

**MEMORANDUM OF UNDERSTANDING
BETWEEN
THE TREASURY AND RESOURCES DEPARTMENT AND GUERNSEY ELECTRICITY LIMITED**

1. Purpose

The Minister and Deputy Minister of the Treasury and Resources Department are equal Shareholders, in trust, on behalf of the States of Guernsey of all shares in Guernsey Electricity Limited.

The Treasury and Resources Department has been mandated by the States of Deliberation inter alia: to advise the States on matters relating to the allocation and administration of all States resources; and, to be responsible for the shareholders' functions and duties in respect of the States Trading Companies, including Guernsey Electricity Limited.

The purpose of this document is to formalise the relationship between the Treasury and Resources Department of the States of Guernsey ("the Shareholder") and Guernsey Electricity Limited ("the Company") by detailing the protocols to be observed in their on-going relationship and setting out the expectations, rights and duties of both parties.

2. Scope

This Memorandum of Understanding covers the current expectations placed on the Company by the Shareholder and details the documentation, levels of disclosure and contact expected to enable the Shareholder to discharge its duties and to ensure that the Company discharges its corporate governance duties. It also sets out the institutional arrangements that the Shareholder has established to exercise its role and responsibilities as shareholder in the Company. It details the objectives of the Company agreed between the Board of the Company and the Shareholder and establishes arrangements setting out how the Company will report its performance against those objectives.

The Shareholder and the Company each acknowledge that it is in their mutual interest for each to act at all times having regard to the best interests of the Company.

This Memorandum of Understanding shall not act so as to enable or authorise the Shareholder or the Supervisory Sub-Committee (see section 3 below) to act in any manner which might constitute either or each of them (including employees, servants or members of such bodies) being capable of being regarded as a "Shadow Director" within the meaning of Section 132 of the Companies (Guernsey) Law, 2008.

3. Supervisory Sub-Committee

The Shareholder has established a Supervisory Sub-Committee ("the Sub-Committee") which has been charged with the following objectives:

- Establish clear shareholder objectives for the Company;
- Monitor the Company's performance against appropriate industry benchmarks and quality standards to ensure that the Company delivers cost-effective and innovative services which are responsive to their customers' needs and that the Company operates efficiently and responsibly in the best interests of the community;
- Ensure that the Treasury and Resources Department is an effective shareholder in the Company; and,

- Seek value and an appropriate return that provides best value to the Guernsey economy from the Company for the community, whilst striking a balance with the enabling role the Company plays in supporting the Island and its social, economic and environmental objectives for the long-term benefit of the Island and its community.

The Shareholder has established the following specific terms of reference for the Sub-Committee:

- Regularly review the guidance (“the States Guidance to the Shareholder”) that, under the provisions of the States Trading Companies (Bailiwick of Guernsey) Ordinance, 2001, the States of Deliberation is able to give on the policies that they wish the Shareholder to pursue in exercising its functions as shareholder;
- Ensure that the Shareholder is fulfilling the obligations set for it under the States Guidance to the Shareholder;
- Establish clear shareholder objectives for the Company, including but not limited to areas such as pricing and pricing controls, dividend policies, financial performance, quality of customer service, corporate governance, sustainability, reputation and compliance with environmental standards;
- Establish the financial, operational and strategic parameters within which the Company can operate with and without reference to the Shareholder;
- Engage with the Company on financial matters and hold it to account in terms of its performance against its business plan and shareholder objectives; and,
- Scrutinise the process employed for the appointment of the Company’s Chairman, non-executive directors and executive management team.

The Shareholder will appoint a Shareholder Liaison Officer who will act as the principal point of liaison between the Shareholder, the Sub-Committee and the Company on a day-to-day basis. The Shareholder Liaison Officer will assist and support the Company in meeting its obligations under this Memorandum of Understanding and will provide a sounding board for the Company and their Executive Directors on matters of shareholder interest.

The Shareholder and the Company agree that the costs reasonably incurred by the Shareholder in exercising its oversight responsibilities for the Company through the Sub-Committee and the Shareholder Liaison Officer will be charged to the Company. These costs will be fairly apportioned between the Company and the other companies for which the Department acts as shareholder on behalf of the States. The Shareholder will provide an estimate to the Company of its anticipated costs and proposed apportionment for each calendar year no later than 30th October of the preceding year.

4. States Strategic Guidance

The States Guidance to the Shareholder¹ is set out in Schedule 1.

The Shareholder believes that the States intended purpose of commercialisation was to enable the Company to run more efficiently, unencumbered by public sector constraints, particularly in respect of staff levels and staff remuneration, to capitalise on opportunities that can make greater use of the Company’s asset base and to investigate new business areas that may be “conveniently combined” with the core business streams.

Schedule 1 will be updated from time to time to take account of any changes in legislation or regulation.

¹ Resolution XIV(4) of Billet d’Etat XV of 2011

In 2011, following consideration of a report from the Commerce & Employment Department, the States agreed² to direct the Treasury and Resources Department to follow the six principles of corporate governance set out in that report and to take them into account in performing the shareholder representative role. The six principles are set out in Schedule 1.

5. Shareholder Objectives

The Shareholder has established and agreed shareholder objectives with the Company. These are set out in Schedule 2, which also sets out the Key Performance Indicators and other criteria on which the Company will report to demonstrate its performance against these shareholder objectives.

Schedule 2 also sets out the guaranteed service standards agreed by the Company and the associated penalty charges for not achieving them. Schedule 2 will be updated from time to time to take account of any changes in objectives or performance metrics agreed between the Shareholder and the Company.

The Company will commission a triennial external efficiency review of its operations, the arrangements and terms of reference for which will be subject to the approval of the Sub-Committee. The company will be responsible for meeting the costs associated with this review.

The Company will establish and maintain an independent User Council to supplement existing methods of communication with its customers. The User Council will provide an opportunity for the company's customers to convey to an independent body issues, ideas and observations on the provision of its services.

6. Documentation

The Company will provide the Shareholder with the following documented information:

- a) An annual confidential Shareholder Report which should cover, as a minimum, the following areas:
 - A review of the Company's performance against its key objectives and strategic goals;
 - A brief description of the principal challenges and other relevant issues that the Company has dealt with in the preceding year;
 - A review of the principal risks being managed by the Company and the steps being taken to mitigate against these;
 - The results of the Board effectiveness review; and,
 - An overview of the work over the year of the Audit and Risk Sub-Committee, the Remuneration Sub-Committee and the Board Nominations Committee, or such sub-committees, however combined, named or constituted which fulfil the tasks and roles of the above named sub-committees.
- b) An annual confidential Remuneration Report, including disclosure of the remuneration package for each of the Executive Directors, including any bonuses paid and their basis;
- c) The Company's annual report and accounts (as published);

² Resolution XIV(3) of Billet d'Etat XV of 2011

- d) An annual transparency report (the content and format of which will be agreed and reviewed with the Company from time to time);
- e) An annual business plan and periodic strategic plans, drafts of which should be submitted to the Shareholder before finalisation;
- f) Quarterly KPIs and financial performance reports, including P&L, Balance Sheet and Cashflow (to date and forecasts).

A timetable showing the timing of the submission of these reports is shown at Schedule 3. It is acknowledged that some of the documentation set out above and not specifically marked as confidential will contain confidential and/or commercially sensitive information which will not be appropriate for publication.

7. Meetings and Liaison

The following annual calendar of Shareholder contact should continue for the term of this Memorandum of Understanding:

- a) Annual meeting between the Board of the Treasury and Resources Department, the Sub-Committee and representatives of the Company (to include the Chairman, Chief Executive and Finance Director) to review and discuss the annual Shareholder Report, the Annual Report and Accounts, the Remuneration Report and the Transparency Report;
- b) Annual meeting between the Sub-Committee and representatives of the Company (to include the Chairman, Chief Executive and Finance Director) to review and discuss:
 - Strategic issues, including company performance;
 - Financial matters, including the latest management accounts;
 - Risk and assurance issues;
 - Current or upcoming events and issues;
 - Development of and updates to the strategic plan for the following calendar year; and,
 - Development of and updates to the strategic plan for the following calendar year.
- c) Annual AGM.

A timetable showing the timing of these meetings is included in Schedule 3.

Regular dialogue and liaison will be maintained between the Company and the Shareholder Liaison Officer to ensure that there are “no surprises” for either party and to ensure that any matters which may have political implications can be discussed with the Shareholder in advance.

8. Matters to be Referred to the Shareholder

From time to time matters will need to be referred to the Shareholder, either for approval or for information. Those matters that are reserved for decision by the Shareholder are set out in Schedule 4.

Prior sight should be given to the Shareholder, for information only, of any press release that deals with a significant announcement (on the basis that there should be “no surprises” for either party).

9. Corporate Governance Issues

The Shareholder is required by the States to ensure that the Company complies with best practice on corporate governance, including financial management and controls and, as such, the Shareholder will expect the following minimum requirements to be in place within the Company:

Appointment of Non-Executive Directors and Executive Directors

The appointment of the appropriate Non-Executive and Executive Directors is essential to the performance of the Board and to the Shareholder in achieving its objectives. Therefore, there should be a formal, rigorous and transparent procedure for the appointment of new Non-Executive and Executive Directors to the Board, which should be agreed beforehand with the Shareholder.

All such appointments shall be in accordance with the Company's Articles of Incorporation and any relevant legislation.

Any new Non-Executive Director appointments will need to be approved by the States of Deliberation on the recommendation of the Shareholder.

The guidance from the Shareholder is that there will be a general presumption that Non-Executive Directors will serve for six years (i.e. two terms of three years). The Company's Board may request the Shareholder to agree to the reappointment of a Non-Executive Director for a third three-year term where such a reappointment would be in the best interests of the Company, having regard to the Non-Executive Director's performance, contribution and the need for continuity. Where such a request is made, the Shareholder will normally respond positively. It is most unlikely that the Shareholder will consent to a further reappointment beyond the nine year period.

Audit Committee

The Company will maintain an Audit Committee which will meet at least biannually. The annual results of their work and considerations should be included in the Shareholder Report.

Internal Control

A sound system of internal control (including financial, operational and compliance controls) and risk management must be in place to ensure effective governance of the Company's finances and resources.

The Company will be expected to conduct a review of the effectiveness of the system of internal control at least annually and to document the above review as part of the annual Shareholder Report.

Remuneration and Nominations Sub-Committee

There should be a formal and transparent procedure for developing policy on executive remuneration and for framing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the Company successfully while avoiding paying any more than is

necessary for this purpose. A proportion of Executive Directors' remuneration should be structured so as to link rewards to corporate and individual performance.

The Shareholder will expect to see full disclosure Remuneration Reports, in respect of each Director, within the annual Confidential Remuneration Report.

The Sub-Committee will also be responsible for leading on the process for appointing new Non-Executive Directors, such process to be subject to the approval of the Shareholder. Evidence of periodic, thorough and effective skills analyses undertaken by the Company's Remuneration and Nominations Sub-Committee and supported by its Board prior to recommendations being put forward to the Shareholder will need to be demonstrated.

Periodic Review of Company Articles of Association

The Company and the Shareholder shall co-operate to review periodically, but at least once every five years, the Company's Articles of Incorporation to ensure that they are fit for purpose and take due regard to changes in company legislation and other relevant legislation and the needs of the Company and the requirements of the Shareholder generally.

10. Dividend Policy

The Shareholder will issue periodically guidance to the Company setting out its expectations in respect of dividends. The Company's Board will recommend the dividend for approval by the Shareholder at the Annual General Meeting, taking into account any such guidance, as well as the Company's strategic plans, its investment plans and available financial resources, its current and projected future debt levels and the overall best interests of the Company.

11. Period of Memorandum of Understanding

This Memorandum of Understanding will be reviewed after a period of three years from the date of its signature.


Signed:

For and on behalf of the Treasury and
Resources Department

Name: Gavin S. Piel

Title: Minister

Date: 5.1.15


Signed:

For and on behalf of Guernsey Electricity
Limited

Name: ALAN BATES

Title: MANAGING DIRECTOR

Date: 18th DECEMBER 2014.

SCHEDULE 1

States Guidance to the Treasury and Resources Department in exercising on behalf of the States the role of shareholder of Guernsey Electricity

1. The extent of the services of Guernsey Electricity Limited shall be to carry on business as a producer, generator, conveyor, supplier, marketing agent and distributor of electrical energy together with any other services that are ancillary or related to or may be conveniently combined with such electrical energy services in the Bailiwick of Guernsey and elsewhere.
2. However electricity services are to be provided in future, they are to be provided within a policy of retaining sufficient on-island generating plant to meet the total long-term demand, to cover for the possibility of interruption or unavailability of power through the cable link to France.
3. Guernsey Electricity Limited shall not be permitted to apply for any licence for the provision of telecommunications services under the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001.
4. Financial performance targets for Guernsey Electricity Limited shall be set so as to:
 1. Deliver improved efficiency in fulfilling the requirements of the Public/Universal Supply Obligation imposed under the regulatory regime; and
 2. Achieve as soon as is practicable an appropriate commercial return on the resources employed in the provision of other services.
5. Without an express resolution of the States, no property or buildings which are essential to fulfilling the Public Supply Obligation imposed under the regulatory regime shall be disposed of except by acquisition by the States under appropriate terms.
6. Policies for the provision of services and other activities of Guernsey Electricity Limited shall have regard to the Economic, Social and Environmental policies adopted by the States and set out in this Strategic and Corporate Plan.
7. Guernsey Electricity Limited shall be required to comply with best practice on corporate governance, financial management and controls.

Six Principle of Corporate Governance – Section 6.6 of Article 14 of Billet d’Etat XV of 2011

1. **Governance Frameworks:** where appropriate, ensure that corporate governance is compliant with the principles of the UK Corporate Governance Code (formerly known as the Combined Code) and fits the needs of the shareholder and business.

2. **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.
3. **Appointments:** recommend to the States appointments as the Chair and actively participate in other Board appointments.
4. **Remuneration and incentivisation:** set or agree remuneration principles so that management and shareholder interests are aligned.
5. **Financing and Investments:** work with businesses to optimise capital structures, agree dividend policy and approve significant investments and realisations.
6. **Monitoring and intervention:** monitor performance to ensure that the strategic plan is on track and that shareholder interventions are timely and well-informed.

SHAREHOLDER OBJECTIVES

The objectives set for Guernsey Electricity in the memorandum of understanding are as follows:

- Provide a rate of return on shareholder capital employed to be agreed between the Company and the Shareholder³ ;
- A commercial return on any loan finance from the States;
- Competitive unit prices for customers, appropriate segmented based on, for example, volume and benchmarked against comparable services in other jurisdictions;
- and, customer satisfaction feedback and/or scores at or above a level to be decided;

With the overall summary of objectives being to:

- Demonstrate good and externally benchmarked customer satisfaction;
- Provide a reliable electricity supply at externally benchmarked and competitive prices for each type of customer;
- Produce a transparency report at least annually (content to be agreed from time to time);
- Demonstrate good environmental behaviour in all respects, establishing externally benchmarked measurements where possible;
- Deliver its business plan and report to the Treasury and Resources Department on progress.

The specific objectives agreed between the Shareholder and the Company are:

- To reduce the Company's average tariffs so that, when benchmarked against the Jersey Electricity average tariff, they are at a comparable level when taking into account all cost driver differences. The target is to reduce the difference between Guernsey Electricity's and Jersey Electricity's average tariffs from 17% to 11% for the period 2015-2018. This will be reviewed on an annual basis.
- To reduce the current year customer minutes lost by 10% compared to the five year rolling average figure. This should at all times be better than the UK equivalent figure.
- To maintain the on island generation level of security above N-2.
- To ensure the on island generation strategy achieves the 80/80 rule for affordability.
- To achieve decarbonisation targets by achieving a level of carbon intensity for electricity consumed in Guernsey of less than 100gCO₂eq/kWh.
- To achieve the targets set for service standards for business activities.

Note:- The above specific objectives will reviewed on a regular basis and new targets set as required.

³ Following consideration of the 2015 Budget Report (Billet d'Etat XXII of 2014) the States of Deliberation has agreed that the Shareholder should commission an external review of the appropriate level of investment return that should be generated from States-owned trading assets. The recommendations arising from this Review will be reported back to the States of Deliberation in 2015.

KEY PERFORMANCE METRICS

In support of the above, Guernsey Electricity will be monitoring and reporting on the following Key Performance Indicators:

Area	Objective	Key Performance Indicator	Notes
People	Employer of Choice	Staff Turnover (voluntary)	% Turnover
		Employee Survey	Employee Engagement Rating (3 yearly)
	Health and Safety	Lost Time Injury Frequency Rate	Time Lost and 3 Day Accidents
	Well Being	Absence	Working Days lost to sickness %
	Maximising Potential	Achievement of Development Goals	Performance Management System (under development)
Operations	Effective Use of Assets	Availability of Plant	% Time available for service
	Reliable Supply	Network	Network Customer Minutes Lost
		Generation	Generation Customer Minutes Lost
	Operational Efficiency	Thermal	Power station thermal efficiency
		Electrical	Billable/Imported/Generated Ratio
		Marginal Cost	Marginal Cost Model
	Resource Productivity/Efficiency	Staff per GWh delivered/1000 customers	
	Security	Importation	N-1
		On-Island Generation	N-2
Customer	Customer Satisfaction Meet Expectation	Number of Contacts	Breakdown of type
		Service Standards	Guaranteed & Overall
		Customer Satisfaction	Customer Survey Results
		Price	Local/Jersey/EU for segments
		Reliability	Total Customer Minutes Lost
	Manage Perceptions	Media Coverage	Planned v Unplanned media coverage
	Provide Centre of Excellence	Customer Efficiency Savings	Energy Sales (to be developed)

Area	Objective	Key Performance Indicator	Notes
Finance	Margins	p/KWh margin	Tariff margin analysis
	Effective Cost Control	Budget Expenditure Analysis	Variance
	Grow the Business	Unit Sales (MWh)	% Increase
	Financial Covenants	Leverage, Interest Cover, Debt:Equity	
	Return	Return on Capital Employed	ROCE/RAB targets
Our Island	Being a good neighbour	Complaints about core activities	Resolution within an agreed timeframe, where required
	Caring for the environment	Environmental KPIs	Waste, fuel & water KPIs
		Carbon Intensity	Carbon content of KWh sold
	Community Engagement	Money/Time participation	Local Environment/Youth Investment
	Guernsey open for business	Percentage of load acceptance/time to delivery	Core Business Only
	Energy Market Share	% of Energy Imports	SOG Figures

GUARANTEED & OVERALL SERVICE STANDARDS

The following are the guaranteed service standards and associated penalty charges for not achieving them.

GS 1. Service fuse failures

Repair faults within 3 hours of notification. Penalty £25.

GS 2. Restoring supplies

Restore within 18 hrs except where approved by the Treasury and Resources Department. Penalty £50 domestic £100 non domestic

GS 3. Providing a supply

To connect new customers with existing supply within 3 working days. Penalty £25.

GS 4. Notice of planned interruption of supply

Give 5 days notice of interruption for planned maintenance. Penalty £25.

GS 5. Voltage complaint

Investigate within 7 working days. Correct all voltage faults within 6 months. Penalty £25.

GS 6. Charges and payments

Answer all written fax or email queries of charges/payments within 3 working days. Penalty £25.

GS 7. Meter disputes

Explain and investigate claims within 7 working days. Penalty £25.

GS 8. Prepayment meters

Failure of meter - Visit customer premises within 4 hours of notification of failure. Penalty £25.

GS 9. Changing meter

Change meter within 7 working days for a tariff or payment method change. Penalty £25.

GS 10. Making & keeping appointments

Offer and keep morning/afternoon appointment or timed appointments within 30 mins. Penalty £25.

GS 11. Payments owed under the standard

Make payment within 10 working days except if approved by the Treasury and Resources Department. Penalty £20.

GS 12. Estimate of charge

New supply or alter existing supply- supply estimate of charge within 5 working days. Penalty £10.

The following are the overall service standards

OS 1. Restoration of supply

Fault / damage, restore supply to 90% within 3 hrs.

OS 2. Estimate of charge

Provide 97% within 15 working days if significant reinforcement required

OS 3. Meter reading

Obtain meter reading from 99.5% of all customers once a year.

OS 4. Customer correspondance

Answer 100% of supply or distribution queries within 10 working days.

OS 5. Cable enquiries - single site

Reply to 97% single site inside 1 hr.

OS 5. Cable enquiries - multiple site

Reply to 98% multiple site within 2 working days.

OS 6. Pollution

Answer 98% complaints within 8 hours of notification.

OS. 7 Relocating meter

Relocate meter at customers request within 15 days.

SCHEDULE 3

Timetables

Timetable for the Submission of Reports and Documentation

Item	Frequency	Guide Date
Shareholder Report	Annual	30 th June
Remuneration Report	Annual	30 th June
Annual Report & Accounts	Annual	30 th June
Strategic Plan	Annual	3 months before the start of the financial year
KPIs & Financial Performance Reports	Quarterly	Within 6 weeks of quarter-end
Transparency Report	Annual	30 th June

Timetable for Meetings

Meeting	Topic	Guide Date
T&R Board	Shareholder Report; Remuneration Report; Annual Report & Accounts; Transparency Report	April/May
Supervisory Sub-Committee	Strategic issues, including company performance; financial matters, including the latest financial performance reports; risk and assurance issues; current or upcoming events and issues; annual business plan	November/December
AGM		July/August

MATTERS FOR REFERRAL TO THE SHAREHOLDER

THE FOLLOWING MATTERS ARE RESERVED TO THE SHAREHOLDER FOR ITS DECISION / APPROVAL:

1. Allotment and transfer of Company shares;
2. Alteration of the Company's Share Capital;
3. Appointment and Remuneration of Non-Executive Chairman and Non-Executive Directors;
4. The removal of any Non-Executive Director;
5. Annual Strategic Plan, including tariff strategy, and any material derivations from it;
6. Determination of dividend policy;
7. Approval of a dividend;
8. Approval of the annual report to the shareholder and the accounts;
9. Alteration of the company's memorandum and articles of association;
10. Appointment, reappointment or removal of the external auditor;
11. Appeals against any decision of the Guernsey Competition and Regulatory Authority.
12. Establishment of any subsidiary companies;
13. Any proposed sale, lease or encumbrance of any property transferred to the company at Commercialisation;
14. Material matters relating to the Channel Islands Electricity Grid;
15. Material litigation prosecuted or defended by the Company;
16. Acquisitions and disposals of corporate entities greater than £250k;
17. Material investments or divestments greater than £5m;
18. Merger with, or takeover by, another company;
19. Change of company name;
20. Winding up of the company;
21. Matters that will not generate a commercial return, but may fulfil other social, economic or environmental objectives;
22. The entry into new markets, or the introduction of new products, outside the core business.

The company is also required to bring all matters which have the potential to attract political interest to the shareholder's attention prior to them being made the subject of any formal media releases. As examples these will include but not be limited to:

1. Closures
2. Potential industrial action
3. Material service issues
4. Redundancies