriate method of scrutinising the regulatory regime (including the responsibilities of the shareholder) on a regular basis.

7. To direct the Director General of Utility Regulation to produce and publish a three-year strategic plan along with an annual business plan detailing the actions proposed to be taken by the OUR in the subsequent year.

8. That the Post Office (Bailiwick of Guernsey) Law 2001 be amended to allow for the introduction of a Universal Service Fund, if it becomes necessary in future in order to fund the Universal Service Obligation for Postal Services.

9. That

    a) the 2001 Direction to the Director General to review and revise the award of exclusive rights from time to time, with a view to opening up the Bailiwick postal services market to competition, provided that any such opening up does not prejudice the continued provision of the universal postal service, should be rescinded.

    b) That the States of Guernsey should determine any revisions to the exclusive rights having taken into account any advice and comments from the Director General of Utility Regulation.

10. That the legislation be amended to require all postal operators with specified de minimis exceptions to obtain a licence from the Office of Utility Regulation.

11. To:
    a) Issue a States Direction to the Director General of Utility Regulation that an exclusive licence be issued to Guernsey Electricity for supply activities subject to any exemptions granted by the Director General under Section 1 (2) of the Electricity (Guernsey) Law, 2001 for the period ending 31st January 2022.

    b) Issue a States' Direction to the Director General of Utility Regulation to issue to Guernsey Electricity an exclusive licence for conveyance activities, subject to any exemptions granted by the Director General under Section 1 (2) of the Electricity (Guernsey) Law, 2001 for the period ending 31st January 2022.

    c) Direct the Director General of Utility Regulation that the exclusive licences set out in Directions (a) and (b) above should be replaced with exclusive licences for retail and network activities respectively when new legislation is enacted amending the nomenclature.

    d) Direct the Commerce and Employment Department to monitor the development of the energy sector in the Channel Islands and bring forward a review of these arrangements by 31st January 2022 or sooner in the event of any material changes to the structure of the sector.

12. That:

a) The Articles of Incorporation of both Guernsey Post and Guernsey Electricity are amended to require the written authority of the States Treasury and Resources Department before registering an appeal against a decision of the Director General of Utility Regulation.

b) The time period for registering an Appeal against a decision by the Director General of Utility Regulation should be extended from 28 to 56 days (with power to the Courts to extend further in exceptional circumstances).

13. That:

a) The Regulation of Utilities legislation be amended to alter the organisational structure of the OUR, thereby replacing the role of the Director General of Utility Regulation with an executive director and independent Board.

b) Subject to the agreement of the Jersey Authorities, the Boards of the JCRA and OUR should comprise the same people, who in practice would operate as a single Board, while administering two separate sets of laws.

c) Once the Board has been established that that part of Resolution XIV 1 (f), Billet d'Etat X, 2006 related to the establishment of an Audit and Remuneration Committee should be rescinded and the Audit and Remuneration Committee shall be abolished.

14 To direct the preparation or amendment of such legislation as may be necessary in order to give effect to their above decision.

COMMERCE AND EMPLOYMENT DEPARTMENT

IMAGE RIGHTS

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

6 May 2011

Dear Sir

1. Executive Summary

1.1 In this report the Commerce and Employment Department proposes the introduction of legislation in the Bailiwick to provide protection for Image Rights.

1.2 These image rights proposals represent a real opportunity for the Bailiwick to place itself amongst the leaders in the world for innovative intellectual property legislation. The Commerce and Employment Department therefore believes that specific legislation to recognise and regulate image rights should be introduced here.

1.3 An image right (sometimes referred to, as in the USA, as a right of publicity) concerns the commercial appropriation or exploitation of a person's identity and associated images linked to that person. It is concerned with distinctive expressions, characteristics or attributes of, or associated with, a personality made available to public perception.

1.4 Image rights are commercially valuable and will provide a marketing opportunity to build on the international standards for intellectual property established under the existing legislation.

1.5 These proposals have been shaped by extensive consultations within the Island and further afield. They are supportive of the States of Guernsey's Strategic Plan to create and maintain conditions conducive to achieving economic diversification with the potential for furthering growth.

2. Background

2.1 The States of Guernsey Report "Bailiwick Intellectual Property Legislation and Economic Opportunities in a Knowledge Economy"[1] set out a policy to modernise the Bailiwick's Intellectual Property Laws to become compliant with international standards and to create an economic opportunity for the management and ownership of these high value assets within the Bailiwick.

2.2 Section 1 of The Intellectual Property (Enabling Provisions) (Bailiwick of Guernsey) Law, 2004 provides that the "States may by Ordinance make such provision as they think fit in relation to the law concerning intellectual property; and any such Ordinance may, without limitation, make provision in respect of the implementation of [inter alia] (m) image rights".

2.3 Introducing a framework of intellectual property legislation to meet international obligations was the first priority and this is in place. The Island is now in a position to introduce legislation which can exploit a market opportunity. As image rights legislation will initially be unique to Guernsey, there were no models to follow and a greater amount of research was therefore needed to produce these proposals.

2.4 Image rights are an integral part of artistic expression and a product of celebrity or sporting achievement in the twenty-first century. Sportsmen, film stars, pop stars, television personalities, and many other well-known people successfully commercialise their images and enjoy large incomes from such exploitation: for example, by allowing their images to be associated with goods which are being sold or services being rendered. Many modern celebrities earn more from this exploitation than from the "performance" fees in the activity which initially brought them to general notice. There can also be value in the fame of a celebrity long after that person's death. Therefore, the value of Image Rights is such that they are already being actively managed and traded, despite the lack of clear legal recognition and the lack of clarity as to the extent of the rights.

2.5 Image rights are therefore commercially valuable and they represent a significant opportunity which Guernsey could exploit as the first jurisdiction in the world to have specific legislation. They represent a similar opportunity for the Bailiwick to Protected Cell Companies and Incorporated Cell Companies by creating economic advantage out of its legislative environment and by providing for image rights law in advance of competitor jurisdictions. This view is supported by the Island's leading professionals in this area and by top sports lawyers in the UK.

2.6 This field of intellectual property covers many high-value and cutting-edge market developments in sports rights, contract terms, appearance and endorsement rights associated with the personality. Those wanting to protect the use of their images will need to register with the Intellectual Property Office which will tie the

[1] (Billet d'État XXIII of November, 2002, Article XIX)

protection to the Bailiwick and also ensure that as many as possible of the economic benefits of these proposals are retained here.

2.7 In those countries where there have been some moves towards recognising the concept of image rights in legislation these have generally been linked to privacy rights. However, it is not proposed in this document or at this time to attempt to codify, alter or expand in any way the law in respect of privacy. Image rights are proposed as a separate, stand-alone concept.

3. The case for introducing specific image rights legislation

3.1 Although image rights are important assets in some market places, the football "industry" for example, the laws of most countries have not properly kept up with this form of trading. Image rights are not expressly provided for in any international agreements; nor do national laws around the world, apart from in some states of the USA, create specific rights of this kind.

3.2 Thus, in both the UK and Guernsey, whilst there is some indirect protection for images at common law (through the laws of copyright, defamation, breach of confidence and passing off), it is far from comprehensive or satisfactory. In addition, English courts so far have declined expressly to recognise character or image rights as such or a propriety right of publicity.

3.3 Registered trade mark law, which, superficially at least, would seem to be the most appropriate legal tool to protect image rights, is of limited and uncertain assistance. The primary (and some would argue only) function of registered trade marks is to identify the source of goods or services. Remedies for trade mark infringement lie against those whose actions confuse the public as to that source. This provides some, but insufficient, protection for image rights. Although, as a result of the developing jurisprudence of the European Court of Justice, there is much broader protection for some celebrity images which are registered as trade marks, there is still considerable judicial resistance to providing comprehensive registered trade mark protection to all images. At the very least, the relevant law is unclear.

3.4 Thus, the various relevant areas of the law which might protect image or publicity rights, albeit still developing, do not provide adequate protection and there is a significant gulf between law and business practice. No country yet has a set of laws which satisfies those with business interests in images; nor is there, as yet, a separate, specific registration system for images.

3.5 There are thus three good reasons for providing a clear legal code for image rights:

- Image rights are high value and a fact of commercial life but the lack of definition in law leads to uncertainty as to the extent of the rights and limits the value-creation opportunities.

- Clarifying the rights will enable their more effective management while also protecting the public interest by defining the extent of the rights in law.

- The Bailiwick of Guernsey could provide such a law custom-made for image rights and the industry supports the introduction of image rights.

3.6 Image rights legislation would provide the Bailiwick with the opportunity to:

- Attract and manage a high value asset here for the benefit of the Islands and their economies;

- Develop registration of such rights in Guernsey into wider rights' management and the use of broader wealth management services. A system of simple and clear registration of an important property right and the availability of wealth management services could encourage celebrities to manage their image rights from the Bailiwick.

- Provide a unique selling point for the overall intellectual property environment;

- Provide "first mover" advantage in the marketplace relative to other jurisdictions; and

- Establish the Bailiwick as a jurisdiction with world-leading legislation in intellectual property.

3.7 The proposed Image Rights legislation would offer the following attractions to sports and other personalities to make use of this new legislation:

- Legal certainty and clarity on Image Rights law;

- Collateral evidence in other countries of the intent of the celebrity to protect his proprietary image;

- Protection linked to licensing of the rights tied into Bailiwick law;

- Securitisation of the image rights which is useful in the financial management of the rights;

- Secure stable environment for the management of the rights; and

- Use of a major international language and proximity to the UK and Europe.

4. Consultation exercise on Image Rights

4.1 In view of the opportunities, the Department carried out a consultation with interested legal, financial and intellectual property professionals (both in

Guernsey and further afield) and local industry bodies in February and March 2011, seeking their views on whether it would be desirable to introduce legislation providing for image rights and what provisions they would wish to see in it.

4.2 Those consulted, including the Commercial Bar Association, the Institute of Directors, the Chamber of Commerce and the Guernsey Association of Trustees, which was also the lead respondent for the Guernsey International Business Association (GIBA), overwhelmingly support the introduction of a specific law regarding image rights and evidenced a real commercial interest in its application. They believe that image rights will be a valuable addition to the financial product range available in the Bailiwick. They also believe that this legislation will increase and enhance other wealth management opportunities in related services.

4.3 That consultation has confirmed that image rights must be registered in Guernsey in order for there to be a commercial benefit in the Bailiwick, provide legal certainty as to location, assist in marketing the local offer and provide for effective enforcement while protecting the public interest.

4.4 The consultation exercise has confirmed the Department's initial research that there is great enthusiasm and strong support from practitioners for specific image rights legislation to be introduced.

4.5 It is therefore proposed that an Image Rights Ordinance be introduced.

5. Scope and content of an Image Rights Ordinance

5.1 Those who wish to protect and commercially exploit celebrity images require legal protection in two main respects: first, to prevent unauthorized uses of images and, second, to enable dealings with images in the same way as for any other type of similar property.

5.2 The proposed Image Rights Ordinance will enable registration of a registered personality right, a property right, which would also provide rights in the registered personality's associated images. Many of the provisions will be based upon the principles of other Guernsey Intellectual Property legislation, in particular the Trade Marks Ordinance.

5.3 In very brief outline summary, the key features of an Image Rights Ordinance are likely to be as follows:

- Establishment of an Image Rights Register and a Registrar of Image Rights.

- The creation of a right for a qualifying personality to be registered on the Image Rights Register (referred to in this report as a "registered personality right"). Registrable features of a qualifying personality will include a personal name and any other associated distinguishing indications (such as voice,

signature, photograph, character or likeness) which identify the personality uniquely.

- Qualifying personalities will include any living or deceased natural person and could extend to some non-living entities, such as fictional characters.

- Creation of an appeals mechanism relating to decisions of the Registrar of Image Rights.

- A registered personality right relating to a living personality will have indefinite duration and can continue to exist after the death of the personality subject to regular renewal / validation of registration on the Register of Image Rights.

- There will be creation of exclusive ownership rights which may be enjoyed and protected by the holder of a registered personality right and which may be assigned and otherwise dealt with as personalty, subject to relevant registration requirements.

- Exceptions and limitations to the exclusive use of rights will be created to ensure that images may be used where it is in the public interest to do so, for example legitimate news coverage.

- Only distinctive images will be enforceable. Distinctiveness will ultimately be a matter for the Courts to decide.

- All infringements of image rights will be actionable as civil, not criminal, matters.

- In an action for infringement of image rights all such relief by way of damages, injunctions, accounts or otherwise will be available to the plaintiff as is available in respect of the infringement of any other intellectual property right.

- The rights will be designed to be fully compatible and integrated with modern media including broadcasting, satellite transmission, the internet and other electronic communications. This will be particularly important in providing protection in the mass media market.

6. Arguments against the introduction of Image Rights legislation

6.1 If image rights are too strong the management of these rights could act against the public interest in the expression of opinion, the dissemination of information, the freedom of the news reporting and the stifling of competition.

6.2 Care is needed because of the potential anti-competitive implications of strong registered image rights, as they could be seen as privacy legislation "by the back door". Image rights legislation could harm press and public freedom, by

restricting reporting and communication.. In order to reduce the ability of rights' holders to use the legislation against the public interest, there will be safeguards in the legislation to ensure that various types of unauthorized use of the image are permitted where they are in the public interest to ensure freedom of news reporting and news commentary. For example, use of the name and a picture of a registered personality in a news story would normally be permitted without the right holder's consent. It would not be possible for a politician, for example, to register his/her name to prevent all unfavourable references in the media. Parody would also be permitted.

6.3 Image rights could also conflict or overlap with other intellectual property rights vested in other people, such as copyright. However, the overlapping rights can complement the potential in the management of rights, as in a portfolio of rights, and this is seen as a positive aspect of intellectual property rights. As with other intellectual property rights, cases of conflict between rights or the strength of complementary rights will be a matter for the courts to decide.

6.4 The proposals are that these rights will only be enforceable for commercial purposes. There will be defences for educational and private use.

6.5 Image rights are often, though not exclusively, attached to persons with a high public profile. Abuse of an image rights structure could attract considerable unfavourable publicity, such as is currently being investigated in the UK in relation to taxation matters. Any risk of unfavourable publicity will be mitigated by the following:

- The definition in law will help prevent such abuse by clearly defining the extent of the rights.

- The industry is proposing the adoption of a "code of practice" which will ensure that the high standards of the financial and legal services sector are maintained.

- It is considered that the development of a well-regulated and innovative image rights law has the potential to attract considerable favourable publicity for the island. It is likely to attract international attention and identify the Bailiwick as a leading jurisdiction in the development of twenty-first century intellectual property laws.

7. Economic benefits to Guernsey

7.1 Registration will provide the reason in law for the rights to be located in the Bailiwick and will therefore bring associated rights and wealth management opportunities here. This should provide a valuable new income stream to the Bailiwick and also increase its profile.

7.2 The introduction of Image Rights legislation and the Register which will be created will result in an income for the Intellectual Property Office as it is proposed that fees will be charged for initial registration and renewals and all other registrable transactions.

7.3 In the longer term, there is the opportunity of attracting a significant market in image rights management structures and associated wealth management to locate here. The placement of image rights in the Bailiwick should lead to wider wealth management opportunities from individuals who have their image rights managed here.

7.4 It will be a high value / low footprint service.

8. Consultation with Alderney and Sark

8.1 The proposed Ordinance will apply throughout the Bailiwick, as is the case with all local intellectual property legislation. The Commerce and Employment Department has therefore consulted with the Alderney Policy and Finance Committee and the Sark General Purposes and Advisory Committee as it has developed these proposals. Both committees are content with the proposals and for the legislation to apply in their islands.

9. Legislative consultation and compliance

9.1 The Law Officers of the Crown have been consulted and support the introduction of legislation. They have confirmed that there is no reason from a human rights' point of view why the proposed legislation should not be enacted.

9.2 The Data Protection Commissioner has been consulted with respect to Data Protection issues in holding personal data in the Image Rights Register. The IP Office will continue to consult the Commissioner as necessary as the proposals are developed in more detail.

10. Proposed Fees and Charges

10.1 It is proposed that fee levels should be sufficient to deter frivolous but not serious applications; recover the cost of developing, installing and maintaining the registration system including the IT costs; and generate an income for the Registry. However, the fee level must be "commercial".

10.2 It is proposed that the fees are set by the Registrar of Intellectual Property by Regulation following consultation with industry and the Department. Fees will include:

- Initial registration of the personality
- Additional fee for each image to be entered on the Register
- Renewal / validation of registration

- Renewal / validation of each image

11. Resource implications

11.1 As stated, it is proposed that an Image Rights Register be established in which individuals would register their images and associated personal distinguishing indications. The Register will be established and maintained in electronic form.

11.2 The Registry will develop a cost-effective registration system for image rights and the capital investment for an IT system will be subject to a business case being made to the Treasury and Resources Department on the basis of an interest-bearing loan to the Guernsey Registry of which the Intellectual Property Office forms a part.

11.3 It is proposed that, initially at least, any infringement of personality and image rights should be treated only as a civil wrong. This should mean that there are no resource implications for the enforcement agencies in the introduction of this legislation.

12. Staffing

12.1 Persons wanting to protect their image rights will need to register themselves and their images with the Intellectual Property Office and those transactions will require processing. However, as the Register will be electronic, it is anticipated that the volume can be handled by the existing staff.

13. The Overall Benefits Case

13.1 In summary, the benefits from the proposals include:

- Making the Bailiwick the only jurisdiction in the world, as yet, where image rights can be registered on a statutory basis;
- Attracting and managing a high-value asset;
- Creating associated wealth management opportunities;
- Enhancing further the business offer available here, both in intellectual property and generally;
- Enhancing the reputation of the Bailiwick;
- Opportunities for promoting the Bailiwick;
- Increasing the contribution to States' revenue; and
- Raising the Bailiwick's competitive position with respect to other jurisdictions.

13.2 The expertise is available in the IP Office (and among local professionals) to administer this legislation.

13.3 The existing freedom of the media to report items of public interest will not be affected by these proposals.

14. Recommendations

14.1 The Commerce and Employment Department recommends the States to:

1. Approve the introduction of specific Bailiwick of Guernsey legislation to protect image rights as set out in this report;

2. Direct the preparation of such legislation as may be necessary to give effect to the foregoing for the reasons set out in paragraph 12.1 of the Annex.

Yours faithfully

C S McNulty Bauer
Minister

Deputy M. S. Lainé
Deputy R Sillars
Deputy M Storey
Deputy R Matthews
Mr P Mills

Annex 1
Information to establish priority for legislative drafting

States' Report – Annex

Information to establish priority for legislative drafting

Image Rights

1. Justification for legislation

1.1 The intention to bring forward Image Rights legislation in due course was set out in the States' Report that was approved by the States in Billet XXIII of 2002 and has subsequently been listed for prioritisation by the Commerce and Employment Department. The first stage was to establish a 21st century suite of legislation meeting the international standards. Although IP legislation can be complex, the drafting process was assisted by models of legislation in other jurisdictions including the UK and Singapore.

1.2 Image rights legislation will, at least initially, be unique to the Bailiwick. There were therefore no models to follow and so producing proposals for the States to consider has taken a greater level of research to achieve. This work has now been completed and comprehensive drafting instructions have been prepared for the Law Officers , subject to the States' decision.

1.3 A consultation has been carried out with industry and professional service providers and the response has been very strong support for the introduction of image rights. Image rights are seen as providing economic diversification opportunities, adding to the financial services product offer and providing the Bailiwick with a promotional unique selling point (U.S.P.) globally as well directly benefiting the IP offer.

1.4 The Intellectual Property Office is now proposing the introduction of legislation in the Bailiwick to create local protection for Image Rights. This legislation would enable personalities to protect and exploit the use of their images and distinctive attributes by registering them in Guernsey with the Intellectual Property Office.

1.5 Image rights legislation would give the Bailiwick the opportunity to attract and manage a high value asset. The U.S.P. referred to in paragraph 1.3 could benefit many sectors of the finance services sector through the cross-selling of financial products in the fiduciary, banking, venture capital and insurance sectors. However, this is dependent upon the Bailiwick's being the first jurisdiction in the world to have such legislation. This will provide first mover advantage in the market place relative to other jurisdictions, provided that the legislation can be drafted with a minimum of delay. It can establish the Bailiwick as a place for world-leading legislation in intellectual property.

1.6 The benefits and market opportunity were informed by an industry survey and consultation in quarter 1, 2011 and have the backing of, amongst others, the

Guernsey Commercial Bar Association, the Institute of Directors and the Guernsey Association of Trustees (which also acted as lead respondent for the Guernsey International Business Association).

1.7 In summary, the legislation will provide the following benefits by:

- Making the Bailiwick the first jurisdiction in the world where image rights can be registered on a statutory basis;
- Attracting and managing a high-value asset;
- Creating associated wealth management opportunities;
- Enhancing further the business offer available here, both in intellectual property and generally;
- Enhancing the reputation of the Bailiwick;
- Providing opportunities for promoting the Bailiwick;
- Increasing the contribution to States' revenue; and
- Raising the Bailiwick's competitive position with respect to other jurisdictions.

2. Availability of Funding

2.1 It is proposed that there will be a Register in which applicants can register their names, images and associated personal distinguishing indications. That will need to be established. Applications to register images with the Office will require processing. However, it is anticipated that it will be possible to handle them with the existing staff.

2.2 Whilst it is possible to create a manual, paper-based registry, the anticipated demand and market expectation is for an electronic system. It would be paradoxical for a cutting-edge development to be linked to outmoded practices.

2.3 Subject to the business case, the Register will exist in electronic form. The technical specification will need to be established with the supplier, worked up, all the necessary computer programming written and the system tested and implemented. The cost of creating the register is estimated at £100,000[2]. A business case is being made to the Treasury and Resources Department. It is being asked, subject to the approval by the States of the legislation and the business case assessment, to make a loan to the Guernsey Registry, of which the Intellectual Property Office forms a part, in the sum of £100,000[1]. The loan and interest payments will be repaid from the income stream arising from the fees for registration of personalities and images.

2.4 It is proposed that, initially at least, the infringement of personality and image rights should be treated only as a civil wrong. This should ensure that there are no resource implications for the enforcement agencies in the introduction of this legislation.

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[2] Current estimate based on range of responses to the "Request for Information" in the IT procurement process.

2.5 The power of the Royal Court to appoint a specialist judge as a Lieutenant-Bailiff for intellectual property cases was noted in the States Report "Bailiwick Intellectual Property Legislation and Economic Opportunities in a Knowledge Economy" paragraph 9.3 Billet D'Etat Wednesday 27th November 2002. The Bailiwick intellectual property legislation has been modernised since 2005 and to date such an appointment has not been required as no cases requiring the appointment have been brought before the Court. However it is noted that the need may arise in the future and if it does would have a cost implication for the Courts.

2.6 It is, therefore, anticipated that funding will be available and there should be no cost implications for other parts of the States.

3. Urgent project

3.1 The Commerce and Employment Department would like to see these proposals become law as soon as possible which would require the legislation to be given high priority for drafting. This image rights legislation offers the Bailiwick the chance to be a world-leading jurisdiction for intellectual property. No other jurisdiction offers specific image rights legislation. These proposals are now in the public domain. Therefore, in order to take advantage of being a first mover, the Bailiwick needs to have the legislation in force so that other jurisdictions cannot take advantage of the detail given in these proposals to implement their own legislation before ours comes into force. This could easily occur if there were a lengthy period between the States' consideration of the proposals and their commencement as legislation. These proposals therefore need to become law as soon as possible.

3.2 There are also external events which strongly support the case for the legislation to be introduced as soon as possible. Firstly and most importantly, the 2012 London Olympics should generate substantial interest from athletes wanting to protect their image rights and exploit the publicity they will attract from participating. In order to benefit from that event the legislation needs to be in force before the Games start, and the sooner the better. This should also generate good publicity for the Island. The second opportunity to market this new service is the 2012/13 football transfer season. This runs from approximately July to August 2012.

4. Estimated drafting time

4.1 The Law Officers have indicated that they estimate that the actual drafting time required for one drafter will be about two months. However, there will also be the time that others (such as the Department, the Office of the Registrar of IP and consultees) will themselves spend in perusing drafts, making comments and providing and refining policy instructions. In aggregate, it is estimated that, subject to the responses, all these stages will take about four months.

5. Fiscal and Economic Benefits

5.1 The legislation has the potential to provide a potentially substantial new income stream to both the States directly and to private firms operating here. Consultations and discussions with Intellectual Property practitioners have confirmed the pent up demand from them for this legislation to be introduced. They are therefore keen to see its early implementation.

5.2 In the longer term, there should also be the opportunity for attracting a significant market in image rights management structures and associated wealth management to locate here. The placement of image rights in the Bailiwick should lead to wider wealth management opportunities in respect of individuals who have their image rights managed from the Bailiwick.

5.3 Image rights can therefore deliver fiscal and economic benefits to the Islands.

6. Social Benefits

6.1 The introduction of image rights legislation and the running of management structures from the Bailiwick will add a further major type of intellectual property activity to the local offer. It will therefore further broaden the types of job opportunities available to local residents. Jobs in this field should be well remunerated.

7. Environmental Benefits

7.1 While there will be no environmental benefits from the proposed legislation, it should also have no detrimental effects as it can be administered virtually entirely by electronic means and with no staffing implications for the States.

8. General Risks

8.1 There are several potential risks to the introduction of this legislation. If image rights are too strong, the management of these rights could act against the public interest in the expression of opinion, the dissemination of information, the freedom of the press and other media and the stifling of competition.

8.2 The most likely risk is that it could be seen as a method of introducing privacy legislation by the back door by restricting the dissemination of information. This is because personalities who have registered themselves and their images can thereby prevent their unauthorized usage.

8.3 However, this potential risk will be mitigated by including in the legislation safeguards to ensure that various types of unauthorized use of the image are permitted where they are in the public interest, for example to ensure freedom of the press (their use of the name and a picture of a registered personality in a news

story would normally be permitted without the right holder's consent), educational and private use.

8.4 It is proposed that these rights will only be enforceable for commercial purposes.

9. Reputational Risks

9.1 Image rights are often, although not exclusively, attached to persons with a high public profile. Abuse of an image rights structure could therefore attract considerable unfavourable publicity, such as is currently being investigated in the UK in relation to taxation matters. Any risk of unfavourable publicity will be mitigated by the following:

- The definition in law will help to prevent such abuse by clearly defining the extent of the right.

- The industry is proposing the adoption of a "code of practice" which will ensure that the high standards of the financial and legal services sector are maintained.

- It is considered that the development of a well-regulated image rights law has the potential to attract considerable favourable publicity for the island.

10. Demand

10.1 Image rights were included as an area where the States can legislate by Ordinance under the provisions of the Intellectual Property (Enabling Provisions) (Bailiwick of Guernsey) Law, 2004. The Department therefore wishes to introduce legislation in this area. Meetings with the industry have confirmed that there is a business demand for this new service as practitioners are already offering some services in this area despite the lack of specific legislation.

10.2 The IPO has carried out a consultation with the industry. The results of that consultation exercise show that the intellectual property professionals consulted indicate a potential for several hundred registrations over the first few years of the service.

11. Departmental Priority

11.1 For the reasons set out in this document, at this time the Commerce and Employment Department regards this proposed legislation as its most time-critical priority for new legislation.

11.2 This image rights legislation offers the Bailiwick the chance to be a world-leading jurisdiction for intellectual property. No other jurisdiction has specific image rights legislation. In order to take advantage of being a first mover, it is necessary to have the legislation in force as soon as possible so that other jurisdictions

cannot take these proposals and implement their own legislation before ours comes into force. These proposals therefore need to become law as soon as possible. Further reasons are also set out elsewhere in this document.

11.4 Contacts with the industry and a specific consultation exercise have identified a substantial demand for this new service from the industry and practitioners both in the Bailiwick and further afield.

11.5 In bringing this proposition to the States the Department is fulfilling the principles of Good Governance the proposition meets its purpose in providing opportunities for economic diversification, the States has a clearly defined role that of creating the legislative environment for the commercial sector to exploit, the Department has engaged stakeholders, is transparent in the decision process, is managing risk and can provide the registration requirements through the existing Registry while noting there may be future demands for Court time.

12. Summary

12.1 In conclusion, the Commerce and Employment Department requests that its proposals for the introduction of Image Rights legislation be given a high priority for legislative drafting for all the reasons set out above, which can be summarised as follows:

- Maintain first mover advantage;
- Prevent another jurisdiction using these proposals to introduce its own legislation first;
- Have legislation in place in advance of the London 2012 Olympics in order to take advantage of the significant opportunities likely to arise from that event;
- Respond to the demands of industry to create this new business opportunity;
- Create a new income stream for the States; and
- Improve the Bailiwick's business offer.

(NB The Treasury and Resources Department supports the States Report. It notes that the capital cost of creating the register is estimated at £100,000 and will carefully consider the business case for this expenditure when requested to make available a loan from States Treasury.)

(NB The Policy Council supports the proposals.)

The States are asked to decide:-

XV.- Whether, after consideration of the Report dated 6 May, 2011, of the Commerce and Employment Department, they are of the opinion:-

1. To approve the introduction of specific Bailiwick of Guernsey legislation to protect image rights as set out in this report.

2. To direct the preparation of such legislation as may be necessary to give effect to their above decision.

COMMERCE AND EMPLOYMENT DEPARTMENT

AIRCRAFT REGISTRY

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

12 July 2011

Dear Sir

1. Executive Summary

1.1 In this report the Commerce and Employment Department proposes the establishment of an Aircraft Registry in Guernsey.

1.2 It is intended that the Guernsey Aircraft Registry will be a high quality, professional registry operated to the highest international safety standards. It will offer a premium service to the owners of new or nearly new privately operated aircraft seeking high service standards in a cost effective, tax efficient jurisdiction. The registry will be low cost to the States, will present a low commercial risk to the States, will have a manageable reputational impact and will offer significant benefits to local businesses. It will also be open to residents of the Channel Islands for the registration of locally based private aircraft, whatever their type.

1.3 Businesses in Guernsey stand to benefit from, and generate, an economic return by selling the aircraft registry's services as an element of their overall service offerings to businesses and individuals. Establishing a Guernsey registry would provide a number of benefits to a range of local beneficiaries, effectively broadening the market for existing finance sector services and also broadening the range of services that local businesses could offer to new and existing clients. It could also reduce regulatory costs to Guernsey citizens who privately own aircraft that are locally based if they transfer onto the Guernsey Register 'the Register'.

1.4 The proposal fits strategically with, and will contribute towards, the States' fiscal and economic objectives of providing a:

- 'Diversified, broadly balanced economy' and
- 'Average economic growth of 2% or more per annum'.

1.5 This report seeks approval in principle for the establishment of an Aircraft Registry in Guernsey and for the drafting of the necessary legislation.

2. Background

2.1 Guernsey cannot presently register any aircraft, as it has no legal power to do so. Locally operated aircraft must therefore be registered in another jurisdiction, typically the United Kingdom, the United States of America or, increasingly, the Isle of Man (which has enacted legislation to enable it to create a registry, which is a sub-register of the UK's).

2.2 The Convention on International Civil Aviation ('the Chicago Convention') governs the registration of aircraft, as a matter of international law. Under the Convention, registration of aircraft is a State function and carries with it a number of obligations. Alongside administrative registration of aircraft, associated mortgages, and flight crew, State of Registry obligations also include certification of airworthiness and safety oversight, physical inspection of aircraft, and accident and incident investigation.

2.3 The UK is a signatory to the Chicago Convention and it is accepted that the UK signature extends the Convention to Guernsey. A Guernsey Aircraft Registry would therefore be a sub-registry of the UK Civil Aviation Authority. Accordingly, the States will require the consent of the relevant UK authorities in order to establish a Guernsey Aircraft Registry.

2.4 A number of Overseas Territories and one Crown Dependency (Isle of Man) already operate their own Aircraft Registries, as sub-registries of the UK. The most recently established of these is the Isle of Man's Registry, which was launched in 2007 and which has been a commercial success with over 300 aircraft registered to date. There is no reason why Guernsey could not successfully operate its own Registry.

2.5 In addition, in order to become a sub-registry of the UK, the UK must permit Guernsey to use one of the registration letters or numbers that it has been given to register aircraft, in accordance with the Chicago Convention. (The UK registry uses the letter 'G', and the UK has permitted the Isle of Man and various overseas territories to use other letters and letter combinations that it has been allocated.) It will therefore be important to engage with the UK at an early stage to ensure that they are prepared to give Guernsey use of one of the UK letters or numbers for registration.

3. Feasibility

3.1 The Department has conducted an extensive feasibility study regarding the commercial viability and potential economic benefits of establishing an aircraft registry in the island.

3.2 A targeted market research survey of both Guernsey and Jersey's aviation and finance sectors was conducted in January 2010 by Island Opinion. This demonstrated clear support for the establishment of an Aircraft Registry, a readily identifiable market, and the potential for real economic benefits to the local economy.

3.3 A feasibility study has been conducted jointly with Jersey. The post of Director of Civil Aviation ('DCA') in both Bailiwicks is currently occupied by the same person and there would be potential benefits in establishing a Registry on a joint basis. Furthermore, market research provides a clear indication that the aviation and financial services sectors which would benefit from the establishment of a Registry see a benefit from Guernsey and Jersey working together to explore the possibility of the establishment of a Channel Islands Registry. There has therefore been close cooperation at staff and political level between the two islands in the feasibility work that has been undertaken.

3.4 A business and technology consultancy firm specialising in the aviation industry was jointly selected and instructed by Guernsey and Jersey government departments to assist in identifying the potential options for delivery of a Registry and in developing an Outline Business Case. That work has led to the conclusion that an Aircraft Registry is a commercially viable and attractive addition to the range of services offered by Guernsey as a jurisdiction and would give rise to a range of direct and indirect benefits to the economy and to the States.

3.5 Whilst the Economic Development Department of the States of Jersey is similarly of the view that an Aircraft Registry is a viable and desirable project, they have concluded that they do not wish to work with Guernsey on the establishment of a joint Channel Islands Registry at this time. In those circumstances, the Department has considered the merits of establishing a Guernsey based register without co-operation from Jersey and has concluded that this is a viable commercial proposition capable of providing economic benefit to the island.

4. The case for introducing an aircraft registry

4.1 There is significant demand for the establishment of an Aircraft Registry in the Channel Islands. Market research has demonstrated that 76% of the 146 companies and individuals who responded to a survey were very strongly or strongly of the view that a Guernsey/Jersey/Channel Islands' aircraft registry would be of economic benefit to Guernsey/Jersey.

4.2 The primary driver for the establishment of an Aircraft Registry is to provide an opportunity for local business to diversify into a new area of economic activity. The finance sector would be a significant beneficiary, with opportunities for local businesses to facilitate and finance aircraft purchasing, arrange aircraft insurance and administer the ongoing operation of locally registered aircraft. Banks,

fiduciaries, corporate services providers, and the insurance sector would all stand to gain, supported by legal and accounting services. In addition, the existence of an Aircraft Registry would provide a significant boost to existing businesses with operations in aviation support and management and would lead to new opportunities in that field.

4.3 The increased economic activity described above would also lead to indirect economic benefits for the States both tangible (increased revenue generated by increased economic activity in the finance sector) and intangible (diversification of the finance sector and wider economy into new areas of activity providing a stronger base for future economic wellbeing). It is also possible that the revenue stream of the Registry may offset some of the costs to the taxpayer of the operation of the Director of Civil Aviation's office.

4.4 It would also provide an opportunity for the DCA to gain safety oversight of locally based aircraft and would reduce regulatory costs to Guernsey based aviators. A local registry would increase the profile of Guernsey in the aviation community and would demonstrate the professionalism of the DCAs office. There are opportunities over time to have Guernsey recognised as a 'home' for best practice General Aviation regulation in the field of non-commercial aviation.

4.5 The current offshore registry market is showing signs of struggling to meet the demand arising from the growing business aviation market. Hence, the registry would be launching into a growing market in which demand is outstripping supply.

4.6 The demand for the services of an Aircraft Registry in a small jurisdiction such as Guernsey is driven by a desire for high standards of regulation, combined with a personal, professional and efficient service that is less costly and less bureaucratic than that associated with the Registries in larger jurisdictions.

5 Scope of the Registry

5.1 One key decision regarding the scope of the Registry is whether or not it will accept commercial aircraft, defined to include all passenger and charter aircraft.

5.2 The main advantage of permitting commercial aircraft to register is that the fee income associated with larger aircraft is higher and this therefore presents the opportunity for greater profitability of the Registry. It would also allow Guernsey based commercial airlines to register should they wish. However, the operation of a commercial register requires the implementation of additional requirements to meet the international obligations of operating such a registry which would be more costly to implement and administer and would increase the commercial risk of the project were such a register to be administered from the outset.

5.3 The Department recommends that the scope of the Register is restricted to non-commercial aircraft owned by Channel Island resident individuals or Guernsey companies only at the outset. However, it is recommended that the primary legislation that will be required to establish the Register permits the registration of all categories of aircraft operation so that the scope of the Registry can be expanded in future if so desired. In this way, the Registry can be allowed to prove itself in the registration of private aircraft before the decision is taken as to whether to seek to expand into the commercial market. It is intended that the Registry should focus on the market for registration of modern, new or nearly new, corporate aircraft, whilst also accepting smaller locally owned private aircraft regardless of age.

6 Preferred Model

6.1 A number of potential models have been considered for the delivery of an Aircraft Registry. These range from an entirely in-house model, where all the necessary services are delivered by the States and directly employed civil servants, to a mainly outsourced model, where all the necessary customer facing services are delivered by private sector providers and only core State functions are retained by the States of Guernsey i.e. responsibility for setting policy and taking regulatory decisions.

6.2 It is clear that an entirely in-house model would not be appropriate given the level of staff resources and specialist engineering and technical expertise that would be required to offer a full service on this basis. Whilst it would be viable to recruit a small number of staff locally to conduct the administrative work of the Registry, it would simply not be possible to find highly specialised airworthiness inspectors, able to inspect aircraft wherever they may be located in the world, from amongst the existing pool of locally qualified residents. It is therefore considered that at least the airworthiness inspection aspects of the Registry would need to be outsourced to the private sector.

6.3 The Department has considered the desirability of retaining the administrative aspects of delivery of the Registry in house. This would create a small number of new public sector jobs for the locally qualified workforce and would present the possibility of deriving a modestly increased direct income from fees associated with the administrative work of the Registry. Potential disadvantages include the increased commercial risk to the States of having to create and support new jobs when income and work levels may be unpredictable in the early years and also the feasibility of locally employed civil servants providing a truly personalised service to the Registry's customers. For example, at least one successful offshore registry offers a 24 hour personalised service in order to distinguish itself, in terms of service standards, from the larger onshore registries and to cater for the needs of its clients around the globe.

6.4 The Department's conclusion is that the best model for Guernsey is one where all but the core State functions of decision making and licensing are outsourced to a private sector provider, who is able to invest in the facilities offered by the Registry to offer a truly class leading service to customers.

6.5 It is anticipated that the private sector provider will interface with the customers, will organise and undertake the necessary activities to inform the DCA's decisions on licensing and airworthiness, and will market the registry to clients worldwide. They will also invoice clients for all fees including those in respect of the DCA's consideration of licensing applications.

6.6 It is proposed that rather than the States paying the private sector provider to provide this service, the private sector provider should pay the States a licence fee for the right to operate the Registry - on the basis that the private sector provider retains the profit generated by the services that it provides.

6.7 In addition to ultimately providing the customer interface and technical work, the private sector provider will be required to assist in the development of the Final Business Case and the Registry policies and procedures that will be necessary to ensure compliance with international standards.

6.8 In this way, the start up cost to the States of establishing the Registry will be minimal and the commercial risk will be largely taken on by the private sector provider yet the benefits to the local economy, which are the primary driver for the establishment of a Registry, would still be realised in full.

7 Economic benefits

Benefits to the local economy

7.1 Given the indirect nature of the benefits that are the driver for this project, it is impossible to project precise figures representing the economic benefit to industry from the establishment of a Registry. That said, the report jointly commissioned by the States of Guernsey and the States of Jersey identifies the economic opportunity that the existence of a Registry would present to the local economy of the jurisdiction or jurisdictions hosting the Registry as being in the region of £18,000,000 cumulatively over the first three years of Registry operation with the potential for this opportunity to grow on an annual basis as the Register grows in size. This is a conservative estimate, assuming a medium level of take-up of the Registry's services amongst the potential domestic and international markets - the figures assume a total number of registrations of 125 aircraft in the first three years of operation. The term 'economic opportunity' refers to the size of the additional turnover to local businesses should they satisfy the demand for services directly created by the existence of the Registry.

7.2 In addition to this, it is anticipated that there would be a significant element of cross selling of other services provided by the local financial services sector. The

existence of an aircraft registry will attract high net worth individuals and corporations to Guernsey and it is anticipated that such persons will be encouraged to conduct more of their business through the island as a consequence of their experience of registering aircraft here.

Benefits to the States of Guernsey

7.3 The States of Guernsey will gain direct revenue from the licence fee paid to it by the private sector provider. It is envisaged that this will be fixed as a percentage of the turnover of fees paid directly to the private sector provider. The precise nature and scope of the licence fee will be determined during the course of the tender process for the private sector services.

7.4 The Office of the DCA will also charge fees, administered by the private sector provider, in respect of the regulatory decision making functions exercised by the DCA. Again, the structure and scope of these fees will need to be determined as the Full Business Case is developed.

7.5 It is anticipated that over time there will be an increase in the incorporation and administration of Guernsey companies as asset holding vehicles for the purchase and operation of aircraft on the Register. This will provide increased income for the Company Registry.

7.6 The States of Guernsey will also benefit from increased taxation (e.g. ETI contributions, corporate taxation on increased bank profits, etc) as a result of the increased economic activity in the local economy.

8 Competition

8.1 There are a number of 'offshore' Registries operating around the world. Perhaps the closest competition will come from the Isle of Man (IoM) Registry. The IoM Aircraft Registry has been operating for around five years and during this time it has registered nearly 300 aircraft which is considered very successful for an intentionally niche registry. It will be a clear competitor for the Guernsey Aircraft Registry, although it is understood that it is already very busy for the level of resource that it has. Furthermore, due to the absence of VAT in Guernsey it is likely that different customers will be attracted to each depending upon their place of business and planned base of activity for their aircraft.

8.2 It is also possible that Jersey may choose to establish an Aircraft Registry in the future. The Guernsey Registry will need to establish a sound reputation and customer base to ensure that it is able to compete should this occur.

9 Costs

9.1 It is expected that the strategic partner will make the necessary initial investment in order to establish the Register. No upfront capital financial investment from the States will therefore be required.

9.2 It is currently anticipated that one contract will be signed with the successful private sector provider for a development period of nine to twelve months, to be followed by an initial period of operation. At this stage, it is anticipated that the initial period of operation would be in the region of 15 years, to allow sufficient time for the private sector provider to recoup its investment in the project.

9.3 Following contract award, the private sector provider will be required to spend an initial nine to twelve months assisting the Director of Civil Aviation with the completion of the Full Business Case and also, importantly, all necessary policies and procedures. The contract will require this work to be undertaken at no cost to the States, in the expectation that the provider's investment would be recouped over the following years of operation of the Registry. The contract will make provision for a breakpoint at nine to twelve months after contract award if the project is not progressing as anticipated. It is likely that the contract will need to make provision for payment for services rendered in the event that the contract is broken after nine to twelve months through no fault of the private sector provider. At this stage, it is anticipated that the value of the work undertaken during this nine to twelve month period would not exceed £100k. This is therefore anticipated to be the maximum potential liability of the States to the end of the nine to twelve month development phase.

10 Main Risks

10.1 A number of risks have been identified, although it is considered that these can be adequately managed.

10.2 The operation of an Aircraft Register necessarily poses some risk of an aircraft on the Register being involved in an accident, or being used for unlawful purposes. This risk exists for all jurisdictions that register aircraft and can be managed through the implementation of the highest, internationally accepted, standards of airworthiness oversight and inspection and flight crew licensing.

10.3 Accident and incident investigation is a State of Registry responsibility under the Chicago Convention. Accident and incidents involving Guernsey based aircraft and/or accidents and incidents in Guernsey airspace are therefore currently investigated by the Air Accidents Investigation Branch (AAIB) of the UK Department for Transport. It is not anticipated that there would be any change to this arrangement following the establishment of a Guernsey Registry, as the UK would remain the State of Registry for the purposes of the Chicago Convention. This would mirror the arrangements in the Isle of Man and the Overseas Territories. It will, however, be important to confirm early in discussions with the UK authorities that the AAIB would continue to provide such services on the same basis as they do at present.

10.4 The proposed model of outsourcing all but the core state functions to a private sector provider poses the potential commercial risk of withdrawal/commercial failure of the private sector provider. It will be necessary to manage this risk and to ensure that appropriate contingency plans are in place as part of the procurement of the contract for the private sector services.

11 Legislation

11.1 The establishment of an Aircraft Registry will require primary legislation in order to create a registry, to permit the DCA to exercise the functions of the registrar (delegated as appropriate to an external provider) and to ensure that all the standards imposed by the Chicago Convention will be met. A Projet de Loi will be required to put the necessary legal framework in place.

11.2 It is proposed that other relevant existing legislation should be reviewed in conjunction with the development of the new Projet de Loi. It is possible that amendments to existing legislation, in particular the Aviation (Bailiwick of Guernsey) Law, 2008 will be necessary and/or desirable in order to facilitate the successful establishment of an Aircraft Registry.

12 Consultation

12.1 The Law Officers have been consulted regarding this proposal and have raised no issues.

13 Recommendations

13.1 The Commerce and Employment Department recommends the States to:

1. Approve in principle the establishment of a Guernsey Aircraft Registry on the basis set out in this States Report.

2. Direct the Department to work with the Law Officers to identify the necessary legislative requirements for the establishment of a Registry and to report back to the States outlining the necessary legislation.

3. Direct the Department to appoint a commercial partner for the Registry.

4. To delegate authority to the Treasury and Resources Department to approve the Full Business Case for the establishment of a Guernsey Aircraft Registry.

Yours faithfully

C S McNulty Bauer
Minister

M Laine
Deputy Minister

R Matthews
R Sillars
M Storey
States Members

P Mills
Non States Member

APPENDIX 1
DRAFTING OF LEGISLATION – PRIORITY RATING SCHEME
STATES REPORT AIRCRAFT REGISTER

Criteria

Criterion 1 – Need for legislation
Primary legislation is essential for the establishment of an Aircraft Registry. A Projet de Loi will be required to put the necessary legal framework in place.

It is also proposed that relevant existing legislation should be reviewed in conjunction with the development of the new Projet de Loi. It is possible that amendments to existing legislation will be necessary and/or desirable in order to facilitate the successful establishment of an Aircraft Registry.

Criterion 2 – Funding
States funding will not be required in order to implement the Aircraft Registry after the necessary legislation has been drafted, assuming a suitable commercial partner is identified and is willing to proceed on the basis of the preferred option outlined in the States Report.

In fact, the only potential need for funding arises in the event that the States decide not to proceed with the implementation after the nine to twelve month development phase identified in the States Report in which case it is anticipated that a contingent contractual liability in the region of £100,000 would be likely to arise.

Criterion 3 – Risks and benefits associated with enacting/not enacting the legislation
An Aircraft Registry cannot be established without enacting the necessary legislation. There is a clear demand from the aviation and finance industries for the establishment of an Aircraft Register and not enacting the necessary legislation would mean that the potential economic opportunity identified in the States Report would not be realised.

Criterion 4 – Estimated Drafting Time
It is not possible to provide an estimate of the time required to draft the necessary legislation at this stage, as the scope and extent of the required legislation has not yet been identified. An estimate of the drafting time required will be provided when the legislative requirements have been fully scoped and this matter is brought back to the States in accordance with the Resolutions contained in the States Report.

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

(NB The Policy Council supports the proposal.)

The States are asked to decide:-

XVI.- Whether, after consideration of the Report dated 12 July, 2011, of the Commerce and Employment Department, they are of the opinion:-

1. To approve in principle the establishment of a Guernsey Aircraft Registry on the basis set out in this Report.

2. To direct the Department to work with the Law Officers to identify the necessary legislative requirements for the establishment of a Registry and to report back to the States outlining the necessary legislation.

3. To direct the Department to appoint a commercial partner for the proposed Registry.

4. To delegate authority to the Treasury and Resources Department to approve the Full Business Case for the establishment of a Guernsey Aircraft Registry.

PUBLIC SERVICES DEPARTMENT

EXTENSION OF MERCHANT SHIPPING CONVENTIONS TO THE BAILIWICK

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

7th July 2011

Dear Sir

1. Executive Summary

The Public Services Department ("the Department") wishes to have one international Convention, and Protocols to three other international Conventions, extended to the Bailiwick, and is requesting the States to approve the preparation of the legislation necessary to give domestic effect to them. They relate to liability and compensation, and the prevention of marine pollution, and would increase available levels of compensation available, and improve standards of pollution prevention, at no cost to the Bailiwick. If the legislation is not enacted Guernsey will not be in a position to comply or demonstrate compliance with the conventions that it has requested to be extended and HM Government will be at risk of breaching its international responsibilities as a result. The Conventions and Protocols in question are:

- the International Convention on Civil Liability for Bunker Oil Pollution Damage, 2001 ("the Bunkers Convention")
- The 1996 Protocol to the Convention on Limitation of Liability for Maritime Claims, 1976 ("the LLMC Convention")
- The 2002 Protocol to the Athens Convention relating to the Carriage of Passengers and their Luggage by Sea, 1974 ("the Athens Convention")
- The 1973 Protocol to the International Convention Relating to Intervention on the High Seas in Cases of Oil Pollution Casualties, 1970 ("the Intervention Convention")

The text of these international instruments is available online at the International Maritime Organisation (IMO) website, www.imo.org. The External Relations Group of the Policy Council is content to progress their extension to the Bailiwick.

In order to enact the necessary legislation to implement these Conventions, the Department requests the States to approve the preparation of the following related legislation:

- an Ordinance under section 149 of the Merchant Shipping (Bailiwick of Guernsey) Law, 2002 ("the Law") to apply sections of the Law implementing the Intervention Convention to non-Guernsey ships in certain circumstances.

Finally, the Department requests the States to approve the preparation of legislation necessary to commence those relevant sections of the Law that are not yet in force, and to effect any corresponding repeals and other consequential and incidental provisions.

It may be that the requisite domestic legislation can satisfactorily all be dealt with in one Ordinance, or it may be, once the drafting has commenced, that in the judgement of the Law Officers it would increase the clarity of the legislation for separate Ordinances to be enacted. The "Implementation in domestic law" sections of this report should be read in that context.

References to "SDR" in this report are to Special Drawing Rights, units of account defined and maintained by the IMF and commonly used in IMO Conventions. The conversion rate used here is 100 SDR to £98, the rate in force as of 5th April 2011.

The Department is advised that, on the assumption that no significant policy issues arise that need to be resolved, the legislation should take approximately two months to draft.

2. The Bunkers Convention

2.1 Background

The Bunkers Convention entered into force in November 2008. It ensures that adequate, prompt, and effective compensation is available to persons who suffer damage caused by spills of oil, when carried as fuel in ships' bunkers, and it plugs a gap in the pollution and liability compensation regime by addressing, for the first time, the problem of pollution caused by the escape of bunker fuel from ships other than tankers.

The Bunkers Convention applies to damage caused on the territory, including the territorial sea, and in exclusive economic zones of States Parties. It is modelled on the International Convention on Civil Liability for Oil Pollution Damage, 1969, and as with that Convention, a key requirement in the Bunkers Convention is the need for the registered owner of a vessel to maintain compulsory insurance cover. (The International Convention on Civil Liability for Oil Pollution Damage, 1992 is given effect in Chapter IV of Part VI of the Law.)

Another key provision is the requirement for direct action - this would allow a claim for compensation for pollution damage to be brought directly against an insurer. The Convention requires ships over 1,000 gross tonnage to maintain insurance or other financial security, such as the guarantee of a bank or similar financial institution, to cover the liability of the registered owner for pollution damage in an amount equal to the limits of liability under the applicable national or international limitation regime, but in all cases, not exceeding an amount calculated in accordance with the Convention on Limitation of Liability for Maritime Claims, 1976, as amended.

In short, this Convention removes an important anomaly in the international pollution and compensation framework at no cost to the Bailiwick.

2.2 Implementation in domestic law

The domestic legislation would take the form of an Ordinance under section 130(1)(e) of the Law.

3. The 1996 Protocol to the LLMC Convention

3.1 Background

The LLMC Convention came into force in 1986 and is currently applicable in the Bailiwick by virtue of the extension of the relevant provisions of the Merchant Shipping Act 1979. When the relevant provisions of the Law are commenced the extending Order in Council will be revoked. Under its provisions, the previous limit of liability for claims covered was raised considerably, in some cases up to 250-300 per cent. Limits are specified for two types of claims - claims for loss of life or personal injury, and property claims (such as damage to other ships, property or harbour works).

The limits under the 1976 Convention were set at 333,000 SDR (£326,890) for personal claims for ships not exceeding 500 tons plus an additional amount based on tonnage. For other claims, the limit of liability was fixed at 167,000 SDR (£163,936) plus additional amounts based on tonnage on ships exceeding 500 tons.

The 1996 Protocol came into force in 2004. Under the Protocol the amount of compensation payable in the event of an incident is substantially increased and also introduces a "tacit acceptance" procedure for updating these amounts. The limit of liability for claims for loss of life or personal injury on ships not exceeding 2,000 gross tonnage is 2 million SDR (£1,963,306).

For larger ships, the following additional amounts are used in calculating the limitation amount:

- For each ton from 2,001 to 30,000 tons, 800 SDR (£785)
- For each ton from 30,001 to 70,000 tons, 600 SDR (£589)
- For each ton in excess of 70,000, 400 SDR (£393).

The limit of liability for property claims for ships not exceeding 2,000 gross tons is 1 million SDR (£981,653).

For larger ships, the following additional amounts are used in calculating the limitation amount:

- For each ton from 2,001 to 30,000 tons, 400 SDR (£393)
- For each ton from 30,001 to 70,000 tons, 300 SDR (£295)
- For each ton in excess of 70,000, 200 SDR (£196).

By bringing the Protocol into force, liability limits in Guernsey will be brought into line with those in place elsewhere, notably in Europe.

3.2 Implementation in domestic law

The Department proposes to commence section 194 of, and Schedule 7 to, the Law in relation to the Convention and to repeal the relevant provisions of the Merchant Shipping Act 1979 (Guernsey) Order 1981 as they extend to the Bailiwick. The Protocol can then be given effect by modification of those provisions by Ordinance under section 194(3) of the Law.

4. The 2002 Protocol to the Athens Convention

4.1 Background

The Athens Convention came into force in 1987 and, like the LLMC Convention, is currently applicable in the Bailiwick by virtue of the extension of the relevant provisions of the Merchant Shipping Act 1979, which can be repealed and replaced when the relevant provisions of the 2002 Law are commenced. The Convention establishes a regime of liability for damage suffered by passengers carried on a seagoing vessel. It declares a carrier liable for damage or loss suffered by a passenger if the incident causing the damage occurred in the course of the carriage and was due to the fault or neglect of the carrier.

Unless the carrier acted with intent to cause such damage, or recklessly and with knowledge that such damage would probably result, he can limit his liability. For the death of, or personal injury to, a passenger, this limit of liability is set at 46,666 SDR (£45,810) per passenger.

The 2002 Protocol will enter into force twelve months following the date on which the States have deposited instruments of ratification, acceptance, approval or accession with the Secretary-General of the IMO. The United Kingdom is working towards ratification in December of this year. When it enters into force, it will introduce compulsory insurance to cover passengers on ships; introduce higher liability limits on carriers (up to 400,000 SDR or £392,661 per capita); require the carrier to provide evidence of insurance up to 250,000 SDR (£245,413) per capita on the basis of strict liability; require the compulsory insurance to be verified by a certificate issued by a State Party; and introduce the right of direct action against the insurer. It will effectively replace the Convention.

As such, entry into force of the Protocol will improve the situation for all fare paying passengers in the event of an incident involving the international carriage of passengers by sea, by establishing a guaranteed level of compensation beyond the sums currently available.

4.2 Implementation in domestic law

The Department proposes to commence sections 192 and 193 of, and Schedule 6 to the Law, in relation to the Convention and to repeal the relevant provisions of the Merchant Shipping Act 1979 (Guernsey) Order 1981 as they extend to the Bailiwick. The

Protocol can then be given effect by an Ordinance made under section 192(4) of the Law.

Extension of the Protocol can be requested to be at the same time as the United Kingdom ratifies it, which as noted above is expected to be December 2011, or at a later date. The choice of when to request extension will principally depend on whether the necessary domestic legislation is in place before the United Kingdom's ratification.

There is power in the Law to provide by Ordinance for the Convention (as amended in domestic law by the 2002 Protocol) to have effect in the Bailiwick in relation to carriage within the British Islands (ie Britain, the Channel Islands and the Isle of Man). The Department is currently liaising with the authorities in the other jurisdictions in relation to this, and if it appears to the Department that such a step would be in the interests of the Bailiwick, it will revert to the States with a separate, short report seeking approval.

5. The 1973 Protocol to the Intervention Convention

5.1 Background

The Convention came into force in 1975. Its provisions have effectively been implemented in the Bailiwick by sections 144 to 148 of the Law, which are in force. Agreed in the aftermath of the Torrey Canyon disaster of 1967, the Convention affirms the right of a coastal State to take such measures on the high seas as may be necessary to prevent, mitigate or eliminate danger to its coastline or related interests from pollution by oil or other substances or the threat thereof, following upon a maritime casualty. The coastal State is, however, empowered to take only such action as is necessary, and after due consultation with appropriate interests including, in particular, the flag State or States of the ship or ships involved, the owners of the ships or cargoes in question and, where circumstances permit, independent experts appointed for this purpose.

A coastal State which takes measures beyond those permitted under the Convention is liable to pay compensation for any damage caused by such measures. Provision is made for the settlement of disputes arising in connection with the application of the Convention. The Convention applies to all seagoing vessels except warships or other vessels owned or operated by a State and used on Government non-commercial service.

The Convention proved important in combating marine pollution from oil. However, in view of the increasing quantity of other substances, mainly chemical, carried by ships, some of which would, if released, cause serious hazard to the marine environment, the need was recognised to extend it to cover substances other than oil. Accordingly the London Conference on Marine Pollution in 1973 adopted the Protocol to the Convention. This extended the regime of the Convention to wide range of additional substances such as oils, noxious chemicals, liquefied gases and radioactive substances.

As matters currently stand, the Bailiwick has no means of taking early preventative action in relation to an event that threatens pollution of our waters and beaches by pollutants other than oil; no action can be taken until the

chemicals actually enter the sea. It is clearly far more preferable to be able to take action before that point is reached, as we can in the case of oil. The Protocol would empower the States to take such preventative measures in respect of a wide range of other pollutants.

5.2 Implementation in domestic law

The main provisions of the Convention have been given domestic effect by sections 144 to 148 of the Law, which are in force.

The Department proposes that the Protocol be given effect by an Ordinance made under section 130(1)(b) of the Law.

Sections 144 and 148 of the Law do not apply to ships that are not Guernsey ships which are for the time being not within Guernsey waters (nor within a part of the sea specified by virtue of section 131(2)(b) in any Ordinance in place from time to time made under section 131(1); no such Ordinance has been made and there are currently no plans to make one). However, there is power by way of an Ordinance under section 149(1) to apply those sections to such ships. The Department proposes that such provision should be made, to enable the Bailiwick to benefit from the widest and most flexible protection available domestically under the Law and internationally under the Convention.

6. Consultation

The Department has consulted the relevant authorities in Alderney and Sark in relation to these matters and can confirm that both jurisdictions support the extension of these Protocols and Convention and the implementation of the requisite domestic legislation. The Law Officers have been consulted and raise no objections to the proposals.

7. Cost/Resources

These proposals would not lead to any increase in public expenditure, nor would they have any other significant impact on the public sector.

8. Recommendations

The Department recommends that the States:

1. Approve the preparation of the legislation identified in section 2 to give domestic effect to the Bunkers Convention, together with such incidental and consequential provisions as are required.

2. Approve the preparation of the legislation identified in section 3 to give domestic effect to the LLMC Convention as amended by the 1996 Protocol, together with such incidental and consequential provisions as are required.

3. Approve the preparation of the legislation identified in section 4 to give domestic effect to the Athens Convention as amended by the 2002 Protocol, together with such incidental and consequential provisions as are required.

4. Approve the preparation of the legislation identified in section 5 to give domestic effect to the 1973 Protocol to the Intervention Convention, together with such incidental and consequential provisions as are required.

5. Approve the preparation of an Ordinance under section 149(1) of the Law, as identified above, to apply sections 144 to 148 of the Law to non-Guernsey ships in certain circumstances.

Yours faithfully

B M Flouquet
Minister

Other Members of the Department are:

1) S J Ogier, Deputy Minister
2) T M Le Pelley
3) A Spruce
4) J Kuttelwascher

Annex 1

In accordance with the requirements of the Policy Council, this Annex contains the necessary detailed information concerning the drafting and implementation of new legislation as follows:

1. Legislation is required to implement the provisions of international maritime conventions that have been extended in respect of the Bailiwick. See sections 2-5 of the Report for a full analysis.

2. As explained in section 7 of the Report these proposals would not lead to any increase in public expenditure, nor would they have any other significant impact on the public sector.

3. As explained in the Executive Summary if the legislation is not enacted Guernsey will not be in a position to comply or demonstrate compliance with the conventions that it has requested to be extended and HM Government will be at risk of breaching its international responsibilities as a result.

4. As confirmed in the Executive Summary the Department is advised that, on the assumption that no significant policy issues arise that need to be resolved, the necessary legislation should take approximately two months to draft.

Annex 2

Compliance with the Principles of Good Governance

In accordance with Resolution VI of 2011 (Billet d'État IV, 2011 refers) this annex sets out the degree to which the Public Services Department considers that the Report complies with the six principles of good governance as detailed in the aforementioned Billet d'État.

Core Principle 1 – Good governance means focusing on the organisation's purpose and on outcomes for citizens and service users.

This Principle is closely linked to the States Strategic Plan (SSP). The issues covered in the States Report are loosely related to the SSP in so far as the Environmental Plan therein includes the need to tackle "threats to the nature of the Island's countryside including the coastal and marine environments", together with the desired outcome that "our biodiversity will be healthier".

Introduction of the legislation outlined in this Report will make a potentially significant contribution to the prevention of marine pollution, which thus links in to the Environmental Plan.

Core Principle 2 – Good governance means performing effectively in clearly defined functions and roles.

This Principle does not seem strictly relevant to this Report. Consequently the Department has no comment in this respect.

Core Principle 3 – Good governance means promoting good values for the whole organisation and demonstrating the values of good governance through behaviour.

This Principle does not seem strictly relevant to this Report. Consequently the Department has no comment in this respect.

Core Principle 4 – Good governance means taking informed, transparent decisions and managing risk.

If the legislation is not enacted Guernsey will not be in a position to comply or demonstrate compliance with the conventions that it has requested to be extended and HM Government will be at risk of breaching its international responsibilities as a result. Consequently the request to extend the legislation to Guernsey is, of itself, a demonstration that risk – in this case reputational risk to both Guernsey's and the UK Governments - is being adequately managed.

Core Principle 5 – Good governance means developing the capacity and capability of the governing body to be effective.

This Principle does not seem strictly relevant to this Report. Consequently the Department has no comment in this respect.

Core Principle 6 – Good governance means engaging stakeholders and making accountability real.

This Principle does not seem strictly relevant to this Report. Consequently the Department has no comment in this respect.

(NB The Policy Council has no comment on the proposals.)

(NB The Treasury and Resources Department has no comment on the proposals.)

The States are asked to decide: -

XVII.- Whether, after consideration of the Report dated 7th July 2011 of the Public Services Department, they are of the opinion:-

1. To approve the preparation of the legislation identified in section 2 of that Report to give domestic effect to the Bunkers Convention, together with such incidental and consequential provisions as are required.

2. To approve the preparation of the legislation identified in section 3 of that Report to give domestic effect to the LLMC Convention as amended by the 1996 Protocol, together with such incidental and consequential provisions as are required (including the commencement and repeal of legislation).

3. To approve the preparation of the legislation identified in section 4 of that Report to give domestic effect to the Athens Convention as amended by the 2002 Protocol, together with such incidental and consequential provisions as are required (including the commencement and repeal of legislation).

4. To approve the preparation of the legislation identified in section 5 of that Report to give domestic effect to the 1973 Protocol to the Intervention Convention, together with such incidental and consequential provisions as are required.

5. To approve the preparation of an Ordinance under section 149(1) of the Law to apply sections 144 to 148 of the Law to non-Guernsey ships in the circumstances described.

6. To direct the preparation of such legislation as may be necessary to give effect to their above decisions.