

# Economic Affairs Scrutiny Panel

## Jersey Telecom - Privatisation

### JCRA Annotations

Presented to the States on 6<sup>th</sup> March 2007

S.R.5/2007

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## Introduction to JCRA Annotations

This paper presents the JCRA's comments to the Economic Affairs Scrutiny Panel's Report on the Privatisation of Jersey Telecom. The JCRA worked closely with this Panel throughout its consideration of this important matter. Representatives of the JCRA testified twice before the Panel, and the JCRA responded to numerous information requests from the Panel. Furthermore, on 27 February 2007, the JCRA gave extensive written comments to the Panel on the content of its proposed report. The JCRA also produced its own report on possible structures for the sale of Jersey Telecom pursuant to a request received from the Economic Development Minister; a copy of which was provided to the Panel.

In light of the JCRA's close cooperation with the Panel, we were disappointed that the Panel's final Report failed to take note of many of our comments. We thus are publishing this annotated version of the Panel's Report to present, in our opinion, a more fair and balanced view of the evidence presented to the Panel concerning the proposed sale of Jersey Telecom and the current regulatory framework and competitive environment for telecommunications in Jersey. This annotation is not intended to be a criticism of the Panel or of the Scrutiny process. This document also takes no view on the ultimate question of whether Jersey Telecom should be privatized. The JCRA's comments presented to the Panel on 27 February, prior to the final Report's publication, form the basis of these annotations.

JCRA,

15 March 2007

## **Executive Summary**

The Panel, having considered the available evidence, is not inherently opposed to the principle of privatising Jersey Telecom (JT). It accepts that in the right circumstances, and with careful planning, privatisation can bring meaningful additional benefits to some competitive markets. Notwithstanding this, the Panel considers that the case which has been made by the Minister for Treasury and Resources falls far short of that which is necessary to show that privatisation, certainly in the form of a 100 per cent sale, is the right way forward for Jersey Telecom.

The Panel's research has shown that it is competition, backed or substituted where necessary by effective economic regulation, that ensures firms produce and price their services efficiently.<sup>1[1]</sup> Privatisation is a secondary issue in that, without the former in place, the chances of a change in ownership delivering any significant benefit are limited. It therefore follows that privatisation may not deliver significant benefits unless the conditions are right.

In the view of the Panel, the Minister for Treasury and Resources has not sought to establish in sufficient detail whether the conditions are right for a sale of Jersey Telecom. Instead he has attempted to orchestrate privatisation in the shortest possible timeframe and in accordance with an initiative which was actually removed from the Strategic Plan following the adoption of an amendment brought to the States by Deputy J.G. Reed of St. Ouen.

The Minister's hurried approach is reflected in the questionable validity of the discussion paper published in July 2006, which failed to properly set out options and encourage discussion. Rather it served as a clear statement of the Minister's intent, thereby discouraging responses. In that sense public consultation on the future of Jersey Telecom was compromised from the outset.

### **The Company**

It is worthy of note that Jersey Telecom is already very successful as an incorporated company under public ownership. Over the last two years it has returned a total of approximately £33 million to the States in tax and dividends. It enjoys the support of a committed workforce of around 470 staff across Jersey and Guernsey. The company is competing effectively in both jurisdictions. Enterprising initiatives have seen JT gain a foothold in valuable niche markets such as installation of mobile networks on cruise ships and mass text messaging delivery services serving TV quiz shows. Moreover, JT has consistently managed to fund impressive rounds of investment in modern infrastructure; yet the company has a marked absence of debt on its balance sheet. These facts mean that the company is likely to be attractive to a number of possible buyers. They also mean that the States must consider carefully whether the asset is worth retaining.

The Panel acknowledges that the global telecommunications industry is evolving. In the coming years Jersey Telecom needs to benefit from certain economies of scale. For example it requires access to revenue generating content, to supplies of retail products at reasonable prices. Jersey Telecom also needs to be able to purchase new infrastructure equipment at competitive rates. Access to those economies of scale may well require some form of external investment. Nevertheless, the Panel considers that a possible sale of a minority stake in order to secure a partnership with a global telecoms operator is a viable option in this instance. Pursuing this route could well allow JT to obtain access to economies of scale without the States having to relinquish 100 per cent of the shares in the company, a decision which might have strategic implications in future years.

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<sup>1[1]</sup> See: Y. Vickers and J. Yarrow (1988) *Privatization: An Economic Analysis*, MIT Press.

## Strategic Importance

It is the considered view of the Panel that, in a small island nation such as Jersey, the only full telecommunications service provider must be regarded as a key strategic asset by virtue of the infrastructure it builds and maintains and the services it provides both to Island residents and to various sectors of the economy. Furthermore, paragraph 6.3 of the Strategic Plan 2006 – 2011 calls for recognition of the strategic importance of all utility companies.

At present Jersey Telecom is collectively owned by those who rely on its infrastructure and its services; the people of Jersey. The services provided by JT are relied upon by the finance industry and by other information technology dependent industries in the Island. It follows that consideration of a sale must be undertaken with extreme care and after considering not just the financial ramifications but also the full range of strategic, social and competition issues affecting Island residents and businesses.

On that basis the Panel considers that a comprehensive cost-benefit study of the economic and social implications of privatising Jersey Telecom is absolutely necessary in order that the States is in a position to determine whether it would be right to sell the company.

## The Analysis

In fact the Panel has discovered that a detailed cost-benefit analysis has yet to be carried out. Instead the Minister for Treasury and Resources and the Minister for Economic Development have, between them, commissioned a patchwork of reports during the latter part of 2006 which fail to give the full picture. Several key papers, including that produced by the States Economic Adviser, are too narrow in scope and lacking in supporting evidence. In particular the Panel considers the conclusion of the Citigroup consortium that the status quo *'is a non-viable (and potentially value destructive) long-term option'*<sup>2[2]</sup> is open to challenge.

In the absence of a comprehensive cost-benefit analysis of the economic implications and social consequences arising from a possible sale of JT, the Panel considers that the States will not be in a position to take an informed decision on privatisation.

The only topic which the Panel considers has been examined rigorously is the concept of separating the wholesale and retail sections of Jersey Telecom prior to a sell off; yet the result of this work is inconclusive. The Jersey Competition Regulatory Authority (JCRA), which is to be relied upon to regulate a privatised Jersey Telecom, hints strongly that there is merit in structural separation on the grounds that it may make regulation more manageable. In marked contrast, and for a variety of different and important reasons Citigroup, Analysys, the Economic Adviser and the Board of Jersey Telecom conclude that structural separation should not be pursued. The Minister's

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<sup>2[2]</sup> 'Economic Adviser's report on the structure of the proposed sale of Jersey Telecom' – 1st Feb. 2007, p.7

proposition to sell suggests that he favours the majority view over that which the Panel considers is implicit in the JCRA report.

### **The Regulatory Framework**

Experience in smaller jurisdictions worldwide demonstrates that the capability of the JCRA to regulate a telecoms market in which the incumbent operator, and its competitors, are all privately owned is of critical importance. {As detailed in the JCRA's comments below, international experience suggests strongly that a regulator's burden does not change depending on whether a dominant telecommunications provider is publicly or privately owned} Worryingly, the Panel has found evidence that the JCRA, with its complement of only 9 full-time staff, may be struggling to address an already significant workload with the resources at its disposal {As detailed below, this statement overlooks evidence submitted or available to the Panel of the JCRA's current competencies and past track record of success}.

The JCRA was unable to provide advice for the Minister of Economic Development on the practicalities and relative merits of structural separation within the original 3 month deadline set {As detailed in the JCRA's comments below, the advice was delivered on time within the time frame agreed by the Minister}. Other reports it has produced have also been affected by delays. More importantly, the JCRA has struggled with regulation of JT under States ownership, as the ongoing complaints by Cable and Wireless concerning number portability, and by JT itself concerning the need for comprehensive accounting separation, indicate. {This statement is contradicted by the evidence presented to the Panel: (1) the JCRA has provided the Panel with a list of examples where the JCRA has successfully resolved regulatory issues with JT (which the Panel's Report appears to ignore); (2) the JCRA currently is undergoing the required statutory process with respect to MNP – it is therefore incorrect and misleading to cite MNP as an example of the JCRA "struggling" to regulate JT; and (3) as detailed below, the JCRA has used JT's separated accounts as a tool in its regulatory work – it is therefore without basis to say that accounting separation is another example of the JCRA's "struggles" with JT.} As the Panel's adviser considers that the difficulties faced by the JCRA are only likely to increase following full privatisation of JT, particularly in terms of its ability to access information, {The JCRA's powers to require the production of information apply notwithstanding whether the target of an investigation is publicly or privately owned} the Panel concludes that it would be a high risk strategy to proceed with a sale of the company in the absence of a rigorous assessment of the capability of the JCRA to oversee a fully privatised telecoms market.

### **The Financial Argument**

In terms of the rationale underpinning the sale, the Panel concludes that the Minister has not looked very far beyond the financial implications – and even in this area the case for undertaking a sale is weak on the basis of the evidence presented. While the Panel understands that the Minister's approach has been affected by his responsibility to 'act in the interests of the States as

holder of securities’<sup>3[3]</sup>, it questions the logic of his assertion that the risk profile of Jersey Telecom should be considered in line with that of assets held within the Strategic Reserve. Curiously the Minister has failed to explain why the same approach should not be applied to other States assets such as other utility companies, Jersey Airport and even property used for the provision of educational services.

With regard to the specific financial implications arising from a sale, the Minister has not been clear. In December 2006 the Minister for Treasury and Resources stated -

***‘we will probably get a lower return on the re-investment of these funds than we are getting at the current stage’<sup>4[4]</sup>***

This view contrasts with that which is outlined in the proposition to sell; that a full sale and investment of the proceeds in an off-Island portfolio of equities and gilts would –

***‘provide a better annual return to the States’<sup>5[5]</sup>.***

### **Employee Protection**

The Minister for Treasury and Resources has claimed from the outset that the terms, conditions and pension arrangements for Jersey Telecom’s staff will be adequately protected following privatisation. Having taken legal advice on this issue, the Panel has concluded that any ‘guarantees’ the Minister might be able to provide have practical limitations. He is not in a position to protect the terms and conditions of employees from subsequent changes of company ownership; moreover, the legal concept of privity of contract dictates that employees would be required to rely on the Minister for Treasury and Resources, and his successor in office (who could not be bound by the current incumbent), to enforce clauses contained in any contract of sale.

### **The Panel’s View**

The Panel has formed serious reservations regarding the speed at which the proposed sale has been progressed. Although criticism of the States for taking decisions slowly is not uncommon, it should be borne in mind that the British government was unable to progress privatisation of British Telecom in less than 18 months. While Jersey Telecom may be a considerably smaller company than its UK equivalent, it does not necessarily follow that the number of issues and considerations arising from a proposal to privatise the Island’s operator is correspondingly less. Moreover, the Panel’s adviser has expressed similar concerns. He warns –

***‘A rushed privatisation is likely to be a bad privatisation.’***

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<sup>3[3]</sup> Article 32(6) of the Telecommunications (Jersey) Law 2002.

<sup>4[4]</sup> See transcript of hearing attended by Minister for Treasury and Resources – 19th Dec 2006, p.47

<sup>5[5]</sup> See P.28/2007 ‘JT Group Limited: Proposed Sale – Executive Summary (Available online at [www.statesassembly.gov.je](http://www.statesassembly.gov.je))

The Panel firmly believes the over-riding objective must be to ensure the long term security of efficient, effective and resilient telecoms services in the Island. Accordingly its key findings and recommendations are as follows –

### **Key Findings**

1. Consultation on the proposal to sell has failed in several key areas to meet the standards required in the Policy and Resources Committee report (R.C. 82/2005). Equally, it does not satisfy the revised draft Code of Practice on Public Consultation presented to the Council of Ministers in January 2007. The seriousness of these failures leads the Panel to conclude that the consultation process has been a failure.
2. The Panel finds that the T&R minister has failed to correctly balance the four competing key principles set out in his response to consultation and has relied far too heavily on the fourth - "attainment of the highest possible sale proceeds".
3. Given the vital importance of telecommunications to the economy and especially the financial services sector, the Panel is disappointed to find that a full cost/benefit analysis has not been carried out by any Minister. It recommends that such analysis be carried out as an essential precursor to any proposal to sell off the island's only full service telecoms provider.
4. If the States were to ultimately agree to the sale of JT, the Panel would recommend that consideration should be given to a dual track approach whereby trade bids are invited alongside an IPO offering. It therefore welcomes the move by T&R from a trade sale to a more flexible approach to other bids.

However, the Panel is concerned that;

- a) a) If existing local telecoms operators were to bid successfully, this would reduce competition which the JCRA would have to act on, and
  - b) b) If a private equity bid were to succeed, there may be problems with the identity of the buyers and the economies of scale arguments would fall.
5. The Panel accepts that economies of scale and access to premium products may result from a partnership with a major global operator. However it is not convinced that a 100 per cent sale is the only way to achieve these ends.

6. The Panel can only interpret the JCRA implicit recommendation for structural separation in the light of the contrary result being produced by both JT and the consultants Analysys, and in the light of the JCRA's reservations concerning its ability to regulate a dominant telecoms incumbent {The JCRA has expressed no reservations concerning its ability to regulate a dominant telecoms incumbent. The JCRA's Report only recommends that, common with other jurisdictions, Jersey may wish to use the opportunity presented by the sale of JT to consider the option of structural separation}. The Panel shares these reservations concerning the range of powers and the ability to resource effective delivery.
7. The successful track record of JT following incorporation clearly demonstrates that competition and effective regulation are the driving forces for improvements to services and economic efficiency. The emphasis placed on privatisation by the report of the Economic Advisor is potentially misleading.
8. The Panel finds that the value of JT is unlikely to have peaked. Evidence shows that Incumbent operators tend to retain significant market share even after liberalisation and the introduction of competition. The Panel is concerned that a 100 per cent sale of JT might replace a publicly owned dominant company with a private one.
9. The evidence produced by T&R reveals that the majority of European countries have chosen to retain a partial stake in, or total control of their incumbent telecom operator.
10. Confidential projections presented in support of the rationale for trading ownership of Jersey Telecom for additional investment in equities and gilts are viewed by the Panel as highly unreliable.
11. The Panel finds the central argument that Jersey Telecom should be assessed as part of the Strategic Reserve unconvincing.
12. 12. The Panel is of the view that Minister for Treasury and Resources is not in a position to 'guarantee' current employee terms and conditions for any significant period of time in the event that the States divests itself of 100 per cent of Jersey Telecom's shares.

## Recommendations

1. A comprehensive cost-benefit analysis of the economic and social implications arising from a sale of Jersey Telecom should be completed before the States decides whether to sell the company.
2. Should the States decide that it wishes to proceed with privatisation, it should agree to sell only a minority stake in Jersey Telecom.
3. The Panel recommends that there should be an immediate review of the JCRA's skills base, resources and legal powers. Such a review should be part of any privatisation planning and should be completed before the States is asked to decide whether to sell. {As the JCRA's comments show, the evidence presented to the Panel does not support this recommendation}.
4. A possible sale to a private equity group should be approached with caution.
5. TUPE style legislation should be introduced in Jersey at the earliest possible opportunity.

The Panel hopes that its work will lead to a measured, researched and considered decision on the future of Jersey Telecom made in the interests of taxpayers, the shareholder, the employees of the company and telecoms consumers.

## Panel Membership

On 26th July 2006 the Economic Affairs Panel agreed to form a Panel to conduct a review of the proposal to sell Jersey Telecom. The Panel was constituted as follows –

Deputy G.P. Southern (Chairman)  
Deputy J.A. Martin (Vice Chairman)  
Senator B.E. Shenton  
Deputy G.C.L. Baudains  
Deputy J.G. Reed

Officer support was provided by I. Clarkson, S. Power and C. Le Quesne.

## Terms of Reference

The terms of reference for the review were as follows –

To determine whether the overall interests of the Island are best served by either maintaining or divesting all or part of the States shareholding in Jersey Telecom and, in particular –

- • To examine the short and the long term implications of the financial projections for the maximisation of financial gain, as laid out in the Treasury and Resources Department Consultation Paper, dated 13th July 2006;
- • To consider the implications of privatisation on the requirement for continued modernisation and development of infrastructure in a commercial environment;
- • To consider whether the existing regulatory framework for the Jersey telecommunications market is sufficiently robust to ensure the continued provision of services and protection of the interests of all consumers;
- • To assess employee protection arrangements and pensions provision, and
- • To examine the impact of privatisation of telecommunications in other small jurisdictions.



## The Panel's Adviser

Privatisation is now well established worldwide as one possible avenue for public policy makers to pursue in order to achieve efficient use of resources within particular sectors of the economy. Jersey's experience of privatising state assets is somewhat limited.

In order that the Panel might be in a position to make a meaningful contribution to the forthcoming debate on the sale of Jersey Telecom, it sought to obtain the services of a suitably qualified adviser.

The Panel was delighted when, in September 2006, it secured the services of Mr. D. Parker, PhD, MSc Econ (public sector economics).

Mr. Parker is Research Professor in Privatisation and Regulation at Cranfield School of Management, University of Cranfield, UK. He currently serves as the Official Historian for UK Privatisation (a part-time post funded by the UK Government), is a member of the UK Competition Commission and occasional adviser to the UK's National Audit Office. He is acknowledged as an expert on privatisation and economic regulation.<sup>1[6]</sup> In addition, he has written over 100 reports, books and articles on economics and management, with particular emphasis on privatisation and regulation of markets.

The number of other countries in which Professor Parker has either worked or studied is extensive. He is currently Economic Adviser to the Office of Utilities Regulation in Jamaica. In 2005 he produced a report for the Organization for Economic Co-operation and Development (OECD) on the impact of regulatory assessment techniques in Russia. From 1997 – 1999 he served as Economic Adviser to the Taiwan government's Council for Economic Planning and Development. Privatisation of telecommunications was a matter under consideration at that time. His expertise has taken him as far afield as South Africa, Estonia and the Russian Federation.

With the foregoing in mind, the Panel considers that Professor Parker is eminently qualified to advise the States of Jersey on the proposal to privatise Jersey Telecom.

## Glossary of terms

### Telecoms Related

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<sup>1[6]</sup> Examples of his recent publications are the '*International Handbook on Privatisation*' – Edited by David Parker and David Saal and the '*International Handbook of Economic Regulation*' – Edited by Michael Crew and David Parker (both Edward Elgar Publishing, UK & USA).

**3G** - The third generation of mobile networks in which the ability to make standard voice calls is supplemented by the ability to make video calls or to download data at speeds approaching those of early broadband internet connections.

**ADSL** – Asymmetric Digital Subscriber Line. The most common 'broadband' method for accessing the Internet and retrieving e-mail.

**Bandwidth** – a term commonly used in the context of measuring the speed of an Internet connection. The greater the bandwidth, the more data that can be transferred over a connection in a set period of time.

**Broadband** – a relative term used to describe faster methods of accessing the Internet and retrieving e-mail.

**Convergence** – a telecoms industry trend towards a consolidated business model in which Internet, television and other multimedia services are made available over the same infrastructure as that used for fixed and mobile voice services.

**Fixed line** – the wired telephone network.

**Next Generation Network (NGN)** – a generic term used to describe the Internet Protocol (IP) based network infrastructure being installed by telecoms operators as part of the industry drive for convergence.

**System X** – a digital telephone exchange system deployed by British Telecom from 1980 onwards. Also used by Jersey Telecom.

**Voice over Internet Protocol (VoIP)** – a system used to route voice calls over the Internet, rather than the standard Public Switched Telephone Network (PSTN).

#### **Other Terminology**

**Amortization** – the process of treating as an annual expense the amount deemed to waste away from certain classes of asset, including the gradual loss of value of a lease or of the 'goodwill' existing within an acquired company.

**Deregulation** – the process of removing government restrictions on businesses in order to encourage markets to operate more efficiently.

**EBITDA** – Earnings before interest, tax, depreciation and amortization.

**Flotation** – The launch of a public company using a process whereby shares are offered for sale to the public

**Goodwill** – The difference between the value of the separable net assets of a business and the total value of that business.

**IPO** – initial public offering (see 'flotation')

**Liberalisation** – the process of establishing a competitive market for a particular product or products.

**TUPE** – A generic term used to describe legislation similar to the UK Transfer of Undertakings (Protection of Employment) Regulations 1981 and 2006.

## Key Dates <sup>1[7]</sup>

- 1895** first telephone exchange opened in the Island.
- 1922** States of Jersey accepts recommendations of a Special Committee formed to consider telecoms provision in the Island. Finance Committee instructed to provide funds to acquire what was by then a local network of 14 exchanges, serving approximately 1,500 customers.
- 1923** Purchase of Island network complete. States confers on new Telephone Committee necessary powers to undertake the efficient administration of telephones.
- 1940** Development of the telephone network affected significantly by World War II, although company staff reportedly implement some ingenious methods of keeping the network running during periods of petrol rationing and other energy shortages.
- 1973** States formally secures exclusive privilege in respect of telecoms services in the Island when the old UK General Post Office was superseded by the creation of British Telecom.
- 1982** A proposition suggesting possible partial privatisation of the Telecommunications Board is defeated by 2 votes.
- 1984** Limited competition in the local telecoms market begins. Connection of certain type approved equipment to JT lines permitted.
- 1985** Senator R.J. Shenton lodges a proposal calling on the Policy Advisory Committee to produce a report on the viability of selling off to the public 49 per cent of the assets of the Telecommunications Board. The States votes to move to the next item on the Order Paper.
- 1995** States approves the 'Strategic Policy Review and Action Plan 1996 – 2000 and Beyond', which calls for trading activities to *'be structured and organised in the most effective way to meet the challenges of the future.'*
- 1996** Telecommunications Board lodges 'Jersey Telecoms Limited: Incorporation'<sup>2[8]</sup> It recommends incorporation as a response to rapidly changing industry pressures. Privatisation is rejected on strategic grounds.
- 1999** Report from the Centre for the study of Regulated Studies, University of Bath highlights need to balance incorporation of Jersey Telecom with the creation of an independent regulator.
- 2000** States agrees to continue with incorporation, backed by the creation of an independent regulator.
- 2001** Telecommunications (Jersey) Law 2002 approved by the States. JCRA formed.
- 2003** Jersey Telecom (JT) incorporated.
- 2005** JT generates a pre-tax profit of £13 million, despite a £1.4 million programme of voluntary redundancy. It pays £9.1 million to the States in tax and dividends and sees revenue growth in broadband, in mobile services and in its Guernsey operation. Company providing premium rate SMS services to TV shows such as 'Who Wants to Be a Millionaire?'.
- 2006** JT remains Jersey's only full telecommunications service provider. JT project teams manage installation of GSM mobile infrastructure to cruise ships. Cable and Wireless launch mobile and business services in Jersey.
- July 2006** Minister for Treasury and Resources proposes sale of Jersey Telecom

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<sup>1[7]</sup> For a full history of the company see <http://www.jerseytelecom.com/templates/LayoutB.aspx?id=327>

<sup>2[8]</sup> Projet No. P.147/1996



# 1. Introduction

In 2001 the World Bank published a report on policy options for infrastructure reform. It observed –

***‘In many countries, privatisation transactions are spearheaded by the Ministry of Finance, which tends to view the process in narrow transactional terms, with the focus on maximizing the fiscal revenues from the asset sale. This is unfortunate because there are some important trade-offs between the sale value of the assets, and the downstream economic and social impacts of the reform.’***<sup>1[9]</sup>

In other words, some governments have pursued privatisation from the narrow perspective of raising cash for the treasury coffers. Economic and social implications of privatising have been set aside in the pursuit of that hard currency.

There are other reasons for pursuing a policy of privatisation. For some governments the motive has been primarily ideological. Others have decided that their publicly owned operations have been performing poorly and that a sale to the private sector might inject some market-driven corporate discipline. From time to time privatisation has also been ‘credited’ with: promotion of technological advancement; the development of capital markets; redistribution of wealth through wider share ownership, and even with reducing inflation<sup>2[10]</sup>. In a significant number of cases, however, it remains a policy pursued for negative reasons. Some countries have privatised operations because they considered them to be a burden, due to mounting subsidies, unresponsive management and / or excessive union power<sup>3[11]</sup>. Nevertheless, a motivation at the heart of many privatisation proposals is, quite simply, cash.

## 1.1 The Minister’s Proposal

On Thursday 13th July 2006 the Minister for Treasury and Resources went public with a proposal to sell off Jersey Telecom. In doing so, he ensured that Jersey followed almost to the letter the trend identified by the World Bank.

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<sup>1[9]</sup> ‘*Making Infrastructure Reform Work for the Poor: Policy Options based on Latin American Experience*’ - WBI Studies in Development 2001

<sup>2[10]</sup> ‘*The Rationale for Privatisation*’ – Prof.Dr.Coşkun Can Aktan  
<http://www.canaktan.org/ekonomi/ozellestirme/aktan-makaleler-ceviriler/aktan-rationale-of-privatisation.pdf>

<sup>3[11]</sup> ‘*International Handbook on Privatisation*’ – D. Parker and D. Saal, Edward Elgar Publishing, p.44

The Minister's discussion paper claimed that –

- a) *a) he supported privatisation,*
- b) *b) he wanted to apply that policy to Jersey Telecom,*
- c) *c) he would prefer to sell 100 per cent of the company,*
- d) *d) he had a preferred class of buyer in mind, and*
- e) *e) he favoured a quick sale.*

What is presented is a single argument, defined in such detail that it borders on having prejudged the outcome of public consultation.

In his discussion paper and in his subsequent letter to all States members circulated on 15th December 2006, the Minister claims that a sale would 'create the right environment' 'for enhance[d]... long term growth and development of Jersey Telecom's business' and would 'ensure the continuing strength' of the telecoms industry as a whole. The current operating practices of the Jersey Competition Regulatory Authority (JCRA), and the powers available to the Authority, are considered to be 'a more than adequate safeguard' for consumers and for companies that will be competing against a privately owned JT. Looking to the wider economy, it is suggested that a sale would provide opportunities for 'growth and diversification' and would have a positive effect on 'the long term security and prosperity of Jersey, its people and their jobs'.

Downstream economic and social impacts are effectively dismissed as being the responsibility of the Minister for Economic Development, through his powers to direct the JCRA, who could in turn direct telecoms operators, on matters of social and environmental importance.

Turning to the alleged consequences of a failure to privatise, the Minister suggests that the negative effects would be highly significant. He claims –

- a) *a) that JT's existing revenue streams will decrease through competition*
- b) *b) that disruptive changes to the industry worldwide will erode JT's existing revenues further;*
- c) *c) that 'accelerated' rates of change in the industry will result in potentially more frequent, and expensive, rounds of investment, and*
- d) *d) that JT's small size will count against it as it tries to tap new sources of revenue in response to the above.*

In the consultation document a full sale of the company to a global, telecoms operator is put forward as the most appropriate response to these four issues. An existing larger telecoms operator, bringing with it potential economies of scale, appears likely to receive a more favourable reception than would a private equity firm. A flotation of the company (also known as an Initial

Public Offering or IPO), giving Islanders the option to buy shares in a local business, seems to have been ruled out. Considered evaluation of the wider merits of partial privatisation and / or a partnership arrangement between a States owned JT and an international private sector telecommunications operator, is also missing. The Minister's paper comments –

***'While some governments have chosen to maintain a partial shareholding in the incumbent operator, for reasons [of control and / or value], this is not the approach being advocated by the Minister.'***

The Minister's subsequent proposition alters the position in that neither a private equity buyer nor an IPO are ruled out. Although there is clearly still a reluctance to pursue the IPO option<sup>4[12]</sup>, the possibility of a private equity purchase is discussed in more positive terms<sup>5[13]</sup>.

The proposed sale would generate cash. Moreover, the Minister has argued that a sale executed quickly would possibly generate more cash – an approach which would be consistent with what the discussion paper describes as the Minister's legal obligation 'to maximise the value of the States shareholding in Jersey Telecom'<sup>6[14]</sup>. Full ownership of a successful telecoms company would therefore be traded for sale proceeds, which would be transferred to the Strategic Reserve–

***'where they should be invested in a diversified portfolio of equities and gilts.'***<sup>7[15]</sup>

## **1.2 Consultation or Notification?**

Shortly before the introduction of ministerial government, a new system of public consultation was introduced by the former Policy and Resources Committee.<sup>8[16]</sup> The system specified that discussion papers would not only 'set out for debate and discussion' provisional proposals, they would also 'set out competing arguments to a decision', or clarify where those arguments might be found.

On 27th January 2007 a revised draft policy on consultation was received by the Council of Ministers. It listed nine proposed principles for future consultations. Principle 3 states that Ministers should –

***'Be clear about any aspects of an issue on which decisions have been taken, or are inevitable in order to avoid wasting the time of respondents. It is OK to explain some elements of a policy are 'givens'. It is dishonest to fail to declare them from the start... there are dangers: expressing the view too strongly might affect people's willingness to engage,'***

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<sup>4[12]</sup> 'JT Group Limited ("Jersey Telecom"): Proposed Sale' – P.28/2007, p.33

<sup>5[13]</sup> Ibid, p.35

<sup>6[14]</sup> Discussion paper, p.11

<sup>7[15]</sup> Discussion paper, p.3

<sup>8[16]</sup> See R.C. 82/2005 entitled 'Public Consultation'.

In the case of the discussion paper on the proposed sale of Jersey Telecom, the Minister invited the public to respond to eleven questions on aspects of the proposal, including: the robustness of current consumer protection; the 'potential benefits' to JT from access to economies of scale, and whether the States should seek to protect employee terms and conditions.

A review of the paper reveals that the Minister has progressed well beyond the stage of considering provisional proposals. More than half of the questions address the question of **how** to sell. Of the minority which concern the issue of **whether** a sale should even be contemplated, four make it clear that the Minister favours the sale option. The one remaining question, concerning the potential benefits to JT of economies of scale, is preceded by a series of cursory assertions regarding the state of the global telecoms industry which again tend to make the case for privatisation. On that basis it falls foul of Principle 3.

Principle 5 declares -

***'Written consultations should be concise and easy to grasp. They should include a concise summary of the main questions and a complete picture of the issue and decision criteria.'***

As **Appendix 5** of the Panel's report demonstrates, there is some evidence that the argument concerning JT's future viability may not be as one-sided as the Minister's discussion paper suggests.

Another of the proposed new principles on consultation (principle 9) states –

***'Responses should be analysed carefully and with an open mind.'***

Yet when consultation on the Minister's proposals concluded (on 8th September 2006, one full day after the Panel's investigation began in earnest with a public meeting at Hautlieu School), the Minister issued a press release advising that a majority of the 35 responses he had received had come from directly interested parties whose views were already well known and understood. The Panel considers that he set aside the significant number of responses received by Scrutiny from concerned individuals and organizations when he declared –

***'Beyond the directly interested parties, it is clear that very few others felt a need to respond to the document.'***

The Panel questions whether the above conclusion reflects adequately the significant number of genuine and detailed concerns expressed by employees of JT in response to the Minister's discussion paper.

Rather than encouraging discussion, the Minister has attempted to constrain the scope of debate. Referring to the adoption of the Telecommunications (Jersey) Law 2002, the discussion paper suggests that the States decision to separate the roles of telecoms operator, owner and regulator is reason enough to assert that –

***‘the decision on whether to sell Jersey Telecom must not be about maintaining an interest in a telecommunications operator for the purposes of consumer protection or the meeting of social obligations... it must be a decision on whether the investment strategy of the States of Jersey is best served by either maintaining or divesting of its shareholding in the company.’***

In doing so the document fails to give adequate weight to one of the key reasons why the States had ruled out privatisation back in 1996; the strategic implications of releasing control of such a vital infrastructure resource.<sup>9[17]</sup>

Having issued his response to the consultation, the Minister ‘reaffirmed’ his belief that a proposition proposing the sale of JT should be drafted in accordance with 4 key principles, as follows -

- a) a) It must provide the basis for an outcome that will contribute to the maintenance and enhancement of the competitive environment and quality of telecommunications services to the benefit of today’s and tomorrow’s islanders.***
- b) b) It must ensure that the rights of Jersey Telecom’s employees are adequately safeguarded;***
- c) c) It must provide for the achievement of the best possible basis for the long term growth and development of Jersey Telecom;***
- d) d) It must provide for the attainment of the highest possible sale proceeds for the benefit of the people of Jersey.***

Satisfying all 4 criteria would be far from straightforward. Indeed, the Minister would subsequently admit –

***‘There will be tensions between the 4 certainly and it is my job to try to strike a fair balance.’***<sup>10[18]</sup>

The Panel points out that the Minister’s four aims are mutually contradictory. In particular, steps taken to protect employee terms, conditions and pension provisions will inevitably impact upon the final sale price of the company, should it be sold. The Panel considers that a balance has not been achieved and that principle d) above, has dominated the Minister’s thinking.

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<sup>9[17]</sup> See Projet No. P.147/1996 entitled ‘*Jersey Telecoms Limited: Incorporation*’.

<sup>10[18]</sup> Transcript of hearing attended by Minister for Treasury and Resources, 19th Dec 2006, p.13

**Findings**

Consultation on the proposal to sell has failed, in several key areas, to meet the standards required in the Policy and Resources Committee report (R.C. 82/2005). Equally it does not satisfy the revised draft Code of Practice on Public Consultation presented to the Council of Ministers in January 2007. The seriousness of these failures leads the Panel to conclude that the consultation process has been a failure.

The Panel finds that the Minister for Treasury and Resources has failed to correctly balance the four contradictory key principles set out in his response to consultation and has relied far too heavily on the fourth – ‘the attainment of the highest possible sale proceeds’.

## 2. A Thorough and Objective Analysis?

The Minister for Treasury and Resources asserts that Jersey Telecom is no longer a viable investment for the States of Jersey in terms of the level of financial risk associated with continued ownership. JT has been assessed as a poor fit within the latest Treasury investment strategy and, as the market in which the company operates is evolving rapidly (particularly with regard to the advent of increased competition) the level of financial risk is allegedly increasing.

On 7th September 2006, the Minister for Treasury and Resources summarised his view at a well attended public meeting held at Hautlieu School. Acknowledging the entry into the local market of Cable and Wireless and Bharti Enterprises, he contended –

***'It is like comparing a corner shop when Tesco sets up next door'.<sup>1[19]</sup>***

Readers of the Jersey Telecom Annual Report 2005 might well be surprised by this negative assessment. On page 4 of that Report, Chairman John Henwood stated –

***'Clearly we face a challenging future, but we remain optimistic... we continue to welcome competition, believing that our unique combination of local market knowledge allied to world class services will be more than a match for newcomers.'***

The Panel considers that the investment value of Jersey Telecom must be viewed in a much wider context. Telecommunications has been described as *'the lifeblood of the financial services sector'*<sup>2[20]</sup> and an industry which has a key rôle to play in securing *'economic and social well being'*<sup>3[21]</sup> in a community. Jurisdictions such as Scotland and the Isle of Man have in recent years considered telecoms to be of sufficient importance as to warrant the formulation of broadband communications strategies in order to ensure widespread implementation of the latest technology. Both have developed their strategies in light of concerns that the current operation of the market, occupied entirely by private sector operators, might not necessarily provide the infrastructure to which those jurisdictions aspired<sup>4[22]</sup>. In fact the Isle of Man government has deemed it necessary to offer grants to cover the cost of any individual or business wanting to install a broadband connection<sup>5[23]</sup>.

The Jersey economy, and the finance industry in particular, is particularly dependent on high quality and reliable telecommunications. Thankfully the standard of service offered by the States owned JT, together with its ongoing high rate of investment in infrastructure, has served the Island

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<sup>1[19]</sup> Transcript of Minister of Treasury and Resources, dated 19th Dec. 2006 - p.3

<sup>2[20]</sup> Andrew Adonis – Financial Times, 15th June 1994

<sup>3[21]</sup> See *'Connecting Scotland: Our Broadband Future'*–

<http://www.scotland.gov.uk/Publications/2004/06/19531/39251>

<sup>4[22]</sup> *ibid.* (Executive Summary)

<sup>5[23]</sup> See <http://www.gov.im/lib/news/ebusiness/broadbandStrategy.xml>

well in terms of providing the advanced services that the economy requires. This has also had the highly positive social side-effect of keeping the comparatively small Jersey community well connected globally. In truth the performance of JT has been so good, both under States control and, latterly, as an incorporated company, that the reasons more commonly cited to justify a policy of privatisation, such as to improve efficiency, are not readily applicable to the company. {This statement overlooks instances where JT actually has taken actions which prevent the introduction of new and innovative services into Jersey, most recently and notably concerning mobile number portability.}

It is widely understood that the finance industry is a comparatively mobile industry – a point which has been raised regularly during the course of the developing Zero-Ten tax proposals <sup>6[24]</sup>. Consequently the Island has for many years lived with the possibility that the finance industry could relocate in the event that Jersey became a less attractive location from which to operate. Ironically, one factor which could conceivably cause Jersey to become less attractive would be a deterioration in the quality of and / or the cost of using the telecoms infrastructure. For the moment, however, the States owns a company which has invested well. Through ownership it also maintains a moderate degree of influence over the rate at which the company invests in future years.

Even taken in the light of the Treasury Minister's argument that, were we to suffer a serious economic setback, it would fall to the States to ensure that the right conditions existed to encourage other industries to set up in the Island, or for existing industries to expand, in order to at least partially fill the void. Were such a scenario to become a reality, the States may not wish to rely on private sector investment.

## **2.1 Cost Benefit Analysis**

With the foregoing in mind, the Panel had anticipated that either the Council of Ministers or one of two Ministers (either the Minister for Treasury and Resources or the Minister for Economic Development) would call for a considered cost benefit analysis of the economic and social implications of selling Jersey Telecom, so as to test the robustness of the preliminary conclusions reached by the Minister for Treasury and Resources. This expectation was considered entirely justifiable on the grounds that Jersey Telecom remains the Island's only full service provider in the telecoms sector. As we shall see in Sections 2.2 – 2.5, none of the reports commissioned have achieved this comprehensive cost-benefit analysis.

The need for such analysis became increasingly apparent following an open lecture, held on 12th December 2006 in St. Helier, at which Professor Massimo Florio, European Commission adviser

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<sup>6[24]</sup> e.g. See accompanying report to the proposition '*Fiscal Strategy*' – P.106/2004

and author of the EC Guide to Cost-Benefit Analysis of Investment Projects, discussed the impact of the privatisation of British Telecom and Telecom Italia.

Professor Florio stressed that both investment and divestiture by governments had significant and measurable impacts on the economy and on the interests of all four stakeholder groups in particular, namely –

- • taxpayers,
- • shareholders,
- • consumers, and
- • employees. 7[25].

Having explained that the impact of privatisation was not always as intended (in the case of British Telecom, privatisation had a ‘negligible impact on productivity trends’<sup>8[26]</sup>) the Professor asked –

***‘If governments conduct a cost-benefit analysis when they invest, why do they tend not to do so when they divest?’***

## **2.2 The States of Jersey Economic Adviser’s Report**

Of the various reports and papers circulation during the course of the review, the report from the States of Jersey Economic Adviser was regarded by the Panel as being of critical importance. While the Treasurer of the States was responsible for clarifying the relevant investment approach to Jersey Telecom, it was clear to the Panel that the first significant privatisation in Jersey’s recent history, and of the only full service operator in a key industry, could not realistically be pursued without the endorsement of the Council of Ministers. Moreover, responsibility for providing the best possible objective economic advice to the Council of Ministers fell to the Economic Adviser. With the foregoing in mind, the Panel had expected –

- that the Economic Adviser would be charged with producing or with overseeing production of a full cost-benefit analysis of the proposal to sell, and
- that the resulting report would be sufficiently comprehensive, dispassionate and well researched as to constitute an assessment that could be relied upon by the Council of Ministers, and ultimately by the States.

In fact the Panel learned that the full implications arising from the proposal were apparently going to be considered by the Citigroup consortium. Moreover, it was only at the end of November 2006 that the Panel learned that the Economic Adviser had been tasked with undertaking any work at all

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<sup>7[25]</sup> See also ‘*The Great Divestiture*’ – Massimo Florio, 2004 MIT Press

<sup>8[26]</sup> *Ibid.* p. 343

on the subject. His task was to oversee the economic analysis of the key issues surrounding the structure of the sale of JT and advise the Council of Ministers on those implications.

These terms of reference appear to the Panel to be somewhat constrained in scope. Professor David Parker agrees and has advised that, under the circumstances as they apply to Jersey, he would ordinarily expect a government economic adviser to address at least two key issues, namely-

- a) a) who might be a suitable (and unsuitable purchaser) of JT from an economic welfare perspective, and
- b) b) the extent to which the JCRA has all of the necessary legal powers and resources to regulate a privately-owned JT, and what further powers or resources should be provided.

On 1st February 2007 (two days after the Minister for Treasury and Resources had been encouraging the Panel to present its final report to the States), the Panel was provided with a copy of the Economic Adviser's report.

Initially the Panel had been encouraged by the introduction to the report, which clarified that its purpose was –

***'to distil all the information to give the Council of Ministers the best possible understanding of the economic implications of the proposed sale.'***

Having now considered the Economic Adviser's report in detail, that initial optimism has been replaced with severe disappointment. The degree of analysis falls so far short of that which should be expected when considering the sale of a successful company, employing over 400 committed staff locally and which provides a service of such strategic importance to the economy, that the Panel is positively alarmed that the Council of Ministers may have been tempted to rely upon it.

Although the strategic implications of a sale to the wrong company could inflict significant damage on the wider economy of the Island (particularly the finance sector, which depends on reliable, high quality services), the report prepared by the Economic Adviser for the Council of Ministers does not address this issue. There is a marked absence of any reference to the possibility of reduced competition, and the resultant scope for impact on the economy, in the event that either Cable and Wireless or Jersey Airtel were to bid successfully.

Professor Parker regards this omission as disappointing, notwithstanding that it may have been a consequence of the terms of reference given to the Economic Adviser. He comments–

***‘At no point does it consider who might be a suitable buyer for JT, and whom an unsuitable buyer, from an economic welfare perspective. Instead, it simply endorses a "100% sale" of JT. This really is not acceptable when dealing with the strategically important business of Jersey Telecom.’***<sup>9[27]</sup>

Although the report does include an oblique reference to the need for ongoing review of the legal powers under which the JCRA can act to regulate the market, the report fails to consider the question of whether existing powers, together with the human and financial resources required to exercise them, might be sufficient. In fact the issue of appropriate resourcing of a regulator is completely ignored. Accordingly the report fails to deal with the two issues flagged up by the Panel’s adviser.

Nothing of significance is said on the strategic importance of Jersey Telecom to the economy of the Island as a whole; yet the Panel is clear that without the high quality of telecoms infrastructure and support as currently provided by JT, the Island would appear far less attractive to finance and other information technology dependent industries.

No comment of any significance is made regarding potential job losses and the ramifications for Jersey’s economy; yet the Panel is well aware of the regularity in which announcements of significant job losses have tended to follow privatisations and takeovers worldwide, from British Telecom in the 1980s and 1990s through to Guernsey Telecom in recent years.

There is a serious absence of consideration of the potential for a takeover to result in a loss of key telecommunications engineering skills base in the Island. In the 2005 Annual Report, the Managing Director of Jersey Telecom expressed particular pride in high number of Cisco Certified Engineers working for the company; yet a multinational buyer of JT might already have access to its own significant pool of qualified engineers that could be brought in as work required.

Of the content that has been included in the report, several sections are flawed. For example, the Economic Adviser declares –

***‘With the new [Competition (Jersey) Law 2005] in place and JCRA as the regulator the privatisation of Jersey Telecom is therefore consistent with the States economic objectives.’***<sup>10[28]</sup>

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<sup>9[27]</sup> E-mailed response from Professor Parker re. Economic Adviser’s report – received 3rd Feb. 2007

<sup>10[28]</sup> ‘Economic Adviser’s report on the structure of the proposed sale of Jersey Telecom’ – 1st Feb. 2007, p.2

By economic objectives, the Panel assumes that the Economic Adviser is referring to the passage of his report which outlines the need for telecommunications providers 'to invest significant amounts of capital in updating the network at key points in the future'. What the Economic Adviser fails to point out is that 100 per cent privatisation is not the only route to achieving this investment. Jersey Telecom already has a good track record of investment whilst maintaining efficiency, with its current (outsourced) cable laying activity, the ability to borrow and its recent efforts to rationalise its workforce. In fact both incorporation and 100 per cent public ownership of JT are also consistent with the States economic objectives, particularly if any aspect of industry regulation is in doubt.

The Economic Adviser concentrates on citing six reasons for privatisation and follows with a claim that five of those reasons are consistent with the States economic objectives. The reasons cited are –

- a) a) to raise revenue for the state,**
- b) b) to increase economic efficiency,**
- c) c) to reduce the rôle of government in the economy,**
- d) d) to introduce competition, and**
- e) e) to subject state owned enterprises to market discipline.**

These appear to have been lifted from a paper by Megginson and Netter entitled 'From State to Market: A Survey of Empirical Studies on Privatisation'<sup>11[29]</sup>. Points b) to e) have in fact been achieved through incorporation, leaving a) as the sole relevant reason for pursuing privatisation.

Missing from the Economic Adviser's paper is an acknowledgement that the existing States policy of owning an incorporated Jersey Telecom is also consistent with the policy. JT has raised over £33 million in revenue for the States in taxes and dividends during the period 2005 – 2006, as **Table 1** (opposite) shows.

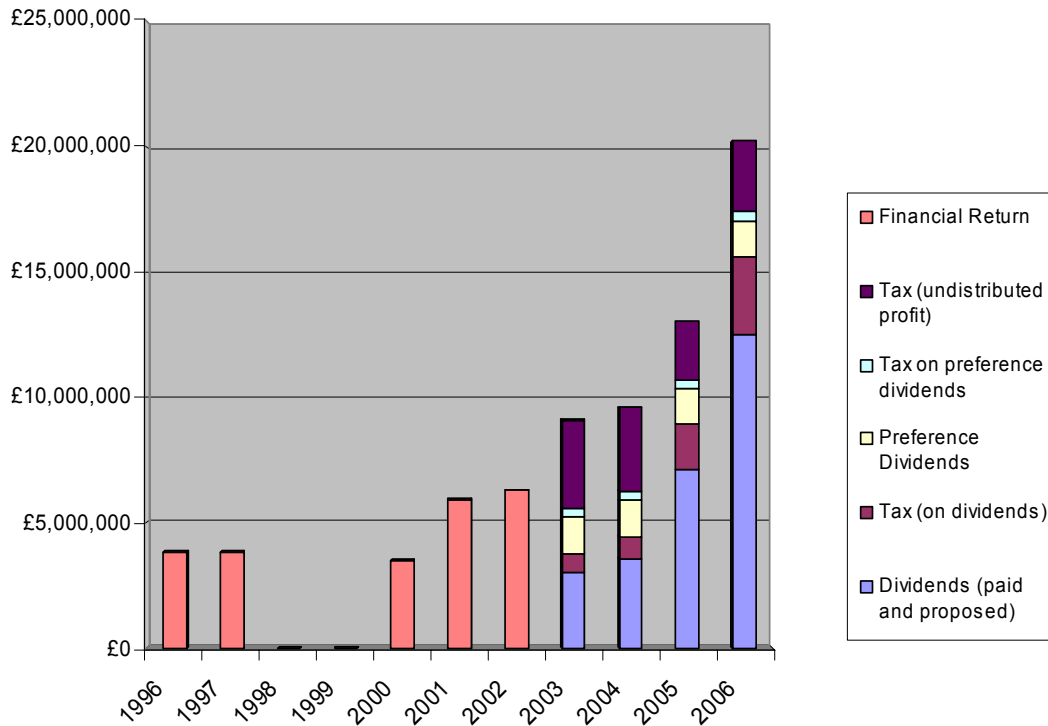
Competition has already begun in most sectors of the telecoms market and this has been achieved without privatisation. Moreover, the States owned Jersey Telecom has been competing very effectively against the privately owned Cable and Wireless in both Jersey and Guernsey.

As far as the matter of reducing the rôle of government in the economy and introduction of market discipline is concerned, this was achieved to a greater or lesser extent on 1st January 2003, when JT was incorporated.

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<sup>11[29]</sup> Journal of Economic Literature, June 2001. Preview available at <http://faculty-staff.ou.edu/M/William.L.Megginson-1/privpape.htm>

**Table 1: Jersey Telecom – Returns to the States of Jersey**



(n.b. – 2006 figure contains an estimated figure for Tax (undistributed profit). In addition the dividend paid in 2006 includes a surplus cash sum of £6 million built up over a period of several years.

Of particular concern to the Panel is Professor Parker’s assessment of those parts of the Economic Adviser’s which purport to represent the literature on privatisation. The Professor comments –

***‘I do believe that the content on pages 5 & 6 of [the Economic Adviser’s] paper purporting to represent the literature on privatisation is partial and potentially misleading.’***<sup>12[30]</sup>

Having reviewed a number of the papers quoted by the Economic Adviser in consultation with its adviser, the Panel concludes that the Economic Adviser’s report gives undue weight to the merits of privatisation and underplays the importance of competition and effective regulation.

<sup>12[30]</sup> E-mailed response from Professor Parker to Scrutiny Office concerning Report of Economic Adviser – received 3rd February 2007.

Taken in its entirety, the paper suggests that privatisation is fundamental to delivering efficiency improvements. Page 2 of the Economic Adviser's report even goes as far as to imply that the 'right regulatory structure' is not necessarily a prerequisite for those efficiency improvements. Yet the research seen by the Panel suggests that a poorly regulated private sector company with a dominant market share could be potentially disastrous for Jersey.

The Megginson and Netter paper relied upon by the Economic Adviser in support of his claim that privatisation will 'deliver efficiency improvements' actually states -

***'On balance, these studies generally indicate that deregulation and liberalisation of telecom services are associated with significant growth in teledensity and operating efficiency, and significant improvements in the quality and price of telecom services. The impact of privatisation, per se, is somewhat less clear-cut, but most studies agree that the combination of privatisation and deregulation is associated with significant telecommunications improvements.'*<sup>13[31]</sup>**

Professor Parker considers that a thorough and objective review of research papers would demonstrate that competition is the primary driver for market efficiency. He advises-

***'in general it does seem that competition is more important than privatisation per se in raising performance (productivity, lower costs, more innovation) and that privatisation without competition and in its absence effective regulation cannot be relied upon to raise performance.'*<sup>14[32]</sup>**

The Professor cites a further paper by S.J. Wallsten <sup>15[33]</sup> in support of his assessment that privatisation, while undeniably successful in a number of cases, is of secondary importance to competition and effective regulation.

#### **Finding**

The successful track record of JT following incorporation clearly demonstrates that competition and effective regulation are the driving forces for improvements to services and economic efficiency. The emphasis placed on privatisation by the report of the Economic advisor is potentially misleading.

<sup>13[31]</sup> *'From State to Market: A Survey of Empirical Studies on Privatisation'* p.28

<sup>14[32]</sup> E-mailed response from Professor Parker to Scrutiny Office concerning Report of Economic Adviser – received 3rd February 2007.

<sup>15[33]</sup> Wallsten, S.J. (2001) 'An Econometric Analysis of Telecom Competition, Privatisation and Regulation in Africa and Latin America', *Journal of Industrial Economics*, vol.XLIX, no.1, pp.1-19.

### 2.3 The Citigroup Report

The terms under which the Citigroup consortium has been engaged to advise the Minister for Treasury and Resources are confidential. Notwithstanding this, the Panel considers that the public has a right to know what the consortium has *not* been instructed to do.

The Panel, having reviewed the terms of reference given to Citigroup, considers that the consortium has not been instructed to properly consider the viability of retaining Jersey Telecom in full public ownership. Moreover, the confidential report produced by Citigroup for the Minister (and circulated to Scrutiny) under those terms of reference is entitled 'Optimum Transaction Alternative'. Clearly retention of the company would not require a transaction.

The Minister disclosed in a non-confidential letter sent to all States members on 15th December 2006 that Citigroup had been instructed -

***'to ensure that I receive the best advice available on all aspects of a potential sale.'***

The only evidence the Panel has found to suggest that the Citigroup consortium was expected to assess the merits of continued States ownership of JT is a statement in an e-mail sent to the Scrutiny Office on 17th November 2006 by the Strategic Investments Manager at the States Treasury.

The e-mail states –

***'For clarity, I would advise that part (b) "assessment of the optimal transaction alternative" is the work that Citigroup is presently undertaking to establish the best option for a sale (including if any sale is the best option)'***

On 11th December 2006 the Panel was afforded the opportunity to receive a confidential briefing from representatives of the Citigroup consortium employed to advise the Minister for Treasury and Resources on the proposal to sell.

On 16th January it received a final draft of the confidential report entitled 'Optimal Strategic Alternative'. Although the Panel is not permitted to report on the briefing meeting or on the contents of the confidential Citigroup report, it has drawn a number of conclusions following discussions with its own adviser, Professor David Parker.

The Panel has several difficulties with the Citigroup report. No specific calculations or other sources of evidence are offered in direct support of its overall assessment that a 100 per cent sale is an appropriate way forward. Although the confidential 'Optimal Transaction Alternative' report runs to 29 pages, much of the content takes the form of bullet point summaries and statistical tables which broadly endorse conclusions the Minister had already reached, albeit provisionally, before the public meeting at Hautlieu School on 7th September 2006, when he declared –

***'The only way [Jersey Telecom] will compete is as part of a bigger organisation with some financial muscle.'***<sup>16[34]</sup>

Consideration of a flotation or the accelerated IPO (aIPO) approach outlined to the Panel by the Chief Executive of Collins Stewart C.I. Ltd has been superficial.

Of particular note are the comments concerning Jersey Telecom as an asset falling within the Strategic Reserve. The Panel considers that Citigroup fully supports the Minister's view that ownership of JT is not compatible with the investment profile of the Strategic Reserve. Having reviewed the document, the Panel's adviser has commented that he would ordinarily have expected to see at least some 'serious analysis' of the concept that JT should be sold so as to diversify risk through the Strategic Reserve.

The Minister has said that Jersey Telecom should be sold –

***'... as soon as possible to a larger operator rather than prevaricating and delaying until much of the value of Jersey Telecom may be lost.'***<sup>17[35]</sup>

This view, which appears to have remained largely unchanged following advice from Citigroup, is in marked contrast with experience in other jurisdictions. Experience demonstrates that, in general, incumbent operators have actually been successful in maintaining value and market share following the introduction of competition. Professor Parker concludes that –

***'In spite of competition, incumbent telecommunications operators have remained profitable internationally. Although they have lost market share, this has been a share of a growing market. Moreover, technological change has reduced unit costs.'***<sup>18[36]</sup>

Moreover, the Panel finds it difficult to reconcile the Minister's view both with confidential projections that it has been provided with in recent months regarding JT's future prospects and with the views of JT Chairman John Henwood, who says –

***'You know, if we are the corner shop and they are Tesco, then we cannot compete with them on quality or price, but as events are showing ... we are certainly competing on quality. In fact, we lead the market on quality and we are leading the market on price as well. So, we are pretty bloody good corner shop, if that is what we are.'***<sup>19[37]</sup>

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<sup>16[34]</sup> Transcript of Public Meeting held at Hautlieu School – 7th Sept. 2006, p.3

<sup>17[35]</sup> Ibid, p. 4

<sup>18[36]</sup> Possible Sale of Jersey Telecom – Review of the evidence to 31st Dec. 2006 – D. Parker, para 3.5

<sup>19[37]</sup> Transcript of hearing attended by Board of Jersey Telecom – 25th Sept 2006, p.14

The Panel has been particularly concerned to learn that the Citigroup report includes a reference to the possibility of market consolidation (subject to regulatory/competition approval). One possible interpretation of this reference is that both Cable and Wireless and Bharti are to be viewed as potential buyers. Professor Parker has suggested to the Panel that, having regard to the status of Jersey's telecoms market, a purchase by Cable and Wireless or Bharti should be ruled out 'on competition grounds'.<sup>20[38]</sup> The Professor points out that profit driven private sector firms 'may have more incentive than a state-owned firm to hide information from the regulator'. Were a multinational owner of the only full service provider in Jersey to find itself competing against only one notable competitor (or no competitor at all) in mobile and internet services, that company might be tempted to factor in its ability to contest attempts by the JCRA to exercise its regulatory powers.

The Panel's adviser notes that a privatised Jersey Telecom may operate with a geared balance sheet (where loan capital is substituted for equity), thereby lowering tax receipts generated by the company. He comments –

***'This is very likely to happen - but it is not clear that this was taken into consideration in the "States of Jersey Strategic Reserve" paper when computing withholding tax receipts on dividend payments'***<sup>21[39]</sup>

In summary, the content of the Citigroup report indicates that it has not thought it necessary to assess the underlying basis of the Minister's proposal. On that basis alone the Panel considers that the Citigroup report cannot be regarded as a considered cost-benefit analysis. Instead it has concentrated on delivering the outcome sought – maximised value.

## **2.4 The JCRA Report**

Bearing in mind the rôle and the responsibilities of the Minister for Economic Development, and his commitments under the Strategic Plan 2006 – 2011, the Panel had expected the Minister to commission a body of work concerning the wider economic impact of a sale.

On 3rd October 2006 the Minister for Economic Development commissioned a report from the Jersey Competition Regulatory Authority concerning the structure of Jersey Telecom which would best promote competition in telecommunications and thereby economic growth as whole. The terms of reference given to the JCRA were –

- 1. The structure of JT that the JCRA believes best serves the States policy of promoting competition in telecommunications and thereby economic growth as a whole, including:**
  - a) selling JT in its current form, ie a transfer of ownership in JT as a whole;**

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<sup>20[38]</sup> Possible Sale of Jersey Telecom – Review of the evidence to 31st Dec. 2006 – D. Parker, para 5.4

<sup>21[39]</sup> E-mailed response from Professor Parker to confidential Citigroup report - received 24th Jan 2007

- b) retaining JT under State ownership but structurally separating the network (wholesale) business from the fixed retail and mobile businesses;
- c) retaining JT's network (wholesale) business and selling its fixed retail and mobile businesses (separately or together);
- d) selling JT's network (wholesale) business to one purchaser, and its fixed retail and mobile businesses to a second purchaser;
- e) selling JT's network (wholesale) business to one purchaser, its fixed retail business to a second purchaser, and its mobile business to a third purchaser.

2. The economic costs of each of the scenarios in 1(a) to 1(e) above, including:

- i) on-going costs of regulation for both the JCRA and JT;
- ii) one-off transitional costs of structural modifications; and
- iii) the efficiency losses from structurally separating a vertically integrated business.

The Panel is of the view that the decision to commission this report was flawed. Clearly the report requested was not a full analysis of the economic impacts arising from the sale of JT. Instead the JCRA was asked to conduct a comparatively narrow analysis of one issue, prompted by a recommendation of the Organization for Economic Cooperation and Development (OECD) concerning structural separation in regulated industries.<sup>22[40]</sup>

Notwithstanding the fact that the JCRA is empowered to advise the Minister for Economic Development on matters concerning competition and utilities<sup>23[41]</sup>, it should be noted that the Authority will have an ongoing duty to regulate a privatised Jersey Telecom. Therefore the JCRA has been placed in a difficult position in terms of weighing its obligations and advising accordingly.

{The JCRA itself does not feel it was placed in a difficult position, as Bill Brown, the JCRA's Executive Director, stated to the Panel on 3/10/06:

'I think, correct me if I am wrong, the implication of that question is that we have an interest in having a solution which involves our regulation. I do not believe that that is the case. Our role is to give objective dispassionate advice to the States and the legislation has provided the framework for that to happen.'}

<sup>22[40]</sup> It might be noted that full structural separation has not occurred in **any** OECD country. Professor Parker advises that the relevant OECD paper has been highly contested.

<sup>23[41]</sup> See Article 6(4) of the Competition Regulatory Authority (Jersey) Law 2001.

Having analysed the findings of the JCRA, the Panel considers that its own concerns were well founded. The report arrived two weeks late. {This was in fact a two week extension of the target date for delivering the JCRA's advice to the Minister, agreed by the Minister. So effectively the advice was delivered within the agreed timescale. While the two week extension may have been inconvenient to the Panel, who wished to have sight of the advice before delivering their Report, it has no bearing on the JCRA's effectiveness in performing its statutory function of advising the Minister.} When it was finally copied to the Panel it was found to have suggested an unconvincing argument in favour of splitting JT (an already rather small telecoms operator when assessed on a global scale) into component parts. {The Report, while pointing out both the costs and benefits of various options of structuring JT, expressly does not recommend any particular course of action.} Although the JCRA stopped short of formally recommending structural separation, the Panel's adviser considers that the report makes it sufficiently clear that the Authority advocates separation as its preferred way forward.

Sections of the JCRA report, which cost approximately £26,000 to produce, have been based on analytical work carried out for the JCRA by Robson Rhodes. Around £10,000 of the total cost of the report is attributable to the engagement of these external consultants. The Panel agreed only to view an executive summary of the advice received by the JCRA from these consultants and commercial confidentiality precludes any detailed comment on the content of that report.

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Having taken advice from Professor Parker regarding the content of the Robson Rhodes paper, the Panel does not consider that the information contained within it provides significant support for the implicit conclusions within the JCRA's own report for the Minister for Economic Development.

The Panel also understands that Jersey Telecom was very concerned at the JCRA's apparent failure to approach it in early course for a discussion regarding the subject matter of the report requested by the Minister for Economic Development. It is understood that the Board, having waited for some 2 months, decided to submit its own report on the subject of structural separation to the JCRA. {This is inaccurate and misleading. During the course of our analysis, JT informed the JCRA that it was conducting its own examination of the potential costs of structural separation, and offered to provide this report to the JCRA. JT subsequently provided a copy of this report to the JCRA.} The Board's own report clearly disputes the notion that structural separation presents a viable way forward. In particular it notes that the potential costs of managerial restructuring would be particularly significant and would take a significant period of time to put in place.

It is clear to the Panel that the JCRA report cannot be regarded as a thorough analysis of the economic impact of selling JT. What it does provide, however, is important, and somewhat unexpected, evidence that the current regulatory framework in Jersey may not be sufficient to deal with a privatised Jersey Telecom. In turn, this gives rise to another important question; just how

much will the cost to the taxpayer of regulating the telecoms industry increase as a result of privatising JT? {The JCRA's Report does not state this, nor was it our intention to imply this. It simply discusses potential problems arising from a vertically integrated dominant telecommunications provider. The JCRA's Report further states that the potential problems arising from vertical integration appear notwithstanding whether the company is publicly or privately owned:}

“On the issue of whether the structurally separated network business should be kept in States ownership or privatised, the JCRA is neutral from a competition perspective for it is most likely that the structurally separated network business will remain a monopoly.” (p. 33, JCRA Report).}

These issues are explored in more detail in **Chapter 4**.

## 2.5 The Analysys Report

During the course of 2006 the Panel became aware that international telecoms consultants Analysys were producing a confidential report for the Minister for Treasury and Resources on the possibility of separating out parts of the Jersey Telecom business. The report was entitled 'Perspectives on Structural Separation'.

The Panel notes that the Minister for Treasury and Resources has now published the Analysys report, which provides a detailed insight into the costs of structural separation.

Analysys appears to have been working to similar terms of reference to those of the Jersey Competition Regulatory Authority but comes to the opposite conclusion; that the costs of pursuing such a measure may well be prohibitive and that the company should not be forced to undergo structural separation. Analysys is clear that the resulting business units would be too small.

In any event, the Panel considers that the Analysys report is far too narrow in scope to constitute a full cost-benefit analysis of the proposal to sell JT.

### Finding

Given the vital importance of telecommunications to the economy and especially the financial services sector, the panel is disappointed to find that a full cost/benefit analysis has not been carried out by any Minister. It recommends that such analysis be carried out as an essential precursor to any proposal to sell off the island's only full service telecoms provider.

## 2.6 What about the Strategic Plan?

Commitment 6.3 of the Strategic Plan 2006 – 2011 charges the Council of Ministers with maximizing the potential of States owned strategic resources. One of the specific actions arising from this Commitment is specified at paragraph 6.3.1, which requires the Economic Development Department to –

***'Provide clear criteria for the protection and efficient provision of services provided by States-owned, and States-controlled, utility companies'.***

The above was inserted by way of a successful amendment to the Plan lodged by Deputy J.G. Reed. Therefore, and in the absence of a full and detailed assessment of the strategic implications of any provisional privatisation proposals for the Island's economy and its population as a whole, the Minister for Treasury and Resources does not have a mandate to pursue the sale of JT.

On 16th January 2007 the Council of Ministers presented to the States a report entitled 'Strategic Plan – Progress Against Initiatives'<sup>24[42]</sup>. That report confirmed that work on the clear criteria required by virtue of paragraph 6.3.1 of the Strategic Plan had not yet been completed. Neither was there an estimated date of completion for the work.

A more detailed analysis of the mandate given to the Minister for Treasury and Resources by the States in respect of Jersey Telecom can be found at **Appendix 1**. It shows that the Minister has simply set aside Amendment No. 15 to the Strategic Plan and has pursued his own timetable for privatising the company, in contradiction of the will of the States.

## **2.7 Are Other Small Jurisdictions Privatising?**

In the absence of a considered piece of local analysis regarding the economic implications of selling off Jersey Telecom, the Panel has reviewed the status of telecoms markets in a number of other jurisdictions worldwide. The results of this work have been surprising, particularly when compared with assertions made by the Minister for Treasury and Resources in his discussion paper.

According to the Minister–

***'Jersey Telecom is one of only a few operators of any note that remains fully state-owned (the other jurisdictions of interest being Cyprus (where privatisation is underway), the Faroe Islands, Greenland and Luxembourg)'***<sup>25[43]</sup>

He has since told the Panel –

***'I would say that the majority of governments have divested themselves completely of their telecoms infrastructure and that Jersey is one of the few places left in the world which still owns, as in the Jersey case, the entire telecoms company.'***<sup>26[44]</sup>

In order to establish the veracity of the Minister's claim, the Panel asked Professor David Parker with production of a briefing paper on the state of telecoms markets in a number of other smaller jurisdictions around the globe. A copy of his report is enclosed at **Appendix 3**.

Having analysed the position, the Panel considers that the description given by the Minister of the status of telecoms markets is simply not true. In Europe, five jurisdictions (including Cyprus and Luxembourg, both of which have significant finance industries) have retained full ownership of their incumbent operators, while a further twenty-one have retained a partial stake. Twenty countries have either fully privatised their incumbent operators or have never owned the operator. These

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<sup>24[42]</sup> R.4/2007 refers

<sup>26[44]</sup> Transcript of public hearing attended by the Minister for Treasury and Resources, 19th Dec. 2006 – p.6

figures reveal that the majority of countries in Europe have retained a significant shareholding in their telecoms companies, presumably for strategic control reasons.

The Isle of Man appears never to have been in a position to consider the merits, or otherwise, of privatisation, having never secured ownership of its incumbent telecoms operator. Instead it reached an agreement with the UK for provision of services. When the Thatcher government privatised BT, the Isle of Man retained BT as operators of what became Manx Telecom. When BT de-merged sections of its business in 2001, as a result of mounting debt, Manx Telecom became part of the then mmO2 group, which was subsequently renamed O2 and was acquired by Telefónica in 2005.

In Guernsey, the former state owned incumbent operator is owned by Cable and Wireless, following a sale in May 2002 for a reported £30 million. A report produced by Analysys in 1999 was broadly complimentary about the state of the service provider; however, the facts at that time were that Guernsey had been less inclined to force its telecoms operator to function as a commercial entity and it was generally not required to return profits to the government.

JT Chairman John Henwood has corroborated the Panel's own research. He explains -

***'My observation, both as someone who ran a business in Guernsey as well as Jersey, was that the States of Guernsey... failed to make the investment to the degree that Jersey deemed necessary. Consequently, when they faced the decision of whether to dispose of their telecommunications asset, they were looking at an asset which was... impoverished, in the sense of lacking in investment... Hence, it was not worth very much when they came to sell it.'*<sup>27[45]</sup>**

Consequently Guernsey Telecom fitted the classic 1980's stereotype of a poorly performing nationalised industry ripe for a sale.

### **2.7.1 Partial Privatisations**

As Professor Parker's own paper reveals, a significant number of smaller countries worldwide that have privatised their incumbent telecoms operators have retained a stake in the company.

The incumbent operator in the Republic of Estonia (a country with a burgeoning information technology industry) is Eesti Telecom. Eesti is 27 per cent owned by the state. A total of 19 per cent of shares in the company are held by public investors, with the majority stake in the hands of Baltic Tele AB.<sup>28[46]</sup>

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<sup>27[45]</sup> Transcript of public hearing attended by JT Board, 25th Sept. 2006 – p.42

<sup>28[46]</sup> See also <http://www.telekom.ee>

Malta's national provider was partly-privatised in June 1998 through a 40% sale of Maltacom shares via a public offering, half of which was offered for sale domestically. Liberalisation followed after privatisation.

Monaco Telecom is 45% owned by the Principality of Monaco.

### 2.7.2 Retained Ownership

Neither is it particularly difficult to find countries that have elected to retain full ownership of a telecoms company. These include the incumbent operator in Cyprus, which remains 100 per cent state owned. In spite of an assertion within the Minister's own discussion paper that privatisation of CYTA was underway, the Panel has found that this is not the case. Our understanding is that it has an effective partnership agreement with Vodafone and that pressures to privatise are non-existent.

In Luxembourg, a major rival low tax jurisdiction, the incumbent operator EPT remains state owned.

#### Findings

The evidence produced by the Minister for Treasury and Resources reveals that the majority of European countries have chosen to retain a partial stake in, or full control of their incumbent telecom operator.

### 2.8 Conclusions

The Panel has been most disappointed to learn that the approach taken by the Minister for Treasury and Resources to the possible sale of Jersey Telecom has been unacceptably narrow and fragmented. To summarise -

- Citigroup has focused on selling the company and maximizing the return to the shareholder, at the expense of the three other key principles advocated by the Minister.
- The JCRA implies that Jersey Telecom should undergo structural separation prior to privatisation. Indications are that its advice, which the Panel considers to be flawed in any event, will be ignored. {The Panel's Report does not explain why the Panel considers the JCRA's Report to be "flawed".} The Panel considers that the JCRA has arrived at its position because it has concerns regarding the prospect of regulating a privatised JT {This is not correct. As noted above, the JCRA Report's conclusions on the potential benefits arising from structural separation apply notwithstanding whether JT is publicly or privately owned}.

- • The report produced for the JCRA by JT says that structural separation will be costly (both for the company and possibly also for the regulator) unproductive and should not be pursued.
- • The Analysys report broadly concurs with the JT report. Structural separation would be costly and would result in business units too small to be viable.
- • The Economic Adviser's report also challenges the case for structural separation offered by the JCRA.
- • None of the above constitute a fully developed cost-benefit analysis of the proposed sale.

Scrutiny has received a series of reports prepared for the Minister for Treasury and Resources, for the Minister for Economic Development or for the Council of Ministers as a whole. Unfortunately these reports, even when taken together, fail to provide a comprehensive assessment of the full economic and social implications of relinquishing control of Jersey Telecom. Neither can they be regarded collectively as an attempt to comply with related commitments in the Strategic Plan 2006 – 2011 (See **Appendix 1**).

Claims made by the Minister for Treasury and Resources regarding the extent to which other countries have pursued privatisation of their incumbent telecoms operators are clearly overstated.

As Professor Parker explains in his review of evidence received –

- a) a) incumbent telecommunications companies are developing international strategies and strategically partnering arrangements irrespective of whether the telecommunications company is privately or state owned;
- b) b) Jersey's decision to regulate telecommunications through the competition authority, the JCRA, is unusual (an issue which is considered in more detail in Chapter 4) {As detailed below, Bill Brown explained to the Panel on 19 December that the JCRA is both a competition law enforcement authority and a telecommunications regulatory authority.};
- c) c) privatisation has (at least so far) not occurred in some jurisdictions and even where countries have now transferred majority ownership to the private sector, this has tended to occur through the sale of tranches of shares over time;
- d) d) privatisations in smaller countries have tended to involve the introduction of a strategic partner as part owner; and

- e) e) In spite of market liberalisation, the incumbent operator (whether privatised or state owned) continues to maintain significant market shares especially in fixed line services but often mobile services too. <sup>29[47]</sup>

#### **Finding**

The Panel finds that the value of JT is unlikely to have peaked. Evidence shows that Incumbent operators tend to retain significant market share even after liberalisation and the introduction of competition. The panel is concerned that a 100 per cent sale of JT might replace a publicly owned dominant company with a private one.

The Panel is concerned that the Minister is attempting to rush the privatisation through the States; yet his only argument presented in favour of proceeding with a quick sale seems to make little sense. As Professor Parker observes –

***‘I have been surprised by the sense of urgency that seems to exist in the Government of Jersey in terms of taking a final decision on privatisation... There is no evidence that Jersey Telecom’s business is collapsing and were it to be so, Jersey Telecom would be difficult to sell now’.***

He adds -

***‘A rushed privatisation is likely to be a bad privatisation. The result is likely to be incompatible with maximising both the economic gains and financial receipts that privatisation should bring.’*** <sup>30[48]</sup>

One further report which the Panel has received is a confidential Treasury paper on the matter of how an asset such as JT should properly be assessed within the States portfolio. This presents a superficial argument. The paper, and the issues it raises, are discussed in the following Chapter.

#### **RECOMMENDATION**

A comprehensive cost-benefit analysis of the economic and social implications arising from a sale of Jersey Telecom should be completed before the States decides whether to sell the company.

<sup>29[47]</sup> See Appendix 3 - Conclusions

<sup>30[48]</sup> ‘Possible Sale of Jersey Telecom – Review of the Evidence to 31 December 2006’ – D. Parker. p.23-24

### 3. How Valid is the ‘Strategic Reserve’ Argument?

Central to the proposal of the Minister of Treasury and Resources is the contention that Jersey’s long term financial security would be better preserved by trading ownership of Jersey Telecom for a significant increase in the size of the Strategic Reserve.

#### 3.1 What is the Strategic Reserve?

In order to assess the merit of the Minister’s argument, it is first necessary to consider exactly what the purpose of the Strategic Reserve is. Article 4 of the Public Finances (Jersey) Law 2005 frames the definition. It reads –

##### ***‘4 The strategic reserve fund***

- (1) There is established a strategic reserve fund, being a permanent reserve that shall not be used to defray directly expenditure of the States.*
- (2) There shall be transferred from the consolidated fund to the strategic reserve fund such amount as the States may decide on a proposition lodged by the Minister.*
- (3) Money shall not be withdrawn from the strategic reserve fund otherwise than in accordance with a decision of the States made on a proposition lodged by the Minister that provides for the amount withdrawn to be credited to the consolidated fund.’*

The policy for the Strategic Reserve was approved by the States Assembly on 5th December 2006<sup>1[49]</sup>. It confirms that the Reserve is essentially a savings account with significant restrictions placed on how funds within it might be used. The policy states –

***‘that the Strategic Reserve Fund, established in accordance with the provisions of Article 4 of the Public Finances (Jersey) Law 2005, should be a permanent reserve, where the capital value is only to be used in exceptional circumstances to insulate the Island’s economy from severe structural decline such as the sudden collapse of a major Island industry or from major natural disaster.’***

Put simply, the Strategic Reserve provides a financial buffer for use only against a major, and unforeseen, natural disaster or economic shock.

Within the accompanying report is confirmation that a long term aspiration exists to grow the Strategic Reserve to a figure equivalent to 20 per cent of Gross Domestic Product (GDP). As of

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<sup>1[49]</sup> Projet No. P.133/2006 refers

October 2006 the level of growth required in order to achieve this aim was broadly equivalent to £100 - £120 million.

Interest earned on the capital within the Reserve is re-invested in order to ensure that the fund continues to grow (unless a 'severe structural decline' event occurs). In fact, the only other mechanism described within the policy under which monies might be transferred out of the Reserve into the Consolidated Fund (effectively the States' current account) concerns return on any capital added as a result of a privatisation. Such returns could be used to meet ongoing expenditure commitments.

### **3.2 Examining the Minister's Perspective**

In reviewing the discussion paper, the Panel looked for answers to three particular questions—

- a) a) Why should Jersey Telecom be considered as part of the Strategic Reserve?
- b) b) What is it about JT that makes it an unsuitable asset for inclusion within or alongside that portfolio?
- c) c) Why will Jersey's long term security be better assured by trading ownership of JT for an increased portfolio of off-Island equities and gilts?

Regarding the first question, Section 4 (Jersey Telecom as a Strategic Investment) of the consultation document reveals that -

***'The Minister considers the investment in Jersey Telecom, for all intents and purposes, as a component of the Strategic Reserve.'***

Closer scrutiny of the previous paragraph of Section 4 provides a clue as to the basis for the Minister's thinking. It claims –

***'The aim of the States is to maximise the long-term value of its strategic assets.'***

This is not a correct statement. In fact the above refers directly to a commitment within the draft Strategic Plan that was deleted and replaced with the following wording, as proposed by Deputy J.G. Reed –

***'Provide clear criteria for the protection and efficient provision of services provided by States' owned, and States' controlled, utility companies'.***

The discussion paper continues -

***If the investment is considered on the basis of the criteria used for the Strategic Reserve though, it falls well outside the current and likely future policy for the following reasons:***

- • ***it is not listed on a Stock Exchange;***
- • ***the investment amount is far in excess of that permissible for single investments within the current investment mandates; and***
- • ***the risk profile is over and above that considered acceptable.***

***Against those criteria therefore, this investment would not be included within the Strategic Reserve.'***

No further evidence in support of the view that JT should be considered part of the Strategic Reserve can be found within the document. It therefore appears that although the Minister has set out reasons why the company is allegedly a poor fit within the Strategic Reserve asset portfolio, he has failed to explain adequately why the company should even be considered as part of that portfolio in the first place.

The Minister's discussion paper states –

***'Whilst strategic investments, such as those in Jersey Telecom, provide a buffer if ever the Island were to suffer an economic catastrophe, it would be at such a time that the value of the company would also fall dramatically and it would therefore be difficult to sell. This is the principal argument for disposing of the States holdings in Jersey Telecom and reinvesting the funds in a more diversified international portfolio. It is for similar reasons that Norway, for instance, has a policy that its surplus oil revenues are invested outside the country.'***<sup>2[50]</sup>

In an attempt to better understand the Minister's perspective, the Panel has reviewed a briefing paper, supplied by the Treasury and Resources Department, which outlines the rationale for the Strategic Reserve. It remains unconvinced that the Minister has a tenable argument, particularly with respect to the criteria used by the Minister to judge the suitability of JT as an asset within his Strategic Reserve portfolio.

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<sup>2[50]</sup> Discussion paper, p.13

### 3.2.1 Stock Exchange Listing

Both the discussion paper and the subsequent confidential briefing paper seen by the Panel fail to adequately justify the existence of the stock exchange listing requirement.

The Minister regards JT as an illiquid investment (one that is unable to be turned readily into cash) that would take too long to offload when the States deems it appropriate to sell the company. Although the Panel accepts that listed equities are generally more liquid than specific individual assets of a state owned company, or that company when assessed as a single entity, the fact remains that stock exchanges serve to bring buyers and sellers together; they do not provide guaranteed liquidity.

Furthermore, an assumption has been made that the States will, at some point, wish to divest itself of Jersey Telecom. In that respect the confidential Treasury document seen by the Panel is premature. It certainly fails to outline any particular scenarios under which such a course of action might be deemed appropriate. For example, it has been suggested that the fund could be used for responsive measures to assist recovery in the aftermath of an event having severely damaged the economy. Should such an event occur, it is entirely feasible that the States would wish to prioritise the rebuilding of, or further investment in, telecoms infrastructure, rather than having to wait for a private company to consider its own investment priorities. In the event that JT is bought by a multinational trade buyer or private investors, the Panel is concerned that it could be competing for urgent investment against assets or operations also owned by the buyer but lying outside of Jersey.

### 3.2.2 Size of Investment

The matter of the size of JT in investment terms is again dependent on whether one accepts the Minister's contention that the company should already be regarded as part of the Strategic Reserve.

JT, when regarded as an individual States investment, undoubtedly appears comparatively large. Nevertheless it should arguably be viewed in the context of a prevailing market perspective that even incumbent telecommunications companies with potential for loss of market share due to competition are widely regarded as a profitable investment. The Panel's adviser notes that -

***'In spite of competition, incumbent telecommunications operators have remained profitable internationally. Although they have lost market share, this has been a share of a growing market. Moreover, technological change has reduced unit costs. It is not axiomatic that Jersey Telecom will be less profitable going forward, at least within any foreseeable time scale.'***<sup>3[51]</sup>

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<sup>3[51]</sup> 'Possible Sale of Jersey Telecom – Review of the Evidence to 31st Dec. 2006' – D. Parker, p.8

Corroborating Mr. Parker's assessment is not difficult. Ovum, a leading business information provider operating in the telecoms sector, holds the view that investment houses (also known as private equity firms) have a particular interest in acquiring telecoms companies.<sup>4[52]</sup> The very fact that the States owns an asset that is so widely sought after indicates that it should not be traded lightly, particularly when one of the more likely customers could well come from the same private equity sector that the Board of Jersey Telecom have indicated that they would rather not be sold to.

### 3.2.3 Risk Profile

The third issue raised is explored in greater detail within the Minister's document. Page 12 contains the following statement -

***'The introduction of competition into the marketplace means that the risk profile of the company, in particular in terms of an investment, has significantly deteriorated from the days when the company was largely an unregulated monopoly.... The compensating returns generated for the shareholder are likely to face downward pressure from those enjoyed currently and in recent years.'***

Put simply, Jersey Telecom, if viewed as a financial investment, effectively raises the risk profile of the Government's entire investment portfolio (including the Strategic Reserve). This argument deserves careful consideration, particularly as it suggests, albeit indirectly, that privatisation has always been an inevitable consequence of the competition policy introduced at the turn of the century.

Adoption of the Telecommunications (Jersey) Law 2001 by the States created the environment for meaningful competition in the telecoms market. Yet rather than privatise JT, the States maintained its deliberate policy of pursuing the incorporation, in the full knowledge that competition was coming and without any suggestion that the Assembly considered incorporation to be a stop-gap measure pending the arrival of major competitors.

The Strategic Reserve criteria have been applied to a state owned telecoms company without a meaningful explanation as to why they cannot equally be applied to other utility companies. In the absence of such criteria, the implication must be that electricity and water could also be sold off because they too are capital intensive enterprises that are also susceptible to certain classes of severe economic shock or structural decline.

It is also worth reflecting on the nature of education and health services provided by the States of Jersey. Both require significant ongoing capital investment. Both enterprises have assets of significant value (e.g. land) located on-Island. In that respect the strategic importance of education

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<sup>4[52]</sup> 'Why investment houses are so interested in telecoms' – <http://www.ovum.com/go/content/c,67474>

and of telecommunications are not particularly different; yet health and education assets appear to fall outside the Strategic Reserve.

Professor David Parker has advised the Panel that, when assessing the risk profile of government assets, it is necessary to remember that governments are in a position to spread risk across an entire population simply because they have access to a regular cash flow in the form of tax receipts. In that respect they enjoy a significant advantage over private investors in terms of accommodating risk. Accordingly, and in the words of Professor D. Parker –

***'It is not axiomatic that investing the proceeds from the sale of JT in equity and bonds will reduce the overall risk of the States' investments'.<sup>5[53]</sup>***

During the course of its investigation, the Panel has been provided with a copy of a detailed report produced for the Minister by the Citigroup consortium. Although its contents are confidential, the Panel considers that it is in a position to report that the document does not contain anything which might reasonably be regarded as a considered analysis of the concept that JT should be sold so as to diversify risk through the Strategic Reserve.

To date the Panel has not been provided with proof that the Treasury has conducted a sensitivity analysis relating to the possible different levels of net proceeds from a sale of JT and different conceivable returns on the sum invested in the Strategic Reserve. Professor Parker, who has reviewed the paper, told the Panel –

***'I would particularly expect a paper of this kind to provide calculations using different interest rates and assumptions about future values - after all, "sensitivity analysis" is a standard procedure in financial appraisal.'<sup>6[54]</sup>***

The Professor refers to the fact that investors are able to reduce their exposure to risk by holding assets that are not perfectly correlated (otherwise known as diversifying their portfolio). Unless the correlation between assets is addressed, any reference to diversification is meaningless. On the basis that the Strategic Reserve fund is predominantly invested in government and corporate bonds, with a smaller proportion in equity, the Reserve does not appear to be particularly diverse. Given the desire to avoid the consequences of a possible cataclysmic equity market failure, the use of corporate bonds looks questionable, given their inherent risks.

What this means in terms of Jersey Telecom is that holding onto the company may, in effect, provide a more effective diversification than would disposal.

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<sup>5[53]</sup> E-mailed response from Professor Parker re. Economic Adviser's report – received 3rd Feb. 2007

<sup>6[54]</sup> E-mailed response from Professor Parker re. confidential Treasury paper on Strategic Reserve – received 24th Jan. 2007

### 3.3 The Figures

In event that the States does decide to sell JT, the proceeds of that sale, minus the fees payable to the Minister's consortium of advisers from the private sector, will be transferred to the Strategic Reserve and invested in a portfolio of equity and debt assets.

If the proposal is to make sense on purely financial grounds, the States must receive a return on investment at least equal, and preferably superior, to that which is obtainable in the future from dividends, from tax receipts and from the capital growth of a state-owned Jersey Telecom. As explained by the Panel's adviser-

***'the Net Present Value of the sales proceeds invested in the Strategic Reserve [should be] greater than the NPV of retaining the States investment in Jersey Telecom.'***

Such a value would not be easy to achieve. It is understood that in 2006 Jersey Telecom returned approximately £20 million to the States in tax and dividends, although this figure has been affected by a £6 million 'one off' payment made in order to return what has been described to the Panel as 'surplus cash' within the business. Moreover, 2006 followed an established trend of increasing returns to the States. In 2005 Jersey Telecom in 2005 made a pre-tax profit of £13million. The States received £7.1million in dividends alone. Retained profits in 2005 after dividends were £3.5m. As the States remained owner of JT, this resulted in an effective return to of £10.6million. Had it not been for one off restructuring costs of £1.4 million, generated as a result of a voluntary redundancy programme, the effective return would have been even greater. Even taking account of the cost of the redundancy programme, profits in 2005 were only slightly down on the previous year.

Against this backcloth the Panel has assessed the returns achieved from the Strategic Reserve. In doing so, it considered the performance of the Reserve over the past 5 years. Figures from the late1990's were deliberately excluded on the advice of the Panel's adviser, who regarded them as flattering average returns when assessed against the likely overall performance of stock markets going forward.

Treasury figures reveal that the Strategic Reserve averaged an annual return of 5.2 per cent over the period selected. This compared with an average return to the States generated by Jersey Telecom of 5.7 per cent, as calculated by the Panel's adviser, using figures provided by the company.

Nevertheless, consideration of a sale in 2007 requires that States members critically assess possible future returns on investment. Two factors in particular are relevant to such an exercise. First, one must estimate the sale value of Jersey Telecom. Second, one must estimate JT's ability to generate net income and dividends going forward. This requires considerable background work. To date, the Panel has not seen sufficient evidence to demonstrate that this work has been done.

The confidential briefing paper outlining the investment policy for the Strategic Reserve and the implications arising from the sale or retention of JT also contains figures detailing anticipated future returns to the States post sale. It suggests that the return from investing sale proceeds in the manner suggested, taking account of the annual withholding tax on dividends paid to private investors, will be greater than the income generated through continued ownership of Jersey Telecom.

The Panel, with the assistance of its expert adviser, has concluded that the figures used are wide open to challenge. For example, they rely on a future average rate of return for the Reserve over 2 per cent higher than the average rate achieved by the Reserve over the last 5 years. In addition, the Panel is not clear that the figures have taken into account the fact that a privatised Jersey Telecom is more likely to have a 'geared balance sheet' (loan capital substituted for equity), which would have implications for the level of tax receipts generated by the company. Professor Parker noted this when he analysed the various financial documents provided by the Treasury.

The assumption of returns from the portfolio described appears to be extremely optimistic. In 1996 base rates were at 6 per cent with the forward market indicating future base rates close to 8 per cent. This was reflected in the bond markets offering higher yields. The current Gilt curve peaks at 5.5% at the 2 year mark and falls to 4.976% at 10 years. The risk premium associated with corporate bonds is also at lower levels than in 1996 with a BBB bond (the absolute minimum rating that is appropriate for such a fund) trading at a maximum of 100 basis points over the gilt. Therefore, assuming no transaction costs and that the full Strategic Reserve is invested in BBB rated bonds, one can estimate that the Reserve will return between 6.5% and 5.976% over the period described in the Treasury paper.

After taking into account management fees and transaction costs, the Panel has estimated that the amount of equity that would be needed to be added to the Strategic Reserve to achieve the sort of returns assumed in the Treasury paper would be broadly equivalent to a 50 per cent increase in the size of the fund. This estimate has been endorsed by Professor Parker <sup>7[55]</sup>, who adds-

***'The return on the Strategic Reserve fluctuates from year to year but has averaged an annual return of 5.2% over the last 5 years. If Jersey Telecom sold for a net sum of £200m (after selling costs) and all of this was placed in the Strategic Reserve at a return of 5.2% the annual return to the Government would be £10.4m. However, if the net value of the sale was as little as £140m, the return in the Strategic Reserve would be £7.3m.'***<sup>8[56]</sup>

#### **Finding**

Confidential projections presented in support of the rationale for trading ownership of Jersey Telecom for additional investment in equities and gilts are viewed by the Panel as highly unreliable.

Of course, a higher average rate of return for the Strategic Reserve has the positive effect of requiring a lower sale price for JT in order to achieve future returns of a similar value to those generated by JT in the recent past. Using the admittedly prudent 5.2 per cent rate of return achieved by the Strategic Reserve over the last 5 years, instead of the higher Treasury figures, the Panel's adviser has calculated that sales receipts of over £180 million (after payment of the Citigroup consortium) would be necessary in order to generate higher returns than JT has received to date.

The Panel has not been made aware of the valuation put on Jersey Telecom by the Minister or by his consortium of advisers. Nevertheless, it is aware of speculative valuations contained in early press reports, which were published prior to any detailed consideration of the effect that requirements to guarantee employee terms, conditions and pension arrangements may have on the final price).

The Panel is particularly interested to note that confidential projections it has seen assume that Jersey Telecom's net income and dividends would continue to rise in future years under States ownership. The figures within the report appear to contradict the Minister's original view, as stated in the discussion paper, that –

***'returns generated for the shareholder are likely to face downward pressure from those enjoyed currently and in recent years.'***

<sup>7[55]</sup> E-mail response received at Scrutiny Office 3rd February 2007

<sup>8[56]</sup> Possible Sale of Jersey Telecom (Jt Group Ltd): Review of the Evidence to 31 December 2006, para.3.3.

In the event that returns are likely to remain buoyant, the logic of pursuing a sale must be in doubt; however, should the Minister's original view on future returns prove to be the more sensible prediction, any bidder for Jersey Telecom will undoubtedly value the company at a level which reflects the prospect of declining profitability. The same would apply to a sale by IPO (a flotation). A depressed valuation will follow, leaving the Treasury advisers with the task of driving the price back up towards a value that might generate returns broadly comparable with those of the recent past. This could be achieved by encouraging a 'bidding war' between a significant number of companies that might consider themselves able to turn any decline in profitability through access to economies of scale and / or scope; however, this strategy would not be without significant risk. Were a buyer to end up over paying for the company, the most obvious course open to that buyer to reduce costs and maintain profitability would be through major staff cuts. This is an outcome that must be avoided.

### 3.4 Conclusions

When in 1996 the States took the in principle decision to incorporate, it did so on the grounds that JT generated significant revenue for the States, because of the strategic importance of having high quality telecommunications services in the Island and because retention of ownership would allow for the States to retain a degree of influence over the direction of the company *without* resorting to micro-management. It did not do so on the basis that JT should form part of the Island's Strategic Reserve.

#### Finding

The Panel finds the central argument that Jersey Telecom should be assessed as part of the Strategic Reserve unconvincing.

Having reviewed the report, the Panel considers that the Minister's approach to Jersey Telecom is unsupported by a considered rationale. The Panel has reached its conclusion following receipt of advice from Professor David Parker, who concluded his own review of the Treasury paper on the Strategic Reserve in the following terms -

***'In summary, I do not believe that this is an acceptable paper on which to make crucial decisions about the future ownership of JT.'***<sup>9[57]</sup>

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<sup>9[57]</sup> E-mailed response from Professor Parker re. confidential Treasury paper on Strategic Reserve – received 24th Jan. 2007

Having reviewed in detail the documentation and the accounting information provided by the Minister and by the Board of Jersey Telecom, the Panel's adviser concludes –

***'The figures available do not seem to support an immediate financial case for disposing of Jersey Telecom... in my view neither the risk argument nor the... financial return argument for privatisation is particularly strong.***

He adds -

***Moreover, it would be quite wrong for any government to dispose of its telecommunications operator on financial grounds only. [emphasis added] Telecommunications are fundamental to Jersey's economic prosperity as a financial centre. The concern of government should be about the availability, quality of service and pricing of telecommunications under state or private ownership'.<sup>10[58]</sup>***

Certainly the Panel believes that it is doubtful the people of Jersey will necessarily get a better annual return if Jersey Telecom were sold. What is also clear is that the firm argument put forward by the Minister, namely that the States must make a decision on the future ownership of Jersey Telecom on the basis of the States' 'investment strategy', is fundamentally flawed. Perhaps this is why the Minister admitted in a public hearing –

***'I am not suggesting that I could invest the sale proceeds of Jersey Telecom to get a higher yield than Jersey Telecom currently generates.'<sup>11[59]</sup>***

The financial logic applied by the Minister appears rather simplistic. Retaining investment in JT might well be prudent in terms of ensuring that the States investment portfolio is sufficiently diverse. It might well alleviate strategic risk by ensuring continued infrastructure and technological investment. Certainly it is incumbent upon the States to ensure that the finance industry enjoys efficient and robust communication links for as long as the Island wishes to rely on the revenues it generates.

In political terms, a decision on the sale of JT, taken on the investment strategy grounds suggested, contradicts the policy and the initiatives set by the Strategic Plan 2006 – 2011, as amended.

The fact remains that the extent to which JT will become an increasingly risky investment is largely dependent on the accuracy of the Minister's predictions regarding the effect of competition, the cost of future rounds of investment and the loss of traditional revenues – together with difficulties

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<sup>10[58]</sup> Possible Sale of Jersey Telecom (Jt Group Ltd): Review of the Evidence to 31 December 2006, para.3.5.

<sup>11[59]</sup> Transcript of hearing attended by Minister of Treasury and Resources – 19th Dec. 2006 – p.30

in securing new sources of income to replace those revenues. These predictions appear somewhat pessimistic.

The Panel's adviser contends that –

***'The Government should assess the risk profile of all of its investments together, including the Strategic Reserve and Jersey Telecom. Should it be decided that the risk profile is not optimal, it is open to the Government to consider adjusting the risk profile of the Strategic Reserve to reflect any identified risk relating to its investments in Jersey Telecom, as a possible alternative to the sale of Jersey Telecom.'***<sup>12[60]</sup>

The Panel agrees wholeheartedly with this conclusion. In addition, it notes that the Minister's argument makes one particular key assumption; that the system put in place to safeguard the interests of the consumer, and to ensure that social obligations are met, is effective. That question is considered by the Panel in the next Chapter.

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<sup>12[60]</sup> Possible Sale of Jersey Telecom (Jt Group Ltd): Review of the Evidence to 31 December 2006, para.3.2.

## 4. Is the Regulatory Framework Sufficient?

Professor David Parker advises that regulating markets is not a straightforward process. He explains –

***‘At the root of economic regulation lies a problem. To regulate effectively, a regulator needs good (ideally, perfect) information about the company that is being regulated. In particular, it needs to know the company’s “efficient” levels of current and future operating costs, investments and costs of capital (funding)... In the real world, regulators lack such information.’***

Regulated firms tend to enjoy an advantage over the regulator in that the board of a regulated company is better placed to access data on costs than the regulatory authority.<sup>1[61]</sup> The Professor states -

***‘The regulator must rely heavily on information supplied by the regulated firm,<sup>2[62]</sup> through the submission of periodic regulatory accounts... and other data requested from time to time by the regulator. The company’s response will depend upon its ability and willingness to comply... Its willingness to supply the information will depend upon the relationship developed with the regulator, the purpose to which the firm’s management expects the information to be put, and any sanctions or incentives available to the regulator to ensure compliance.’<sup>3[63]</sup>***

Put another way, an aggressive private sector company in pursuit of profit and / or retention of market share, and free from any influence derived from a government stake, may not regard provision of information for the regulator as a priority.

[In respect of information gathering powers in particular, the JCRA is not clear as to why the Panel’s adviser believes access to information would be more difficult in a privatised environment: the JCRA’s statutory powers to require information – failure to comply with which is a criminal offence – apply irrespective of whether the company is in public or private ownership.](#)

[BT, Cable & Wireless, and many other companies in private ownership, recognise that regulatory compliance is a priority since non-compliance can affect shareholder value. See for example BT’s regulatory compliance website:](#)

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<sup>1[61]</sup> P. Burns, C. Jenkins and T. Weyman-Jones (2006) “Information revelation and incentives”, M. Crew and D. Parker (2006) *International Handbook on Economic Regulation*, Edward Elgar, chapter 8.

<sup>2[62]</sup> The exception is where some form of “yardstick” competition exists. Yardstick competition or “benchmarking” performance can only be used where the regulated firm has one or more obvious comparators, for example where there are a number of comparable water companies. This is not the case in Jersey for telecommunications. International benchmarking is a possibility but is problematic; M. Crew and D. Parker (2006) *International Handbook on Economic Regulation*, Edward Elgar, chapter 6.

<sup>3[63]</sup> Possible Sale of Jersey Telecom (Jt Group Ltd): Review of the Evidence to 31 December 2006, para.4.7.

<https://www.btplc.com/Thegroup/Regulatoryinformation/Regulatorycompliancepolicy/Regulatorycompliancepolicy.htm>

Beyond good information, effective regulation of a telecommunications market cannot realistically be achieved without –

- • appropriate regulatory legislation,
- • the availability of sufficient resources to the regulator, and
- • the efficient application of those resources by the regulator.

These are necessary both in terms of ensuring the efficient operation of the market and, in particular, that the cost of regulation does not exceed the net benefits to the consumer from the regulation.

By contending that the sole remaining reason for retaining ownership of Jersey Telecom is its value as an investment, the Minister for Treasury and Resources appears to be suggesting that the Jersey Competition Regulatory Authority, and the legislation under which it operates, has proved to be fully effective. Yet although his discussion paper does refer to the States objective of establishing ‘a robust regulatory framework’ in Jersey for telecommunications<sup>4[64]</sup>, it does not consider the performance of the JCRA since it was created in 2001. It declines to acknowledge that the JCRA is relatively new and untested. Where it has been challenged, such as on the issue of mobile number portability, it has tended not to be able to resolve the matter in short order.

The Minister nevertheless acknowledges in his discussion paper that without an effective regulator–

***‘the sale of Jersey Telecom could not reasonably be considered an option for the States.’<sup>5[65]</sup>***

It is for precisely this reason that the Panel has sought to satisfy itself that JCRA could perform its duties effectively if JT was privatised. What it has found instead is evidence that market regulation in small jurisdictions is a particularly difficult task and that the task tends to become significantly more difficult when a state owned operator moves into private hands. In turn the evidence suggests that the JCRA, as currently resourced (even allowing for its use of external consultants) and in light of its current powers, may not be able to regulate the telecoms market in Jersey effectively, post-privatisation. {As noted below, the evidence before the Panel does not support this.}

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<sup>4[64]</sup> Discussion Paper, p.5.

<sup>5[65]</sup> Ibid.

The only reports which appear to contain significant relevant information regarding the competence and effectiveness of the Regulator are a submission made to the JCRA by the Board of JT on structural separation and the report on structural separation produced by the JCRA itself.

{To suggest that the Panel has only two means of judging the JCRA's competence and effectiveness – the JCRA's advice to the Economic Development Minister on the proposed sale, and JT's submission to the JCRA on this subject – is not correct in fact and misleading. Not only is it contradicted by the Panel Report's own reference to several other publicised cases in which the JCRA has more recently been involved, it also ignores the successful interventions the JCRA has made in a substantial number of other cases, most of which are in the public domain – in the telecommunications sector and elsewhere – to address anti-competitive conduct for the benefit of competition and consumers. A list was provided to the Panel before its Report was published, but this unbalanced picture remains.}

Both raise relevant concerns. The Panel is therefore both surprised and concerned that the proposition to sell brought by the Minister for Treasury and Resources refers only to the need for ongoing monitoring of the effectiveness of the regulatory environment. In the Panel's view it is absolutely vital that a comprehensive study of the capabilities of the JCRA is commissioned, and completed in *advance* of privatisation in whatever form, not in parallel with it.

#### 4.1 Effective Regulation in Small Jurisdictions

When, on 7th September 2006, the Minister spoke at a public meeting organised by Scrutiny at Hautlieu School he said –

*'I would just say that at the present time we may have a level playing field but I think the teams on that field have different sizes. That is the difficulty. You talk about fair competition. Is it fair competition for one company to be capitalised at £100 million and one company to be capitalised at £1,000 million? Can they compete on equal terms? I think perhaps not.'*<sup>6[66]</sup>

The Minister's view echoes that of the Chairman of JT, who has since contended –

*'Bharti and Cable and Wireless are licensed and given advantages over us, because we are the ones with significant market power, it is judged, whereas they have global reach. It is bonkers.'*<sup>7[67]</sup> {This quote does not concern the overall competence of the JCRA, but questions the JCRA's finding that Jersey Telecom has Significant Market Power ("SMP"). The JCRA's approach with respect to defining JT as the operator with SMP is consistent with the approach

<sup>6[66]</sup> Transcript of public meeting held at Hautlieu School on 7th Sept 2006 – p.16

<sup>7[67]</sup> Transcript of public hearing attended by Board of JT, 25th Sept. 2006, p.24

taken in many other jurisdictions worldwide, both large and small. These jurisdictions include the EU, UK, US, Canada, Jamaica, Barbados, Malta, Australia, New Zealand, Ireland, France, Iceland, Spain, Germany, Poland, Slovenia, Cyprus, South Africa, Israel, and many more. The Panel's Report itself is internally inconsistent, as it observes later (in the discussion on Estonia), that the approach the JCRA has used to define JT as the operator with SMP in Jersey is the same as that applied across the EU: "Because of its large market share, ETC is subject to the 'significant market power' provisions. This is the case for all of the incumbent telecoms companies across the EU that retain market power."}

Clearly both board and shareholder have reservations regarding the competitive environment that the JCRA has initiated in Jersey. {This conclusion is contradicted by the Treasury Minister's own testimony before the Panel on 19/12/06, in which Minister Le Sueur stated:

"If I thought that the JCRA was not in a fit enough state to be able to ensure the continued provision of good quality telephone services to the Island I would be very concerned. I do not believe that is the case so ..."}.

{Also, the JCRA has not "initiated" a competitive environment in Jersey, but solely acts as the regulator in telecoms markets and seeks to implement the policy adopted by the States of Jersey to introduce competition in telecommunications. This States' policy is expressed in the preamble to Jersey's Telecoms Law: to "abolish the exclusive privilege of the States in telecommunications [and] to make new provision about telecommunications that concern Jersey." }

#### **Finding**

Jersey is a small jurisdiction with a limited consumer base. The JCRA should consider whether the regulatory model used in other, larger jurisdictions is suitable for the Island's economy.

It appears that the task for a regulator in a small jurisdiction is particularly difficult. For example, ensuring that the cost of regulation does not exceed the net benefit to consumers is inevitably a challenge when the regulated market has a limited number of operators, consumers and taxpayers from which financial resources can be drawn, either directly (in the form of subsidies) or indirectly (in the form of licence fees charged to companies by the regulator, which may then be passed onto consumers in the form of higher charges).

Regulators in smaller markets generally seek to adopt a proportionate approach so as to limit the potential for disputes. At the same time they seek sufficient powers and resources to deal effectively with unavoidable disputes as and when they arise.

Mr. C. Taylor, Director of Regulatory Affairs at Cable and Wireless International, has provided the Panel with an insight into the nature of the problem. He explains -

***‘We have very broad experience of operating businesses in what we call small to medium-sized economies... One of the pitfalls, I think it is fair to say, for any regulator operating in a small market is that generally, they have a big challenge. They are constrained in the amount of resources which they can employ and so it is very tempting to use practice and precedent from other larger markets. Now, we think there is an inherent danger in simply importing large market regulation and then imposing it in a small market.’***<sup>8[68]</sup>

{To put this quote in proper context, Mr Taylor goes on to state in the same passage that: “The JCRA (Jersey Competition Regulatory Authority) here, on the other hand, and by contrast, has taken a more pragmatic approach to regulation. I think they are happy in assessing the market on its particular characteristics here in Jersey and they are seeking to apply regulation accordingly.”}

John Henwood, Chairman of Jersey Telecom, clearly believes that the JCRA has not yet managed to adopt a sufficiently proportionate approach in Jersey. He states –

***‘If the cost associated with regulating is greater than the benefit received, then you have to say: “Why are we doing this?” ...[Where] is the net benefit to the community? If the cost of regulation of Jersey Telecom is more than £2 million over the last 2 years - which I can tell you it is - can you show me, or can the Regulator show me, where the community has benefited by £2,000,001? I cannot see it’***<sup>9[69]</sup>

Of course, the Panel is aware that positions are somewhat reversed in Guernsey, where Cable and Wireless is the ‘dominant’ incumbent operator and has a less favourable view of the regulator than JT, which, in its own Annual Report 2005, complements the Guernsey Office of Utility Regulation. {Note that the JCRA is not aware that the OUR’s ability to enforce regulation against Cable & Wireless in Guernsey has been adversely affected by the fact that Cable & Wireless is not state-owned.} Nevertheless, the views expressed demonstrate the difficulty in achieving the right balance.

{Finally, this discussion as drafted overlooks the evidence before the Panel expressing support for the JCRA and its competence. This evidence includes the following statements from C&W and JT:

<sup>8[68]</sup> Transcript of hearing attended by Cable and Wireless Jersey – 18th Dec. 2006, p.5-6

<sup>9[69]</sup> Transcript of hearing attended by Board of JT – 25th Sept. 2006, p.41

“We believe the relationships with the JCRA have been very good, and particularly over the last 18 months with Bill Brown and team on board. They operate with a limited number of resources with a very high level of workload, so we commend them on their work.” (D. Smith C&W 18/12/06)

“All we ask for is fair and open competition. That is all we can ask a regulator to facilitate in the right way and as I said before, I think the JCRA has done an extremely good job of setting up the right mechanism to enable that to happen which I think is very good.” (D. Smith C&W 18/12/06)

“There is a process of good healthy open dialogue between us. The boards of Jersey Telecom and the JCRA meet on a regular basis to discuss issues and, yes, we do have differences, clearly we do. That is a healthy tension. That is all about good regulation, but as I say, I think there is a huge amount of things resolved with proper negotiation and proper discussion behind the scenes.” (B. Lawrence, JT 25/09/06)

“Jersey Telecom agrees that the telecommunications market in Jersey is now fully competitive. When this fact is allied to the powers available to the JCRA under the terms of the Telecommunications Law, Jersey Telecom is unaware of any impediment arising from market structure that would prevent the States divesting its shareholding in the Company.” (Submission from the Board of JT, 19/09/06)}

## 4.2 The International Experience

Professor Parker has extensive experience of market regulation at an international level. Drawing on his own considerable experience regarding the regulation of privatised companies in the United Kingdom, Professor Parker has concluded that regulatory offices in the UK over the last 20 years have struggled to obtain all of the information they need from the regulated companies to regulate efficiently and effectively. <sup>10[70]</sup>

He comments –

***‘The international experience suggests that it can be expected that the JCRA will also struggle to obtain all of the information it needs to regulate a privatised Jersey Telecom. The JCRA has faced difficulties in ensuring regulatory compliance from the state-owned company and privatisation cannot be expected to improve this situation.’<sup>11[71]</sup>***

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<sup>10[70]</sup> See ‘*International Handbook on Economic Regulation*’ – M. Crew and D. Parker, Edward Elgar Publishing

<sup>11[71]</sup> *Structural Separation: the Reports by Analysis and the JCRA* – D. Parker, 14th Jan 2007

The United Kingdom telecoms market provides just one example of the extent of the problem. Constant regulatory pressure was required over an extended period of time in order to break down the dominant position of BT in the last 20 years<sup>12[72]</sup>. By 2003 the annual budget for the UK telecoms regulator stood at £19.5 million. By 2006, and in order to reflect the changing nature of the communications industry as a whole, the renamed Office of Communications (Ofcom) had assumed responsibility for television, radio, telecommunications and wireless communications services and operated on a budget in excess of £130 million. Only in August 2006 were the last price controls on BT's residential services removed.

Telecoms market regulation is generally considered sufficiently resource intensive and specialised as to warrant the creation of a dedicated telecoms regulator, where resources allow. Dedicated regulators are relatively common both in larger jurisdictions, such as the UK. Several smaller countries, including Lithuania, also have a dedicated regulator. [{Some others, however, like Barbados, have kept the responsibilities with one regulator.}](#)

#### 4.3 Legislation

The Competition Regulatory Authority (Jersey) Law 2001 and the Telecommunications (Jersey) Law 2002 set out the powers and responsibilities of the JCRA with regard to the telecoms market. In particular, the JCRA is responsible for enforcing the telecommunications operating licences of the fixed-line and mobile operators in Jersey.

The Panel understands that Jersey's competition and on telecommunications legislation is consistent with that found in many other countries. Under the Telecommunications (Jersey) Law (S.7), the JCRA has the primary duty to exercise its functions in a manner –

***'best calculated to ensure that... telecommunications services are provided... as satisfy all current and prospective demands for them, wherever arising.'***<sup>13[73]</sup>

Secondary duties include promoting competition where appropriate, promoting efficiency, economy and effectiveness in the provision of telecommunications in Jersey, and performing the functions as 'best calculated to further the economic interests of Jersey'.

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<sup>12[72]</sup> See *'International Handbook on Privatisation'* – D. Parker and D. Saal, Edward Elgar Publishing

<sup>13[73]</sup> The primary and secondary duties also apply to the Minister.

#### 4.4 Powers

The Minister for Economic Development has asserted that the legislation currently in force provides the JCRA with all the powers it needs to regulate the local telecoms market effectively, come what may. He claims –

***‘it has got very clear powers, as I think are clearly demonstrated in the law. The Executive Director of the JCRA, I think, very clearly explained to you that he has no fear and the JCRA have no fear of effectively regulating and using their powers effectively and fairly and properly with any telecom provider.’<sup>14[74]</sup>***

Nevertheless, those powers are not sufficient to give comprehensive control over telecoms licences.

Jersey Telecom is licensed by the JCRA. The terms of that licence stipulates that the Authority can refuse to transfer the licence to a new operator; however, the actual ability of the JCRA to exercise its power would be affected by the manner in which control of the business is transferred. For example, should JT be acquired in future through the purchase of issued shares, the company would continue to operate under the existing licence. Accordingly the JCRA would not be able to intervene. [However, any such sale would be subject to the JCRA’s review and approval under the M&A provisions of the Competition \(Jersey\) Law 2005](#). The Executive Director of the JCRA has qualified the position further. He explains –

***‘I am not sure that [the JCRA] can control the identity of the purchaser, at least beyond the competition remit that we have been discussing today’<sup>15[75]</sup>***

The JCRA has the power to intervene in mergers and takeovers where there is a ‘substantial lessening of competition’, in the case of restrictive practices, and where there is an abuse of a dominant position in the market. However, the Panel’s adviser notes –

***‘while this provides protection against monopoly abuse and mergers that might lead to less competition in telecommunications in Jersey, it does not appear to provide grounds for the JCRA to intervene where competition is not at issue. It seems that the JCRA is not empowered to intervene on grounds of wider public policy, except in so far as the Minister of Economic Development gives the JCRA written directions relating to social or environmental policies. No such directions have been issued.’<sup>16[76]</sup>***

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<sup>14[74]</sup> Transcript of hearing attended by Minister for Economic Development – 17th Nov. 2006. p.12

<sup>15[75]</sup> Transcript of hearing attended by JCRA – 19th Dec. 2006, p.26

<sup>16[76]</sup> Possible Sale of Jersey Telecom (Jt Group Ltd): Review of the Evidence to 31 December 2006, para.4.13

In other words the Authority may not be able to prevent companies which have a history of 'asset stripping', or with a record of providing less than adequate services, from acquiring JT in future years.

The recent takeover by Macquarie of Thames Water in the United Kingdom provides an example of the interest shown by private equity investors in utilities and of their motives. <sup>17[77]</sup> {Any acquisition of JT, regardless of the purchaser's identity, would be subject to the JCRA's review and approval under the M&A provisions of the Competition (Jersey) Law 2005. As part of this process, the JCRA would be able to examine in detail the plans of the acquirer with respect to the acquisition in Jersey, and place conditions on its acceptance of the acquisition – including conditions regulating the behaviour of the acquirer post-acquisition – that would have the force of compulsion under Jersey law. As Bill Brown explained to the Panel on 19/12/06:

"If we believed that the proposed merger would substantially lessen competition . . . we would have power to block it or approve it subject to conditions. There would be 3 options. We can either approve it unconditionally if there is no effect on competition. We could approve it subject to conditions if we believe that there are certain ways in which if, for example, certain businesses were divested that we could approve it subject to divestiture of certain businesses. Or we could block it."

Additionally, the JCRA would have the ability to modify the terms of the operator's licence under the Telecommunications (Jersey) Law 2002, which could include express protections against conduct such as asset stripping, etc.}

Regarding the powers of the Authority to intervene and force companies to operate according to the rules, the Executive Director of the JCRA has advised –

***'If they do not comply with the direction, then we would have the ability to go to court to obtain an order.'***

However, when challenged as to what other options were open to the JCRA, he simply added –

***'Not going to court'.<sup>18[78]</sup>***

{This quote is taken out of context and does not accurately reflect the JCRA's working practices. As Mr Brown explained to the Panel on 3/10/06, the JCRA attempts to resolve matters, wherever possible, on an informal basis in lieu of taking formal legal action:

"I think the challenge we have in terms of resources is very much assisted by the fact that so far we have been able to resolve any compliance issues, any competition law issues, on a

<sup>17[77]</sup> See <http://www.guardian.co.uk/commentisfree/story/0,,1928639,00.html>

<sup>18[78]</sup> Transcript of hearing attended by JCRA – 19th December 2006, p.9

one-to-one informal basis without having to go through a formal investigation all the way to decision, litigation and so on.”

“As long as we continue to fulfil our duties to the best of our ability then the scope for litigation should be minimised. The other point, I suppose, is that litigation costs money and litigation under the telecoms law it comes out of the licence fees which pay for the JCRA. So, all I can say on that is that we do our best to avoid or minimise the risk of litigation through the court with our decision making. If a problem does come up then we will do our best to resolve it informally.”

Therefore, the substantive options available to the JCRA are not, as the Report states, simply “going to court” or “not going to court.” In all instances, the JCRA strives to find the most efficient means possible – whether through recourse to formal or informal processes (or through a combination of both) to resolve matters before it.}

If going to court is the only substantive option open to the JCRA in certain cases, there is clearly a need to consider what factors may cause the Authority to discontinue a case before it reaches the court room.

#### **Finding**

The assumption that the JCRA has sufficient powers to regulate a privatised Jersey Telecom is not well founded.

## **4.5 Issues**

### **4.5.1 Existing Workload**

In December 2006 the board of Jersey Telecom, having not been formally approached by the JCRA in early course for its views regarding the ongoing body of work for the Minister for Economic Development on structural separation, submitted a written representation to the Authority. {As noted above, early in November JT informed the JCRA that it was conducting this analysis and would provide its findings to the JCRA. The JCRA accepted the submission of this input from JT.}

The Panel has reviewed the aforementioned report. It notes with interest a claim made by the Board that not a single query has ever been raised by the Authority in relation to ‘*two full sets of 32 separated accounts each*’. The Panel’s adviser comments -

***'JT conclude that this demonstrates that accounting separation and the current regulation are working. But another interpretation... is that the JCRA may lack the resources to assess and police the accuracy of the information supplied by JT.'*** <sup>19[79]</sup>

{The JCRA has used JT's separated accounts in its investigatory work. It is not clear why it is considered important that the JCRA allegedly has not, as yet, queried the separated accounts per se: the JCRA certainly has no obligation to do so.} Also contained in the document is an account of a complaint submitted to the JCRA in 2003 by one of JT's competitors concerning margin squeeze on Digital Subscriber Lines. It is alleged that the scope of the investigation has changed three times and that the case '*has cost Jersey Telecom a significant amount of time, resource and money*'.

These two cases indicate that there might be a problem with the effectiveness of the JCRA in its current form. {The provision of separated accounts is a means to an end, namely to assist the JCRA in monitoring compliance by JT with its licence obligations, and the JCRA has used the information for this purpose. The fact that the JCRA may not have questioned the detail of the accounts as yet is clearly irrelevant to whether the JCRA is performing its role effectively.}

Moreover, the duration of the broadband margin squeeze investigation has no bearing on the subject: margin squeeze investigations – and indeed investigation into pricing abuses more generally, are by their nature lengthy -- as recent experience in other jurisdictions demonstrates. Moreover, the length of investigations is clearly not a matter within the JCRA's control and depends inter alia on the quality and quantity of information supplied.

Finally, this discussion is completely overlooks prior matters where the JCRA's enforcement efforts have resulted in an expedited resolution, such as in August 2006 concerning JT's plans to introduce 18 month mobile phone contracts prior to the entry of new competitors.}

Additional evidence can be found merely by examining the Authority's current staffing levels and programme of work.

The JCRA is a competition body rather than a dedicated telecoms regulator. {This is not correct, as Mr Brown explained to the Panel on 19/12/06:

"[T]he JCRA is both the competition authority and a regulatory authority. The roles to some extent overlap in the sense that competition law is designed to maintain/promote competition and the Telecoms Law has a primary objective to -- sorry, not a primary objective, but one of the objectives of the Telecoms Law is to promote competition wherever appropriate. So, there is an overlap between the 2 and I would regard JCRA and its staff as being experts in both regulation and competition law."} In addition to policing the activities of telecoms operators and Jersey Telecom

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<sup>19[79]</sup> E-mailed response from Professor Parker concerning JT paper on Structural Separation – received 24th Jan 2006

in particular, it has a series of other duties. During the latter part of 2006 the Authority was understood to have investigated cases including, amongst others –

- • the acquisition of a local department store (matter opened 10/10/06, completed 8/11/06);
- • shipping and port services;
- • the GP out of hours scheme (matter resolved 8/8/06), and
- • the proposed acquisition of BA Connect by the Flybe airline (matter opened 13/12/06, completed 29/01/07).

This work was being conducted at the same time as ongoing telecom related matters, including number portability issues and alleged infringements of rules regarding 21 day notice of advertising campaigns, were being dealt with. On top of that, the JCRA had of course been asked to produce its report for the Minister for Economic Development on the proposal to sell JT, as mentioned previously. ... {These dates have been added to show that this discussion is misleading. The matters cited as occurring “during the later part of 2006” actually encompass matters that go beyond the 4<sup>th</sup> quarter of that year, and as the dates above show, the JCRA completed work on some matters before commencing on others. Therefore, the JCRA’s work on these matters did not overlap}

Perhaps unsurprisingly, the JCRA does not enjoy a particularly good reputation for delivering reports on time. It worked for 3 months on its Jersey Telecom report, which came out late and which required input from external consultants prior to its release. {As observed in the JCRA’s comments above, contrary to this suggestion, the JCRA’s Report was delivered on time to the Minister, per a 2 week extension agreed between the Minister and JCRA.} Now that it has been received it seems to have been effectively dismissed by the Minister for Treasury and Resources {The JCRA’s Report was not made for the Minister for Treasury and Resources, but to advise the Minister for Economic Development.} (again demonstrating that the Minister’s confidence in the Authority may not be quite as high as his discussion paper implies) and is contradicted by two other reports.

The JCRA’s work on the GP out of hours took substantially longer to complete than had originally been anticipated, which in turn caused the Scrutiny report on that matter to be delayed significantly. Although the JCRA report was originally anticipated at the end of April 2006, it was actually published on 24th August 2006. {As the Social Affairs Scrutiny Panel is fully aware, the JCRA’s investigation of the GP Coop was conducted with the cooperation of both Jersey’s Health and Social Services Department and Jersey’s GPs. The pace of this review was dictated in large

measure by the ability of health professionals to work with the JCRA without sacrificing the time needed to devote to the ongoing needs of their patients. In light of this and the importance of health care to the Island, reaching the correct conclusion for the consumers in Jersey was far more important than satisfying any artificial target deadlines. Moreover, the investigation still was completed on a very expedient timetable compared to enquiries in other jurisdictions.}

#### 4.5.2 Resources

The fact that such a problem may exist does not come as a particular surprise to the Panel's adviser. Professor Parker notes that the telecoms industry is complex with fast technological change, which poses a challenge even to established regulators such as Ofcom in the UK. Whereas Ofcom has a staffing of around 800 (although its duties do extend beyond telecoms to broadcasting and other related areas), the regulator in Barbados is understood to employ approximately 28 staff serving a market of approximately 270,000 people {Which, like the JCRA, combines both telecoms and competition expertise}.

JCRA manages with a total of 9 full-time staff, plus a part-time Executive Chairman and 3 part-time non-executive directors. Its difficulties are inevitably compounded by the fact that the number of potential issues it has to deal with do not necessarily diminish in line with the size of the regulated market. Indeed, the number of individual legislative clauses that require monitoring are likely to be broadly similar to those of substantially larger jurisdictions.

Although the JCRA has the option to employ external consultants where necessary, the Panel notes that such an approach has financial consequences, can have varying degrees of success and still requires the Authority to commit resources to managing the client / consultant relationship.

On the matter of financial resources, the Panel has formed concerns regarding the ability of the JCRA to fund court cases – an issue which might become increasingly important if JT is acquired by a multinational with its own team of legal advisers and a dedicated budget for litigation. Questions put to both the JCRA and to the Minister for Economic Development have been met with answers which can at best be described as equivocal. The JCRA's Executive Director has advised –

***'In principle, our costs under the Telecoms Law are borne by the operators through the licence fees so that that is how expenses under the Telecoms Law are funded. Whereas under the Competition Law, the money comes from the States'.<sup>20[80]</sup>***

The Minister for Economic Development has added –

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<sup>20[80]</sup> Transcript of hearing attended by JCRA – 19th December 2006, p.10

***‘There is an arrangement between both between the JFSC and the JCRA and the States of Jersey in respect of legal support and... I would confirm to the Panel that I would be happy to support the JCRA. There is a budgetary allocation for their competition work and the JCRA, [with] which we enjoy regular and constructive communication. I would have no hesitation in giving the JCRA all the support it needed in order to deal with its enforcement, if it came to that.’<sup>21[81]</sup>***

What this means is that enforcement action taken under the Competition (Jersey) Law 2005 is paid for by the taxpayer, whereas action taken under the Telecommunications (Jersey) Law 2002 is paid for by the telecoms operators, who are likely to attempt to pass the costs onto the consumer. With that in mind, it is interesting to note the comment made by the Minister for Economic Development in response to a question on the size of his department’s budget for supporting the JCRA. He states–

***‘Well, I mean how long is a piece of string?’<sup>22[82]</sup>***

Precisely. At present the incumbent operator with the largest market share is owned by the States. Although the company operates independently, the fact is that ownership has given the States limited rights<sup>23[83]</sup> to influence the direction of the company. Although the incorporated Jersey Telecom under States ownership appears to have adopted a responsible approach to regulation, the same may not be true in the event that control of the incumbent operator passes to the private sector – particularly if the acquiring company is sufficiently well capitalised as to be able to afford a substantial budget for litigation. Accordingly it is not inconceivable that whether a telecoms dispute reaches court could ultimately be determined by the matter of whether the JCRA’s financial resources are sufficient to match those which the private operator is prepared to commit.

{The JCRA has no evidence to suggest that JT’s stance in competition and regulatory matters has been affected by the supposedly “benign” influence of the States as shareholder. See for example its recent decision to breach the JCRA’s mobile number portability Direction, and the JT Chairman’s statement to the Panel (quoted below) that it would challenge regulatory decisions when the cost to the company of the decision was greater than the cost of challenge. In the context of the proposed sale, the Treasury Minister has made it clear that as JT’s shareholder he has a duty to maximise the value of the investment, and JT like any company including Cable & Wireless has a duty to maximise shareholder value, which means acting in the company’s commercial self-interest.

Furthermore, the record before the Panel does not support the notion that a States-owned company is less likely to challenge a regulator in court than a privately owned company. On the contrary, JT’s Chairman told the Panel on 25 September:

<sup>21[81]</sup> Transcript of hearing attended by Minister for Economic Development – 17th Nov. 2006, p.13

<sup>22[82]</sup> Transcript of hearing attended by Minister for Economic Development – 17th Nov. 2006, p.14

<sup>23[83]</sup> These are codified in a confidential memorandum of understanding, seen by the Panel, between the Minister for Treasury and Resources and the Board of Jersey Telecom.

“We, a short while ago, introduced 18-month rental contracts, and we were told by the Regulator, after a short period of time, that that was anti-competitive and we were told that we could not offer 18-month contracts. Now, we felt very strongly that they were wrong and that we had options in that situation. We could have refused to accept their ruling; they would have issued a direction and we would have said: “See you in court.””

And

“You know, if a rule is handed down and you cannot see any good reason for it, you resist it. But in the interests of the company, we decided the cost and the time expense on senior management in challenging this issue was not justified by the amount of income, if you like, at stake. If you were to say: “Well, on that basis, you will never challenge anything” I would simply say: “No.” On the first occasion that an issue occurs where we deem that the cost and time associated with a challenge is less than the potential damage to the company by accepting the ruling, we will push it.”

And

“We have no concerns about challenging the Regulator in the Royal Court if it seems to the Board that that is the right thing to do, but that is the only option available to us under the law.”

Finally, the Panel’s Report also discusses below past conflicts the regulators in jurisdictions like Slovenia and Cyprus have had with dominant incumbent operators – which in these countries are still owned or controlled by the state. The experiences in these jurisdictions also indicate strongly that state ownership or control has no bearing on the readiness of a dominant incumbent firm to defend its position and challenge the regulator.}

It is worthy of note that any actions brought against a privately owned Jersey Telecom for alleged abuse of a dominant market position could well be brought under the Competition (Jersey) Law 2005. Therefore, the taxpayer would be called upon to underwrite costs associated with litigation.

Such cases have been known to take several years to resolve. For example, a 5 year old dispute between a fledgling internet service provider and Cable and Wireless on the Caribbean island of St. Vincent has now reached court. Both Cable and Wireless and the regulator are being sued for claimed damages totalling £22 million.<sup>24[84]</sup>

## Finding

<sup>24[84]</sup> See <http://news.independent.co.uk/business/news/article2081555.ece> 17th Dec 2006.

Serious consideration has not been given to the issue of whether the JCRA has sufficient resources to regulate the current telecoms market, let alone one in which the incumbent operator is privately owned.

#### 4.5.3 Potential Impact of Privatisation

Competition in telecommunications already means more work for the Authority. In the event that the workload of the JCRA increases following privatisation of JT {The JCRA has no indication that this will be the case}, the cost of regulation will rise as the Authority employs more staff, engages external consultants or engages in legal activity. Sources of income for the Authority include the taxpayer and the companies paying licence fees. It should be borne in mind that any increase in the cost of licence fees is likely to be passed onto customers.

Three companies will soon be competing in the mobile sector and the Panel is given to understand that both new entrants are more experienced than Jersey Telecom in dealing with industry regulation. In addition the new competitors may need protection from unfair competitive practices by the incumbent operator. Certainly Cable and Wireless has alleged that JT is already objecting unfairly to the introduction of number portability. Managing Director David Smith contends that –

***‘It is an extreme frustration to a lot of our customers, to a lot of the Jersey public, and to us as well. The process has been too long a process.’*** <sup>25[85]</sup>

On this evidence it is possible that even *without* privatisation the JCRA will need more resources, with consequent implications for its costs of operation. A newly privatised JT is likely to compound this problem, for precisely the reasons outlined below.

In the event that the States decide to relinquish control of Jersey Telecom by way of a trade sale, as opposed to a partial sale with States representation on the Board, there is potential for the cost of regulation to increase as the Authority engages a potentially less cooperative owner. Regulation of tariffs charged by Jersey Telecom may then form a key part of the Authority’s ongoing work, particularly as certain parts of the business will effectively constitute a natural monopoly. The Panel is concerned that there appears to have been little consideration of any changes that might have to be made in terms of price setting or price or profit capping powers post privatisation. Potential investors and consumers will both require clarification on this issue.

Should Jersey Telecom become foreign owned, or should parts of the JT Group go on to develop more activities outside of the Jersey marketplace, the Panel’s adviser considers that it will then be essential to put in place a robust internal accounting system. Such a system would be necessary to ensure correct transfer pricing within an international firm and that anti-competitive cross-subsidisation from the monopoly to the competitive businesses did not occur within Jersey.

<sup>25[85]</sup> Transcript of public hearing attended by Cable and Wireless - 18th Dec. 2006, p.11

Professor Parker makes two particular points in this respect relating to the sale of Jersey Telecom-

- a) a) Where local telecoms firms are part of multinational organisations, transfer pricing becomes an issue. Typically services and supplies will be provided from group companies outside of the country and payments will be made for them by the local subsidiary. This leaves scope for the head office to reallocate expenditures (albeit the existence of tax laws relating to “transfer pricing” aimed at preventing arbitrary allocations). He considers that the JCRA can be expected to struggle to guarantee that the cost (and possibly revenue) allocations reflect the true costs of provision in Jersey. {These are issues in jurisdictions of all sizes where there is a vertically integrated incumbent whether privately or state owned. It is one of the reasons why the JCRA has recommended that the States of Jersey consider structural separation, in common with several other jurisdictions which are currently looking at it.}
- b) b) Jersey Telecom has introduced separate accounting for its various businesses. But from the Professor’s scrutiny of the resulting accounting statements and the Jersey Telecom guidance document on cost allocation,<sup>26[86]</sup> he is not completely satisfied that the accounts can be relied upon as an accurate record of the true economic costs of operating the different services; in particular Professor Parker expresses concerns relating to the allocation of revenues, costs and assets to the ‘core network business’.

#### 4.5.4 The JCRA’s Own Concerns

The Executive Director of the JCRA has told the Panel –

***I think most competition authorities will have more work or more potential work than they can deal with at any given time. That is our experience so we have to prioritise carefully... We think the States... has got the balance about right for a small jurisdiction.***<sup>27[87]</sup>

{This is not a “concern” of the JCRA, simply a statement about the importance of prioritisation. In this regard, the JCRA is no different that regulators in other jurisdictions such as the OFT in the UK, which have to prioritise their work-loads and the matters brought before them.}

<sup>26[86]</sup> “Separated Regulatory Accounts for the Year Ended 31<sup>st</sup> December 2005”; “Jersey Telecom Accounting Separation Methodology 28<sup>th</sup> September 2006”.

<sup>27[87]</sup> Transcript of hearing attended by JCRA – 19th Dec. 2006, p.22

He implies that the JCRA has sufficient resources to manage its obligations effectively. Yet in January 2007 the JCRA submitted its report to the Minister for Economic Development regarding the structure of Jersey Telecom best suited to promoting competition and economic growth. That report highlighted deficiencies in the existing legal powers of the Authority {This is a separate issue from resources. The JCRA's Report did not highlight deficiencies in the JCRA's powers, nor advocated any strengthening of those powers; but rather suggested that the removal of the incentive to discriminate through structural separation was a more effective way of achieving compliance. This is the case whether the telecoms provider is publicly or privately owned}.

The following is an extract from that report –

***'(v) Regulatory tools not optimal***

***The current regulatory framework in Jersey can compensate to some degree but not wholly for the issues inherent in vertical integration. First, in relation to the Competition (Jersey) Law 2005, this general competition law is not optimal for the following reasons:***

***it is designed to promote and protect existing levels of competition in industries across-the-board but it cannot guarantee an introduction of competition into previously monopolistic markets such as telecommunications; and***

***being ex post in nature, it deals with conduct after the event and may encourage a 'cheat and chase' mentality in interests of getting away with it or, if not, delay.<sup>28[88]</sup>***

***In relation to the Telecommunications (Jersey) Law 2002, this industry-specific law is not optimal for the following reasons:***

- • in requiring access to be granted on 'fair and reasonable' terms, it has to deal with the incentives not to grant such access (as discussed above);***
- • the accounting separation provisions, which are an integral part of the Law, are not wholly sufficient to guarantee equality of access (for the reasons discussed below); and***
- • in general, industry-specific regulation is ex ante in nature which necessarily is heavy-handed despite the States policy of light-handed regulation.<sup>29[89], 30[90]</sup>***

<sup>28[88]</sup> The merger and acquisitions provision of the law are *ex ante* in that they require pre-merger notification, but these provisions are not directly relevant to this paper.

<sup>29[89]</sup> *Competition Law*, Progress Report of Industry Committee presented to the States 3 September 2002,

p4.

<sup>30[90]</sup> 'Proposed Sale of Jersey Telecom' – JCRA, issued 10th January 2007.

{This discussion from the JCRA's Report is out of context. The point of this passage is that potential problems expand under both Competition and Telecoms Law when a dominant firm is vertically integrated. It makes no distinction whether the vertically integrated operator is privatized or government owned. To the contrary, Mr Brown told the Panel on 3/10/06 that the JCRA is neutral as to the ownership of JT:

“We are neutral as to whether it is publicly owned or privately owned. . . . We do not really have a view on that.”

Thus, it is incorrect to characterize the statement from the JCRA's Report as a “relevant admission” from the JCRA. Therefore, for the avoidance of doubt, the Panel did not have the JCRA's consent to quote its report in this context.}

Professor Parker considers this to be a relevant admission from a regulator that would have responsibility for monitoring the performance of a newly privatised incumbent operator. He advises–

***‘A vertically integrated company can be expected to resist approaches by new operators for access to its infrastructure because of the potential effects of competition on the profitability of its retail services.’<sup>31[91]</sup>***

The Professor adds –

***‘The JCRA's position reflects its difficulty in regulating Jersey Telecom so as to facilitate access competition. In essence, the report is an admission that regulating a dominant incumbent, so as to promote competition, is extremely difficult; as other regulators, including the UK regulator, have discovered.’***

It bears repeating that while it is difficult to regulate a dominant incumbent, it may get worse if a multinational, with greater financial resources and accounting systems that operate at an international level, assumes control of Jersey Telecom. {Again, per the JCRA's comments above, the testimony before the Panel, and the international experience cited later in the Panel's Report, does not support this statement. The JCRA also observes the immediately preceding quotes from Professor Parker actually agree with the JCRA's Report that regulating a vertically integrated operator can be difficult, but do not support the point that these difficulties become greater with private ownership}

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<sup>31[91]</sup> ‘Structural Separation: the Reports by Analysis and the JCRA – D. Parker, 14th Jan 2007

## Finding

The panel can only interpret the JCRA implicit recommendation for structural separation in the light of the contrary result being produced by both JT and the consultants Analysys and in the light of the JCRA's reservations concerning its ability to regulate a dominant telecoms incumbent. The Panel shares these reservations concerning the range of powers and the ability to resource effective delivery

## 4.6 Conclusions

The Executive Director of the JCRA has warned the Panel –

***'I think it is a risk of any privatisation that once you have sold the business the States relinquishes control'***

He adds -

***But it does raise the issue... is the Jersey Telecom's network considered to be of such a strategic importance to Jersey that a sale should even be contemplated?***<sup>32[92]</sup>

{These quotes were not a "warning" (which implies a view on privatisation, whereas the JCRA is neutral on this subject) and are taken out of context – they were directed at whether the sale of the JT network (i.e., structural separation) should be contemplated, as opposed to the sale of JT as a whole.}

During the course of the Scrutiny review of the Minister's proposal a number of possible issues have been uncovered regarding the capability of the JCRA to regulate a privatised Jersey Telecom. The JCRA has considered it necessary to suggest to the Minister for Economic Development that it has concerns regarding the legal framework in which the Authority is required to operate and to advocate structural separation {Again, this characterization of the JCRA's Report is inaccurate. The JCRA's Report did not advocate any one approach to the privatisation of JT, but simply discussed the potential costs and benefits for various alternative structures for privatisation}. The Minister for Treasury and Resources has expressed concerns about the proportionality of the Regulator's current approach to the telecoms market {As noted above, the concerns referred to here were not concerns about the proportionality of the JCRA's current approach and, as stated above, the Minister for Treasury and Resources expressed full confidence in the JCRA in his testimony before the Panel} and appears to have ignored the Authority's advice on the issue of structural separation. There are signs that the JCRA may be under-resourced currently, even without having to face up to a dominant privately owned operator. Taken together, those issues are sufficient for the Panel to conclude that Jersey may not have a sufficiently robust

<sup>32[92]</sup> Transcript of hearing attended by JCRA – 19th Dec. 2006, p.27

regulatory framework to ensure effective policing of a privatised telecommunications sector. {This concluding paragraph is inaccurate and misleading, based on the various points the JCRA already has made, above}

Professor Parker's response to the evidence presented has been to suggest that -

***'at privatisation a continued state shareholding and board representation might ensure that the JCRA has better access to the information it needs from Jersey Telecom to regulate effectively than would otherwise be the case. In the economics literature, state shareholdings and board representation have been shown, under certain conditions, to reduce the information asymmetries in economic regulation.'***<sup>33[93]</sup>,

With the foregoing in mind, the Panel considers that it would be unwise to consider full privatisation of JT in the absence of a comprehensive review of the capability of the JCRA, as currently structured, to oversee the market post privatisation. {The JCRA has full powers to require the provision of information from regulated parties under both Part 5 of the Competition (Jersey) Law 2005 and Article 23 of the Telecommunications (Jersey) Law 2002. These powers include the ability to require the production of documents, search computers, and execute search warrants on business premises. A failure to comply with a mandatory JCRA information request issued under the Law, or to respond in a manner that is materially false or misleading, is a criminal offence under Jersey law. The same rules apply to publicly and privately owned entities.}

#### **RECOMMENDATION**

The Panel recommends that there should be an immediate review of the JCRA's skills base, resources and legal powers. Such a review should be part of any privatisation planning and should be completed before the States is asked to decide whether to sell. {As noted above, this recommendation is not supported by the evidence.}

<sup>33[93]</sup> D. Sappington and J.E. Stiglitz (1987) "Information and Incentives" in E.E. Bailey (ed.) *Public Regulation: New Perspectives on Institutions and Policies*, MIT Press.

## 5. Will Employees be Properly Protected?

On 7th September 2006 the Minister for Treasury and Resources gave a speech in his capacity as Minister for Treasury and Resources at an open Scrutiny meeting held at Hautlieu School. During that speech he said –

***'I am willing to guarantee that I will not bring proposals to the States to sell Jersey Telecom unless employment benefits, at their current level, are protected.'***

Records of the States debate on Projet P.95/2006, entitled 'Employee Protection', show that the Minister for Treasury and Resources stated –

***'I believe that we can bring into that contract sufficient safeguards at a sufficient level equally as good as would be under T.U.P.E.<sup>34[94]</sup> If I cannot do that, I shall not bring the proposition.'***

### 5.1 Concerns

The Minister's confidence does not appear to be shared by many of those who currently work for the company. A significant number of JT employees attended a Scrutiny public meeting on 7th September meeting. Many of those employees made their concerns known. One declared –

***'I do not have any faith in what will happen to the company or the staff if we are sold to a large company. As an employer/employee I will not have any faith in [the Minister for Treasury and Resources] upholding any kind of agreement that they might make to enable them to buy the company. We have seen it in so many big companies throughout the world that the least of their worries is staff and their wellbeing.'***

He added -

***'we cannot drive 30 miles down to the nearest town down the road and find another job.'***<sup>35[95]</sup>

Open and confidential representations made to the Panel during the course of its review suggest that a clear majority of Jersey Telecom staff trust their current employer and have full confidence in the ability of their senior management to run the company effectively – and with good reason. The company's enviable record for training and developing its staff, as evidenced by the rise through the ranks of the current Managing Director, undoubtedly underpins the high quality of service offered and the significant profits generated for the States. This level of confidence persists

<sup>34[94]</sup> A reference to the UK Transfer of Undertakings (Protection of Employment) Regulations 1981 and 2006

<sup>35[95]</sup> Transcript of public meeting held on 7th September 2006 at Hautlieu School, p. 25

even though representatives of the Amicus trade union are aware that the company might have to shed further posts in future in order to remain viable under continued States ownership.

Bearing in mind this level of faith in the company, the Panel considers that the sheer number of concerned responses received by the Minister for Treasury and Resources and by Scrutiny demonstrates that the current proposal to privatise has been extremely unsettling for staff.

The Panel, having reviewed case studies of privatisations elsewhere and recent practice in telecoms markets worldwide, has discovered that the fears expressed by JT staff at that meeting are well founded.

Mike Budd, Regional Officer for the Amicus trade union, has advised that the change of ownership brought about by privatisation is often accompanied by severe staff cuts. Reflecting on his experiences of privatisation in the UK, he notes –

***‘British Telecom has had to fulfil the same public service obligations as before privatisation with only half its previous workforce. That has been reduced from 235,000 down to 100,000.’***

When Cable and Wireless assumed control of Guernsey Telecom back in 2002, it set to work making the company more profitable. Job cuts followed. Peter Skyte, National Officer for the trade union Amicus, advised –

***‘the evidence shows throughout the world that privatisation has generally led in one direction in terms of employment in the original operator. Most notably in parallel would be what is happening in Guernsey... there have been 70 jobs lost.’<sup>36[96]</sup>***

## **5.2 International Experience**

On 25th September 2006 the Managing Director of JT referred to the decision of one of JT’s major suppliers, Alcatel, to follow the industry trend and consolidate in order to secure its future. He said–

***‘We have seen one of our suppliers, Alcatel, now merging with 2 others, because they need to get the economies of scale to get their unit cost down.’<sup>37[97]</sup>***

Alcatel’s merger with Lucent Technologies, made public in March 2006 and subsequently completed on 30th November that same year<sup>38[98]</sup>, provides a current case study of the consequences of telecoms mergers and acquisitions in the private sector. The merger was

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<sup>36[96]</sup> Transcript of hearing attended by Amicus representatives, 17th Oct. 2006 – p. 10

<sup>37[97]</sup> Transcript of hearing attended by Board of Jersey Telecom – 25th Sept. 2006, p.31

<sup>38[98]</sup> <http://www.alcatel-lucent.com>

intended to deliver some \$1.7 billion in cost savings over 3 years, arising from economies of scale. Central to those savings was the planned rapid loss of 9,000 staff.<sup>39[99]</sup> News reports indicated that job cuts were more likely in jurisdictions with weaker employment legislation.<sup>40[100]</sup> Those left behind were reportedly told that their existing employee terms and conditions were to be safeguarded for a total of just 12 months.<sup>41[101]</sup>

In February 2007 Alcatel-Lucent announced that 12,500 jobs would be axed over 3 years<sup>42[102]</sup>.

Company shakedowns such as this might be associated more often with an acquisition by private equity investors, who tend to approach such acquisitions with a view to creating a large capital gain within around 5 years. On this occasion the significant number of jobs lost seems in part due to poor execution of a trade merger.

### 5.3 Jersey Legislation

Employment legislation in Jersey is not generally regarded as being particularly comprehensive (although the situation has improved in recent years). For example, the Island does not currently have equivalent legislation to the UK's Transfer of Undertakings (Protection of Employment) Regulations 1981 and 2006.

The Panel considers it vital to establish the likely effect on JT staff of any privatisation proposal. Accordingly it has obtained legal advice from Hanson Renouf, having been unable to obtain assistance from the Law Officers' Department within a specified period. The advice received is included at **Appendix 4**.

It is significant that the Minister has yet to seek advice from the Law Officers' Department on the matter of providing employees with guaranteed protection of terms and conditions of employment.

To summarise, the advice received reveals that Jersey's failure to implement TUPE style legislation is irrelevant in terms of the Minister's proposal. TUPE would not protect employees if there were a subsequent sale of shares in the privatised Jersey Telecom. This is because TUPE applies to the transfer of an undertaking, rather than the sale of shares in a company. Nevertheless, the Sub-Panel considers that it would almost certainly be relevant if the Minister elected to follow the advice of the JCRA regarding structural separation.

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<sup>39[99]</sup> [www.zdnet.co.uk](http://www.zdnet.co.uk) – 'Alcatel and Lucent shareholders approve merger' – 8th Sept. 2006

<sup>40[100]</sup> Financial Times 1st Dec. 2006 <http://www.ft.com/cms/s/2d29cd36-8165-11db-864e-0000779e2340.html>

<sup>41[101]</sup> [http://www.lightreading.com/document.asp?doc\\_id=98703](http://www.lightreading.com/document.asp?doc_id=98703)

<sup>42[102]</sup> See <http://www.ft.com/cms/s/618989be-b8a0-11db-be2e-0000779e2340, i rssPage=8ecc657a-3018-11da-ba9f-00000e2511c8.html>

The discussion paper and subsequent Ministerial statements have indicated that current contracts of employment and collective agreements will remain in place at privatisation. Although these conditions might be written into any sale agreement or flotation prospectus, it is common practice for such conditions to be time-limited. Although the 12 month period given to Alcatel-Lucent employees might be regarded as an extreme example, the Panel has received advice that leads it to believe present terms and conditions could be challenged successfully by a new owner within a 4-5 year period. Enforcement of those terms would be affected by the Jersey legal concept of privity of contract. Hanson Renouf advises that -

***‘due to the principle of privity of contract, the employees themselves would not be parties to the contract of sale of the shares of Jersey Telecom Limited and therefore would not be in a position to enforce any terms included in it for their benefit’.*** <sup>43[103]</sup>

Instead they would have to rely on the Minister for Treasury and Resources, and any future incumbent of the office, to enforce the terms of that contract. Yet it should also be noted that any such agreement could be rendered worthless, depending on the approach of a subsequent Minister for Treasury and Resources, who would not be automatically bound to follow the line taken by the current holder of the office.

Hanson Renouf clarifies that any measures taken to secure employee terms and conditions included in a contract for the sale of JT’s shares would be likely to fall away in the event that the purchaser subsequently decides to sell JT on (a realistic prospect in less than 5 years should the company be sold to a private equity buyer), those terms and conditions may well be at risk. The Amicus trade union adds –

***‘A new company can come in under common contract law and basically terminate our contract of employment: “Sign this or get out”, and you end up with 200 to 300 cases in the employment tribunal with Amicus backing them.’*** <sup>44[104]</sup>

Whilst the figure of 200 might be exaggerated, perhaps staffing losses of 100 may be realistic. Under current employment legislation for unfair dismissal the maximum award is 26 weeks wages. Assuming an average annual salary of £40,000 per annum, 100 unfair dismissals pursued through the employment tribunal would result in a total cost of the order of £2 million. This figure has to be viewed in the light of the estimated sale price of the company. Neither will any protection offered necessarily apply to new employees.

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<sup>43[103]</sup> See Appendix 4 (para 27) – which confirms that the advice given is a simplification of the position but suffices for the purposes of the legal advice given

<sup>44[104]</sup> Transcript of hearing attended by Amicus representatives – 17th Nov. 2006, p.11

## 5.4 Pensions

The Panel understands from Treasury advice that the JT contribution to the PECRS fund is more or less fully funded at present. Jersey Telecom management have already signalled that they wish to close the scheme to new employees. With continuing state ownership this would require political sanction. In contrast, privatisation would, in all probability, make closure of the scheme to new employees a near certainty in the short to medium term. Certainly the history of privatisation is associated with the closure of existing inflation proofed, defined benefit, pension schemes to new employees. The future of pension provision in a privatised Jersey Telecom is therefore very much an issue.

The Panel further notes that the necessary amendment to the PECRS law has been approved by the States and has gained Privy Council approval. It also notes that an amendment to the PECRS Regulations facilitating admission has been lodged following discussions between the PECRS Committee of Management and the States Employment Board<sup>45[105]</sup>. These Regulations, if approved, would give the JT Group the option to close the PECRS scheme to new employees. As the existing management has already signalled a desire to close the scheme to new employees, it is unlikely that a private buyer will wish to continue it, perhaps even for existing employees.

Existing employees will reportedly be able to continue their participation in the PECRS pension scheme, as the proposed changes to the Regulations do not affect their rights. It is nevertheless the case that any protection for pension provision built into the contract of sale will have a negative effect on the sale price achieved for the company, particularly as the Minister has indicated that he intends to put an obligation on a purchaser to fund any shortfall in the scheme.

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<sup>45[105]</sup> *Draft Telecommunications (Public Pensions) (Jersey) Regulations 200-* – P.27/2007

## 5.5 Conclusions

The Panel is very concerned that the Minister for Treasury and Resources is not in a position to guarantee employee terms and conditions at their present level for any significant period of time. It considers that this is not a satisfactory position for the hundreds of loyal and committed staff which have made Jersey Telecom the valuable asset it is today. The Panel considers that detailed clarification is required regarding the manner in which the Minister for Treasury and Resources proposes to deal with this critical issue.

### **Finding**

The Panel is of the view that Minister for Treasury and Resources is not in a position to 'guarantee' current employee terms and conditions for any significant period of time in the event that the States divests itself of 100 per cent of Jersey Telecom's shares.

### **RECOMMENDATION**

TUPE style legislation should be introduced in Jersey at the earliest possible opportunity.



## 6. Loss of Control

Jersey Telecom can rightfully be regarded as a strategic asset, not only because of the vital fixed line communications infrastructure that the company owns but also because the business decisions taken by the States and latterly by the company itself, have resulted in provision of telecoms services of sufficient calibre to keep Jersey at the forefront of the financial services industry. More recently they have allowed Jersey to play host to alternative information technology and online fulfilment industries. Key business decisions have included consistently high levels of well directed investment in staff and technology over many years, to the extent that it would be difficult to find a more successful small independent telecoms operator worldwide.

In the event the States elects to approve the Minister's proposal and sell off Jersey Telecom, finding the right buyer for the company would be of critical importance in order to ensure that Jersey's competitive position is not unduly affected.

Professor Massimo Florio has provided the Panel with a detailed and highly disturbing account of the disastrous privatisation of Telecom Italia, a company which was originally regarded as one of the most successful in Italy, to an operator which, 2 sales on and following a massively leveraged buyout by private finance, became one of worst. At the open lecture held in December 2006 he explained how the Italian regulator had effectively been 'held to ransom'. The regulator was unable to impose sufficient pricing and other controls on the company because the economic and social implications of Telecom Italia collapsing were unpalatable from a strategic perspective.

Telecom Italia provides an illustration of the dangers of getting the loss of control wrong, particularly when there are question marks, for whatever reason, regarding the effectiveness of the regulator. It also demonstrates the strategic issues that can affect even a larger jurisdiction in the absence of powers to control an onward sale. Yet these issues have not been addressed by the Minister for Treasury and Resources. Neither has the Economic Adviser highlighted these potential problems to the Council of Ministers.

Professor Parker has expressed surprise at the apparent lack of interest in who a suitable buyer for Jersey Telecom might be (although he notes that the guidelines on mergers and acquisitions ordinarily preclude the JCRA from issuing advice on hypothetical acquisitions). Several witnesses have questioned whether either Cable and Wireless or Jersey Airtel should be allowed to bid on competition grounds. For Professor Parker, who has an extensive background knowledge of privatisation and regulation issues, the answer is clear. They should not.

In the event that the JCRA is asked for a view on a possible sale, it can approve, reject or put conditions on the sale for the benefit of consumers. In any case, conditions may affect the final sale price for JT. Furthermore, these conditions may effectively result in structural separation of Jersey Telecom, which has been ruled out by the Minister for Treasury and Resources. It might also have implications for employees, who do not currently benefit from the protection afforded by TUPE legislation.

#### **Finding**

By omitting to indicate who might be an acceptable or unacceptable buyer, the Minister for Treasury and Resources has failed to rule out a purchase by either Cable and Wireless or Jersey Airtel (Bharti) – either of which would have a significant negative impact on competition in the Jersey telecoms market (and possibly in Guernsey).

The issue of how to sell is more complex than it might at first appear, as the following will show.

### **6.1 A Trade Sale?**

It is clear from the discussion paper, and from subsequent evidence received, that the Minister favours a negotiated trade sale to one buyer, however, he does not appear willing to rule out any potential suitors at this stage.

According to the Panel's adviser, the Minister's position is highly surprising, particularly as he has already hinted strongly at the nature of the problem. On 7th September 2006 the Minister told the audience at Hautlieu School –

***'I suspect that the competition regulator authorities both in Jersey and In Guernsey would be very unhappy and might prohibit a sale to Cable and Wireless on the grounds that they would certainly kill competition... I do not know at the moment how the JCRA would think but if they are going down a policy in general of open competition, the last thing the Regulator will want to do, having started that policy, is to close it down again.'*<sup>1[106]</sup>**

Certainly the International Chief Executive Officer of Cable and Wireless has indicated that Jersey Telecom –

***'is the type of opportunity that Cable and Wireless as a company would be interested in.'*<sup>2[107]</sup>**

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<sup>1[106]</sup> Transcript of Minister of Treasury and Resources, dated 19th Dec. 2006 – P.16

<sup>2[107]</sup> Transcript of public hearing attended by C&W Jersey, 18th Dec. 2006 – p.12

In addition, the Panel notes that Jersey Airtel has not publicly ruled out a bid for the company.

Professor Parker has advised that the Minister, in consultation with the JCRA, should already be in a position to rule out these two potential buyers on competition grounds. The Panel agrees wholeheartedly. Given that competition, as opposed to privatisation, is generally regarded as the most important factor in achieving adequate, efficient and effective telecommunications services, it should be a matter of States policy from the outset of the sale process that any buyer will *not* be an existing telecommunications operator in Jersey or an operator already seriously planning entry into the Jersey telecoms market.

In the interests of equity and good governance, Professor Parker suggests that any sale document should make clear that existing operators in Jersey will not be considered as buyers of Jersey Telecom, on grounds of competition policy. An alternative to this approach would be to declare in the tender documentation that the JCRA will rule on whether any buyer will lead 'to a substantial lessening of competition in telecommunications in Jersey before a bid is accepted'.

## **6.2 Whole or Partial Sale?**

Ever since the Minister for Treasury and Resources published his discussion paper he has been minded to reject the notion of a partial sale of the company. Material produced by the Citigroup consortium appears to concur with the Minister's view, as does the report produced by the Economic Adviser for the Council of Ministers. The Panel considers this to be indicative of prioritizing one of the Minister's own objectives – that of maximizing value - above the other three (employee safeguards, securing the long term future of the company and encouraging competition and quality of service).

Unfortunately neither the Citigroup material nor the Economic Adviser's report fully addresses the question of whether the interests of Jersey would be better served by proceeding with a partial, rather than a total sale of the company. Professor Parker comments that shares in a previously non-quoted company, sold in a single tranche, tend to be notoriously difficult to value. Sufficient consideration of this issue is absent from all of the reports seen by the Panel. Again this indicates that the Minister for Treasury and Resources has prioritised maximising sale receipts over the 3 other key principles on which he has based his proposition to sell.

Professor Parker concludes that the option of a partial sale may have been dismissed far too quickly. He comments –

***'it is not self-evident that a total sale in one tranche to the private sector of all of the share capital would necessarily be the optimal policy, in terms of either maximising the value of a sale or ensuring the most economically efficient operation post-privatisation.'***

The Professor adds -

***Careful consideration should be given to the option of a partial sale in the first instance. Amongst other things, the retention of a state shareholding will permit the Government to retain an input into the strategic decision making of the “privatised” Jersey Telecom and it may assist effective regulation of the company by reducing information asymmetries.***<sup>3[108]</sup>

The Panel’s adviser notes that, in most cases internationally, the process of privatisation has occurred gradually. He observes –

***‘In a number of countries, the Government retains a sizeable shareholding and in some cases a majority shareholding in the former state-owned provider’.***<sup>4[109]</sup>

The Panel considers that most attractive option from the perspective of the Jersey public could well be a sale of a minority stake, because the States would still be owning the controlling stake in the investment. The States would thereby be able to take into account the strategic economic interests of Jersey to a greater extent than would a prospective private buyer with full control. In that respect a no sale option is possibly equally attractive.

**Appendix 3** reveals that the approach advocated by the Minister and his advisors is still far from the accepted norm in smaller jurisdictions worldwide. This assessment, provided by Professor David Parker, is corroborated by the Executive Director of the JCRA who explains –

***‘I think [a partial sale] is more likely in a smaller jurisdiction than a larger one because of perhaps the greater dependence on one network company to provide the telecoms network.***<sup>5[110]</sup>

***{This quote is taken out of context. It concerned the structural separation of JT and not whether a minority interest of JT should be retained by the States.}***

Professor Parker recommends that ‘serious consideration’ be given to the possibility of pursuing a partial sale in the first instance.

#### **6.4 A Private Equity Sale?**

The consultation paper produced by the Minister suggests that a private equity or financial investor is unlikely to be a long-term investor. The Panel broadly agrees with this assessment. According to Professor Parker, an exit by the investor in around three to five years could reasonably be expected, at which time there could be no guarantee as to whom the private investor sells.

<sup>3[108]</sup> Possible Sale of Jersey Telecom – Review of the Evidence to 31st Dec 2006 – D. Parker, p.20

<sup>4[109]</sup> Possible Sale of Jersey Telecom – Review of the evidence to 31st Dec. 2006, para. 5.5

<sup>5[110]</sup> Transcript of hearing attended by JCRA – 19th Dec. 2006, p.31

In the meantime, a private investor will inevitably look to increase the value of his investment substantially. On the assumption that assurances given by the Board of Jersey Telecom regarding a total lack of surplus property assets are correct, and given that it may be difficult to raise revenues within Jersey Telecom substantially in the face of competition and price regulation, the Panel is clear that any capital gain is likely to be achieved through cost cutting and especially through staffing reductions. This is because, as the Chairman of JT explains –

***‘the principal cost associated with running this business is the human cost; the staff cost’.***<sup>6[111]</sup>

In simple mathematical terms it therefore presents the biggest opportunity for making economies in the overheads of the business. Such cost cutting would have real implications for employment.

#### **RECOMMENDATION**

A possible sale to a private equity group should be approached with caution.

### **6.5 An IPO?**

Professor Parker, having reviewed the available evidence, considers that a sale by public offer (IPO) through the stock market should not be ruled out. He suggests that a simultaneous flotation on the Channel Island and UK stock markets would be one obvious option.

The financial services firm Collins Stewart (C.I.) Ltd has suggested the use of an “accelerated IPO” (aIPO). Under an aIPO investors form syndicates to bid for the entire share offer and then execute an immediate IPO. Having reviewed, in conjunction with its adviser, work by the highly respected economist Tim Jenkinson, at Oxford University<sup>7[112]</sup>, the Panel considers that an aIPO could possibly be an attractive method for the sale of Jersey Telecom. Local Chief Executive Mr. J. Davey comments –

***‘listing Jersey Telecom on the Channel Islands Stock Exchange would be very good in terms of re-enlivening local capital markets. Over the last few years we have lost lots of local companies who have been taken over and disappeared and local capital markets have withered and died. Our plan for Jersey Telecom would be to use that as a foundation on which to rebuild capital markets locally and that would have a number of benefits for the economy in general.’***<sup>8[113]</sup>

If preparations for a negotiated sale and an aIPO can occur at the same time, as the Panel understands is the case, neither route is precluded until the final stage of the sale is reached.

<sup>6[111]</sup> Transcript of hearing attended by Board of JT – 25th Sept. 2006, p.30

<sup>7[112]</sup> T. Jenkinson (2005) “Public or Private Equity? How accelerated IPOs can increase competition in offerings”, mimeo, July.

<sup>8[113]</sup> Transcript of hearing attended by Collins Stewart, 17th Nov. 2006

Although administering two methods of sale will incur additional costs, Professor Parker considers that the suggestion of an aIPO might put pressure on bidders in the negotiated sale to offer a higher price. The resulting extra revenue might more than offset any additional costs.

Notwithstanding the above, the Panel notes that an aIPO would be unlikely to deliver the potential benefits of economies of scale.

## **6.6 Diseconomies of Scale?**

Whilst the Panel appreciates that the economies of scale argument attached to a trade sale to a larger global operator does have advantages for Jersey Telecom, it appreciates that this is not the whole picture. The Panel has had its attention drawn to counterbalancing diseconomies of scale.

Mr. John Davey, Chief Executive Officer of Collins Stewart C.I. Ltd has given the Panel an insight into diseconomies of scale and their implications. Referring to the prospect of JT being purchased by a global telecoms service provider, he explains –

***‘[Telecom] companies are not rational in the way they behave. In terms of a trade sale... It is focused on this idea of economies of scale. They do exist in certain situations but in small complex markets I think the diseconomies outweigh the economies... Often they mean job cuts; they mean undermining of management flexibility; they mean reduced trading, reduced investment over time’.***

He adds -

***‘There are some economies of scale I do not think the Island would want, broadly speaking. There are certainly no economies of scale in customer service or staff retention and anyone who has had to deal with an Indian call centre knows that very well.’***<sup>9[114]</sup>

The Minister for Economic Development acknowledged the existence of diseconomies of scale when he addressed the Panel on 17th November 2006. Nevertheless, his reply indicates that he does not fully understand diseconomies of scale. He claims -

***‘Diseconomies of scale are about the small scale of an operation. I do not think that is about losing control.’***<sup>10[115]</sup>

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<sup>9[114]</sup> Transcript of hearing attended by Collins Stewart (CI) Ltd. 17th Nov 2006, p.3

<sup>10[115]</sup> Transcript of public hearing attended by Senator P.F.C. Ozouf, 17th Nov. 2006, p.32

The Panel has studied a paper entitled 'Diseconomies of Scale in Large Corporations' by Dr. S. Canback<sup>11[116]</sup>. Detailed consideration is given in the report both to traditional economies of scale and to concepts such as the effect of bureaucratic insularity, specialization of worker roles and distorted lines of communication. In his conclusion, Dr. Canback observes –

***'much of the rationale for mergers and acquisitions seems to be weak, at best. Proponents of mergers typically argue that the resulting larger entity after a merger will realise economies of scale, benefiting customers and shareholders; in addition, they claim that growth will be accelerated through the introduction of new products and services that were previously too expensive to develop. But the analysis here shows that although some economies of scale may be realised, they are likely to be offset by diseconomies of scale. Furthermore, there is no evidence that larger, merged entities innovate more and grow faster. Instead, the opposite appears to be true: innovation and growth decline.'***

It is therefore arguable that the references to economies of scale within the Minister's original discussion paper give an overly simplistic view of the implications for Jersey Telecom that may arise from a trade sale to a larger operator. For the convergence based business model to work, the quality of customer service offered by the service provider must be particularly high; however, larger telecoms providers are often cited as having fallen short of the mark.<sup>12[117]</sup>

The Panel nevertheless acknowledges that access to high value content is an attractive reason for pursuing some form of arrangement with a global telecoms operator.

## **6.7 Partnership?**

The Board of Jersey Telecom appears to have discounted the issue of diseconomies of scale in favour of the potential benefits offered by a trade sale to a global operator. The Board's official response to the Minister's discussion paper states –

***'The Board's view is that developments in technology, competition and investment has reached a stage where the Company on its own may not be able to sustain into the future its unique performance in Jersey without the economies of scale in research and investment, buying power and operational factors available to larger companies.'***<sup>13[118]</sup>

While the Panel notes that the international telecommunications market is generating some particularly large multinationals, it has also learned that there are alternative ways forward.

<sup>11[116]</sup> Published by Canback Dangel, Predictive Analytics Advisers, [www.canback.com](http://www.canback.com)

<sup>12[117]</sup> e.g See <http://www.3g.co.uk/PR/Feb2006/2585.htm>

<sup>13[118]</sup> Consultation on the Proposed Sale of Jersey Telecom: response of the Board of JT Group Ltd. – p.3

Companies have been forming with a view to supplying the content that independent operators might require. For example, in May 2005 BT, in conjunction with New Venture Partners, formed iO Global Limited. From the outset the company's objective was to supply 'network operators, content providers, advertisers and other complementary service providers' with content to service 'the consumer on-the-run market'. By February 2006 it had signed an agreement with ITN Multimedia, who would supply the company with news and other mobile content for distribution to customers. One of those customers was Manx Telecom.<sup>14[119]</sup> It is possible that Jersey Telecom may be able to negotiate a similar agreement.

The Panel's adviser has drawn attention to developments in Cyprus. CYTA, a full service provider serving a resident population of approximately 800,000 (plus significant numbers of tourists) claims in its 2005 annual report to have 'signed many content procurement agreements'. He explains –

***'Like Jersey Telecom, CYTA is small and sees its continuing independence as depending upon a strategy of developing alliances with international operators; for example, it has a Partner Network Agreement with Vodafone. In some countries partnerships have been supported by strategic shareholdings.'***<sup>15[120]</sup>

Of course, JT is an even smaller company than CYTA in multinational telecoms terms, with earnings before interest, tax, depreciation and amortization in 2005 of some £28 million against approximately £87 million (just over CYP£73 million) for the Cyprus based company. Nevertheless, this example does demonstrate that smaller companies can negotiate partnerships with larger operators, and without having to relinquish full ownership, or even part-ownership, of the company in return.

The Panel has been advised by JT that it has attempted to negotiate such agreements in the recent past but without success. Regarding the Cyprus example, the Panel has been invited to note that Vodafone would not be in a position to offer a similar partnership arrangement to JT on account of its current financial interest in Jersey Airtel's parent company.

What it has learned is that JT has been successful in negotiating mobile roaming agreements with over 200 operators across 100 countries.

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<sup>14[119]</sup> 'ITN Multimedia 3G Mobile News Content' – 6th Feb 2006 [www.3g.co.uk](http://www.3g.co.uk)

<sup>15[120]</sup> See Appendix 3 - Cyprus

The Managing Director of Jersey Telecom has advised that the process is far from easy. He reports that –

***‘Each one has to be... negotiated separately between Jersey Telecom and the other network players, and 200 in 100 countries sounds impressive, and indeed, we are in all of the major territories that we need to be. But it is still very, very hard for us in comparison to a global player who will [apply] some sort of frame agreement’***<sup>16[121]</sup>

Nevertheless, the fact remains that if roaming agreements are possible then other forms of partnership arrangement may yet prove workable for the company.

#### **Finding**

The panel accepts that economies of scale and access to premium products may result from a partnership with a major global operator. However it is not convinced that 100% sale is the only way to achieve these ends.

### **6.8 Conclusions**

Once Jersey Telecom is sold to the private sector it would be particularly difficult to ever recover control – unless the company is subsequently allowed to deteriorate to such an extent that it becomes a liability to the new owner.

The Panel understands the arguments regarding economies of scale and the need for access to content that necessitate the formation of a partnership deal in one form or another. That does not mean that a total sale in one tranche to the private sector of all of the share capital represents the best way forward, in terms of either maximising the value of a sale or ensuring the most economically efficient operation post-privatisation.

Instead the Panel considers that careful consideration should be given to the option of a partnership, perhaps backed by a partial sale of shares in the company. Amongst other things, the retention of a state shareholding will afford the States the ability to retain limited input into the strategic decision making of the company and it may assist effective regulation of the company by reducing the likelihood that the private company would seek to pursue a policy of limited cooperation with the JCRA in terms of provision of information.

The economy of Jersey depends upon its financial services sector. In turn the financial services sector is especially dependent on having an efficient and effective telecommunications service. On that basis alone the future of Jersey Telecom should be of considerable interest to the States at a strategic level.

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<sup>16[121]</sup> Transcript of hearing attended by Board of Jersey Telecom – 25th Sept. 2006, p.31

**Finding**

If the States were to ultimately agree to the sale of JT, the Panel would recommend that consideration should be given to a dual track approach whereby trade bids are invited alongside an IPO offering. It therefore welcomes the move by T&R from a trade sale to a more flexible approach to other bids. However, the Panel is concerned that -

- a) If existing local telecoms operators were to bid successfully, this would reduce competition which the JCRA would have to act on, and
- b) If a private equity bid were to succeed, there may be problems with the identity of the buyers and the economies of scale arguments would fall.

**RECOMMENDATION**

Should the States decide that it wishes to proceed with privatisation, it should agree to sell only a minority stake in Jersey Telecom.

## 7. Conclusion and Recommendations

The Panel concludes that the Minister for Treasury and Resources has failed to demonstrate that privatising Jersey Telecom now, by way of a full sale, is either necessary or desirable.

### **RECOMMENDATION**

**A comprehensive cost-benefit analysis of the economic and social implications arising from a sale of Jersey Telecom should be completed before the States decides whether to sell the company.**

Professor Parker advises -

***'I would expect a government to undertake such an exercise before embarking too publicly on privatisation if the rationale for a sale is economic. Of course, Governments do not do this when the rationale is really political lest it does not provide the "right" answer'*** <sup>1[122]</sup>

He further advises that, with cooperation from the relevant parties, a worthwhile assessment could be completed 'in around 3 months'.

Jersey Telecom is a successful incorporated company with a healthy turnover, profit margin, market share and infrastructure. Competition has been introduced but the evidence suggests that the markets in which the company operates will expand, through increased market penetration or through technological change. The company benefits from a loyal and skilled workforce. In short, it looks like a good investment. Retention of the company also makes sense from a strategic perspective. In the event that a major and unforeseen event impacts the local economy, ownership may give the States greater opportunities to influence the rate of investment in telecoms so as to assist economic recovery

The Panel considers that the financial argument put forward by the Minister for Treasury and Resources for a sale of Jersey Telecom is weak and arguably a distraction, particularly in respect of the perceived increased risk associated with continued ownership. As Professor Parker explains, any sale of Jersey Telecom should be motivated by the achievement of economic gains (gains in economic efficiency, better services, more services, lower prices) and not by maximising sales receipts or investment returns<sup>2[123]</sup>. With this in mind, the Panel is seriously concerned that neither the economic impact nor the associated social implications of privatising Jersey Telecom have been properly assessed.

<sup>1[122]</sup> E-mail from Professor Parker, received 1st March 2007

<sup>2[123]</sup> See 'Possible Sale of Jersey Telecom – Review of the Evidence to 31st Dec 2006' – D. Parker, Conclusion

**RECOMMENDATION**

**Should the States decide that it wishes to proceed with privatisation, it should agree to sell only a minority stake in Jersey Telecom.**

The telecommunications industry is evolving rapidly and this is creating challenges for all telecommunications companies world-wide. The Panel has found some evidence that Jersey Telecom would indeed benefit from certain economies of scale in order to address these challenges effectively. Furthermore, it acknowledges that access to those economies of scale may require some form of external investment. Nevertheless, the Panel is not convinced that agreements to secure access to content, to purchase infrastructure equipment or to gain access to supplies of retail products at reasonable prices necessarily requires that the States relinquishes ownership of a key strategic asset.

Privatisation is one solution for Jersey Telecom, if it results in its absorption into a leading-edge international telecommunications provider. It nevertheless opens the company up to potentially negative diseconomies of scale and may leave the Island facing significant job losses. Another possible solution is some form of partnering arrangement to address technology and scale economy concerns, possibly backed by the sale of a minority stake, as a number of other smaller jurisdictions have done.

**RECOMMENDATION**

**The Panel recommends that there should be an immediate review of the JCRA's skills base, resources and legal powers. Such a review should be part of any privatisation planning and should be completed before the States is asked to decide whether to sell.**

Although the Panel accepts that privatisation can bring economic gains, these gains are almost invariably dependent upon the presence of effective competition and, in the absence of competition, effective regulation. The Panel concludes that effective regulation is likely to become increasingly important in the event that Jersey Telecom is privatised; however, it also considers that there is clear evidence that Jersey does not yet have a sufficiently robust regulatory framework, nor does it necessarily have the resources to enforce its powers. {As the JCRA's comments show, the evidence presented to the Panel does not support this recommendation}.

**RECOMMENDATION**

**A possible sale to a private equity group should be approached with caution.**

If privatisation proceeds, the Panel notes that options for disposal will be kept open at this stage. It concludes that the possibility of a simultaneous aIPO and negotiated sale should be seriously considered by the Minister for Treasury and Resources. Professor Parker recommends that Dr Tim Jenkinson be approached to provide specialist advice on this route to privatisation. It further

concludes that a sale to a trade buyer is more likely to be of benefit than would a sale to a private equity investor. Quite apart from the fact that a financial investor will be inherently limited in terms of the economies of scale that it could bring to a telecoms operator, the shorter-term nature of private equity investment would result in future uncertainty as to the eventual ownership of the company. A private equity buyer could also be expected to conduct the sharpest cost cutting following privatisation, with consequent implications for employees of the company. Particular care should be taken to ensure that any sale does not have a negative impact on the level of competition in the local telecoms market.

The panel recommends that if the States were to ultimately agree to the sale of JT consideration should be given to a dual track approach whereby trade bids are invited alongside an IPO offering. It therefore welcomes the move by T&R from a trade sale to a more flexible approach to other bids. However, the panel is concerned that;

- a) a) If existing local telecoms operators were to bid successfully, this would reduce competition which the JCRA would have to act on, and
- b) b) If a private equity bid were to succeed, there may be problems with the identity of the buyers and the economies of scale arguments would fall.

**RECOMMENDATION**

**TUPE style legislation should be introduced in Jersey at the earliest possible opportunity.**

Employees are at risk in any privatisation. Although clauses may be written into the initial sale contract in an attempt to protect terms and conditions of employment, privity of contract in Jersey law dictates that employees would be required to rely on the Minister for Treasury and Resources, and his successor in office, to enforce clauses contained in the contract of sale. Moreover, any agreement at privatisation on employment terms is likely to be time limited. The Panel does not accept that sufficient protection could be provided in the event that the ownership of the business should subsequently change. Finally, the absence of legislation equivalent to UK TUPE regulations would leave JT employees in a vulnerable position in the event that the company undergoes structural separation in future. The Panel considers that this weakness in employment legislation is not acceptable.

Finally, the Panel wishes to express serious concern at what appears to be an unjustified sense of urgency on the part of the Minister for Treasury and Resources and his department in pursuing a final decision on privatisation. Rather than run the risk of obtaining significantly lower sales receipts (an assertion which has not been supported by logical evidence), the haste with which the Minister is acting brings with it the real risk that a decision on the future of Jersey Telecom will be taken in the absence of all the key facts.

As Professor Parker advises, privatisation should be properly designed, planned and timetabled. A rushed privatisation is likely to be a bad privatisation.

## Appendix 1: The Strategic Plan – Does the Minister have a Mandate?

On 10th April 2006 the Council of Ministers lodged the draft Strategic Plan 2006 – 2011<sup>1[124]</sup>. In his Foreword, the Chief Minister gave States members, and the public of the Island, a straightforward assurance. He wrote that the Plan -

***‘spells out exactly what we plan to achieve and when’.***

The Panel has revisited the Strategic Plan as part of its investigation. These enquiries have caused it to question whether the Minister for Treasury and Resources has the necessary mandate to pursue his policy proposal.

References to a possible sale of States owned utility companies were undoubtedly present within the body of the original draft Strategic Plan. The first was found in the Minister’s own Resources Statement, toward the beginning of the draft. In it he wrote –

***‘Within the period of this Strategic Plan we will review the ownership of States-owned utility companies. Any sale proceeds will go into the Strategic Reserve and will not be used to generate either capital or revenue spending.’***

This section was intended to identify the resource constraints within which the proposals of the Council of Ministers could be taken forward. Accordingly other States members were not entitled to amend its content. In any event, the comment concerning Jersey Telecom simply mirrored a specific proposal under the draft ‘Commitment Six’ (We will ensure that States services are necessary, efficient and of good quality). Paragraph 6.3 of that draft Commitment read –

### ***‘6.3 Maximised long-term value of States-owned strategic resources***

***Indicated by:***

- • ***Strategy approved by the States***
- • ***Cost to the public purse***
- • ***Long-term asset value***
- • ***Cost to the consumer***

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<sup>1[124]</sup> Projet No. P.40/2006

**What we will do:**

**6.3.1 Review ownership of Jersey Electricity Company, Jersey New Waterworks and Jersey Telecom and have strategy approved by the States by December 2008 (EDD / T&R)**

**6.3.2 Review the ownership structure of Harbours and Airport in line with an air and sea transport policy by 2008 (ED)**

A similar reference was included in the introductory statement outlining Commitment Six; however, it should be noted that the purpose of the introductory statements was (and remains) to describe the main issues relating to each of the six individual Commitments<sup>2[125]</sup>. All the specific proposals that the States were to be asked to approve in principle were detailed in sections entitled 'What we will do'. The logic and the purpose of this structure would become more apparent six months later, when the States received its first progress report on each of the initiatives listed.

Although the Strategic Plan was subsequently adopted by the States on 27th June 2006, it is important to note that Commitment Six was amended five days earlier. Deputy J.G. Reed of St. Ouen had lodged an amendment<sup>3[126]</sup>, which read –

**'6.3 Maximise the potential of States owned strategic resources**

**Indicated by:**

- • **The securing of long term supply of both energy and all other resources**
- • **Demonstrable financial benefits for both the taxpayer and consumer**
- • **Island's needs met both in the short and long term**
- • **Recognition of the strategic importance of all utilities**

**What we will do:**

**6.3.1 Provide clear criteria for the protection and efficient provision of services provided by States-owned, and States-controlled, utility companies (ED)**

During the course of the ensuing debate (a transcript of which is included at **Appendix 2**) Deputy Reed commented –

**'all of a sudden our aims, last year's aims, "clear criteria for the protection and efficient provision of services provided by States-owned utility companies", turns into "review ownership". Whoa, hang on. Where did this come from?'**

While clarifying that he did not consider his amendment to be closing the door on the prospect of privatisations in future years, Deputy Reed nevertheless suggested that to 'just review ownership'

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<sup>2[125]</sup> Strategic Plan 2006 – 2011, p.12 'How the rest of this Plan is structured'.

<sup>3[126]</sup> Projet No. P.40/2006 Amd. (15)

might leave the way clear for the Executive to concentrate on amassing cash sums without having to first conduct a full and detailed assessment of the strategic implications for the Island's economy and its population as a whole. His views clearly struck a chord with a number of other States members, to the extent that , as the debate drew to a conclusion, Senator F.H. Walker felt it necessary to rise to his feet and declare –

***'We are not in any way hell-bent on privatisation... So I do not know what Members are worried about at this point. There is no such proposal on the table'.***

Deputy Reed's amendment was subsequently adopted by the States on a show of hands, despite opposition from the Council of Ministers<sup>4[127]</sup>. Consequently the specific wording that referred directly to the possibility of selling off Jersey Telecom fell away.

Copies of the finalised Strategic Plan 2006 – 2011 published after the debate still contain two references to the possible sale of States owned utilities; one in the Resources Statement and one in the introduction to Commitment Six. As the Resources Statement could not be challenged in the States, and as the latter constituted nothing more than an introductory reference to an action which was subsequently removed by a decision of the States, it follows that neither can be relied upon as justification for pursuing a proposal to privatise Jersey Telecom. Indeed, it is arguable that the introductory paragraph should have been amended automatically following the decision to adopt Amendment No. 15, so as to provide an overview of Commitment Six in its amended form.

The Panel notes that other members were permitted to bring amendments to the introductory paragraphs of certain Commitments. As the Strategic Plan was the first of its kind under the ministerial system, the Panel accepts that there will inevitably be scope for refinement of the process through which this important document should be amended. Nevertheless, the fact remains that the Council of Ministers only felt it necessary to report to the States on the specific initiatives listed under the 'What we will do' sections of the Plan when it release its progress report 'Strategic Plan – Progress Against Initiatives'<sup>5[128]</sup>.

With the foregoing in mind, the Panel considers that for the Minister for Treasury and Resources to bring forward to the States a specific proposal to privatise a States owned utility, he would first have to be satisfied that the comprehensive body of work required by para. 6.3.1 of the Strategic Plan had been completed and, preferably, presented to the States. As of 16th January 2007, when the first update on progress made against Strategic Plan initiatives was published, the required work was described only as '*ongoing*'.

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<sup>4[127]</sup> P.40/2006 Amd. (15) - Comments

<sup>5[128]</sup> R.4/2007 refers

In fact it took just 16 days following the approval of the Strategic Plan for the Minister for Treasury and Resources to issue his discussion paper on the proposed sale of Jersey Telecom. Key to the underlying basis for the proposal to sell was a statement, contained within Section 4 of the paper. It read -

***'The aim of the States is to maximise the long-term value of its strategic assets.'***

At the time this was an incorrect statement and it remains so. It is a repeat of wording deliberately removed from the draft Plan several weeks previously.

When the Panel requested copies of draft versions of the discussion paper, with a view to establishing the extent to which the Minister and his department had been actively engaged in finalizing its proposals prior to the Strategic Plan debate, it was refused access. Instead the Department advised –

***'The Minister confirms that the adoption of the amendment had no impact on his plans or on the drafting of the consultation document'.***

## **Conclusion**

The Strategic Plan 2006 - 2011, as amended, did not provide the Minister for Treasury and Resources with a mandate to pursue a proposal to privatise Jersey Telecom. Notwithstanding this, the Minister has committed over 6 months of officer time, and significant financial resources in the form of consultancy fees, to a project without first waiting for the necessary body of work to be completed by the Economic Development Department.

## Appendix 2: Public hearings and Events

<b>DATE (2006)</b>	<b>WITNESS</b>
7th September	Public meeting held at Hautlieu School. Speeches delivered by Minister for Treasury and Resources and by Mr. M. Budd, Regional Officer, Amicus.
25th September	Hearing attended by representatives of the Board of Jersey Telecom
3rd October	Hearing attended by the Executive Director and Legal Adviser, Jersey Competition Regulatory Authority
17th November	Hearing attended by the Chief Executive of Collins Stewart (C.I.) Ltd.
“ “	Hearing attended by Mr. P.Skyte, Mr. M. Budd, Ms. L. McMillan and Mr. T. Langlois of Amicus.
“ “	Hearing attended by the Minister for Economic Development
11th December	Private meeting with representatives of the Citigroup consortium, accompanied by the Treasurer of the States.
12th December	Public lecture on the welfare impact of privatisation delivered by Professor Massimo Florio, Professor of Public Economics and Jean Monnet Chair of Economics at the University of Milan, Italy.
18th December	Hearing attended by the Chief Executive of Cable and Wireless Jersey and the Head of Regulatory Affairs, Cable and Wireless International.
19th December	Hearing attended by the Minister for Treasury and Resources
“ “	Hearing attended by the Executive Director and Legal Adviser, Jersey Competition Regulatory Authority



## Appendix 3: Telecoms markets in other small jurisdictions

In the USA in 1984 AT&T was divided into a number of separate telecommunications companies to promote competition and in the same year, in the UK, British Telecom was privatised. In the build up to privatisation cellular operators were licensed in the UK, two initially, and value added services (VANS) were permitted and later public line resale. At privatisation BT faced competition from the fledgling Mercury Communications, but from 1990 the duopoly in fixed-line services was removed, as later were restrictions on full competition in international services. At the same time, from the mid-1980s cable network providers were licensed to provide combined entertainment and telephone services.

In the USA, telecommunications are regulated nationally by the Federal Communications Commission and by state-level regulatory authorities. In the UK the Office of Telecommunications (OfTel) was established headed by a Director General of Telecommunications. More recently, OfTel has been merged into the new Office of Communications (Ofcom).

This general model which developed in the UK involves permitting competition in telecommunications services to replace the previous state-owned monopoly, privatisation (in some form), and the creation of a dedicated regulatory system for telecommunications to protect consumers from monopoly abuse while competition develops. This model has been copied around the world, but with a number of national variations.

Small countries, that is to say countries or states with relatively small populations, such as Jersey with a population of around 90,000, may face particular difficulties in implementing the international model. In particular, a small population means that it is likely that the minimum efficient scale for fixed-line services (where average costs are minimised) is incompatible with having a number of competing fixed-line suppliers. Telecommunications fixed-line networks are expensive to build and update and they operate most efficiently when used close to capacity. The existence of duplicate networks, all under-utilised, would clearly be uneconomic.

However, it is important to recognise that what is important for the economics of telecommunications provision is the *population density* rather than the level of the population per se. A highly concentrated population reduces the costs of individual connections to the network. Even in countries with larger populations, such as the UK, in general it has not proven to be profitable to build competing fixed-line services (including cable services) except in areas of high population density.

Jersey has a concentrated population in and around St Helier, including the economically important financial services industry. It is possible that more than one fixed-line supplier could make profits if it targeted its service provision at this more densely located and high-user telecommunications market.

The economics of operating wireless networks is similar but without the same high fixed costs of fixed-line systems. Therefore, it is normally the case that competition develops more readily in mobile communications than in fixed-line networks, except where telecommunications services can be coupled with entertainment services, such as in cable networks. The other area where competition more readily develops is in value added and leased-line services, utilising the incumbent's existing network. Where new fixed-line and radio networks are developed, interconnection with the incumbent's fixed-line network is essential if the services are to appeal to customers. A potential area of conflict in the liberalising of the telecommunications market is ensuring fair access by new entrants to the incumbent's network through the terms of interconnection. The incumbent may also adopt other anti-competitive practices, which will need policing. This necessitates the creation of a regulatory system; only in a small number of regimes have governments chosen to rely simply on the existing competition authority to oversee the development of competition and control monopoly behaviour.

All of the above trends are evident in the brief review of the developments in telecommunications in small countries below.

### **Developments in Small Countries**

It is difficult to find countries with as small a population and area as Jersey. However, the experiences of the following European countries – Estonia, Latvia, Cyprus and Slovenia - are of interest as some form of benchmark for Jersey. Member States of the European Union are required to follow the various Directives on telecommunications (most recently those of 2002: details can be provided if required), which broadly require competition in services and apparatus supplies and the separation of ownership from the regulatory functions within government, provisions for the maintenance of public services (the universal service obligation), and the harmonisation of standards.

Privatisation is not a requirement of the Directives but with the ending of monopoly powers the case for state ownership recedes. Most telecommunications providers in the EU have some private capital, but often alongside a continuing state shareholding, which may (or may not) be sold in the near future.

## **Estonia**

Telecommunications in Estonia was provided by a state-owned enterprise. With separation from the Soviet Union, in 1992 the Estonian Telephone Company (AS Eesti Telefon) and the Government of Estonia signed a concession agreement, which gave ETC exclusive rights for eight years to provide national and international switched fixed voice telephony services, telex and telegraphic services, and installation and connection of apparatus. In 1999 legislation was passed, the Cable Distribution Act, to promote competition through cable provision. A new Telecommunications Act was adopted in 2000, clearing the way for more competition, with operating licenses required where there is connection with a public communications network and involving radio frequencies. In April 2000, the Government abandoned its earlier decision to sell its remaining nearly 28% holding in ETC in the face of a decline in telecom stock prices internationally.

By 2001 the exclusive rights to operate telecommunications services held by the state-owned ETC expired. Today there is a large number of telecommunications operators in Estonia (the International Telecommunication Union claims 169 companies are involved; this figure seems to include cable television network licenses and nine applications to operate a public fixed voice telephony network). However, large numbers of the new entrants are concerned with providing specialist services not mainstream telecommunications services such as voice calls. Much of the new investment has come from Nordic investors. The result is one of the most developed telecommunications sectors in Central and Eastern Europe.

In 2001 a number of companies announced their intention to offer competing fixed-line services to the Estonian Telephone Company. But the pace of technological change in telecommunications appears to have created a “wait and see” attitude amongst potential investors in alternative fixed-line systems. The breaking of the “dot com” stock market bubble has been another contributory factor in the failure of competing networks to develop. Nevertheless, the electricity, gas and railway companies, which operate private circuits, are seen as possible entrants into the industry. There are also four cable distribution companies operating in Estonia.

The Telecommunications Act regulates organisations with “significant market power” through special provisions. Under the Government of the Republic Act of 1998, the Estonian National Communications Board (ENCB) regulates telecommunications including the significant market power provisions and reports annually to the sector Ministry. New service providers have to notify the ENCB of their intentions and, where necessary, obtain an operating license. Because of its large market share, ETC is subject to the “significant market power” provisions. This is the case for all of the incumbent telecoms companies across the EU that retain market power.

ETC retains market dominance in the voice telephony market. However, the market for data services has become increasingly competitive. In consequence, ETC has been rebalancing its tariffs to minimise “cream skimming” by the new providers and to see off potential entrants. At the same time, the number of fixed phone lines has decreased, as customers have switched to the use of mobile phones. In December 2000 there were 35.9 fixed-lines per 100 inhabitants. By the end of 2004 this had dropped to 32.9. Over the same period the number of mobile phones per 100 population had risen from 41 to 93. Cable operators have launched triple play services, posing potentially a significant challenge to ETC. ETC has responded by providing fibre-to-the-home networks and broadband TV services.

In June 2006 the ENCB launched a public tender for the construction of broadband wireless services in the 450MHz band. Estonia is enjoying a boom in broadband usage, fuelled by competition amongst internet service suppliers and public policies to encourage IT use in schools and through providing Public Internet Access Points. By 31 December 2005 there was a 15% broadband penetration rate in the country and this is growing quickly as internet service charges decline. As a result, Estonia is amongst the leading nations in Europe in terms of the number of permanent high speed internet connections.

As in other jurisdictions around the world where competition has been introduced into telecommunications, there have been legal disputes. A number have gone to court; including one over a 10-year cable distribution licence issued to Tele2. The issue here was whether the licence was lawful or not.

## **Latvia**

Lattlekom is the incumbent operator in Latvia, in which the TILTS communications consortium of Cable & Wireless and Sonera Corporation acquired a 49% stake in January 1994. TILTS is now wholly-owned by TeliaSonera AB. Lattlekom was given exclusive rights under the resulting concession to provide telecommunications services in Latvia. However, in March 2004 a legal dispute ended with compensation for the shortening by 10 years of Lattlekom’s monopoly operating concession. The Government’s aim was to start to liberalise the telecommunications market ahead of the country’s accession to the EU and to meet World Trade Organisation commitments.

Latvia’s telecommunications market has technically been fully liberalised since 1 January 2003. But delays in implementing legislation and an uncertain regulatory regime have meant that so far there has been little effective competition to Lattlekom. What competition exists comes from leased lines, internet services and international calls based on carrier pre-selection.

The possibility of privatising more of Lattekom has been floated by the Government and TeliaSonera has expressed interest in raising its shareholding. TeliaSonera also has a direct 49% ownership of the mobile operator, Latvijas Mobilais Telefons, in which Lattekom hold a 23% stake. The other mobile operator is Baltkom, now owned by Sweden's Tele2. In July 2002 the Ministry of Transport and Communications asked for expressions of interest in three GSM 1800 licences. Two were purchased by the existing mobile operators. There was little interest in the third licence. However, in March 2005 Lithuanian mobile operator, Bité GSM, a wholly owned subsidiary of TDC Mobile International, was announced as the successful applicant for a new GSM/3G cellular licence.

In summary, fixed-line networks remain dominated by Lattecom, which is still majority state-owned, but competition is developing especially in mobile services.

### **Cyprus (Greek Cypriot area)**

There are around 418,000 main lines in use in the Greek Cypriot area of Cyprus and 641,000 mobile phones. The main operator in Cyprus is the Cyprus Telecommunications Authority (CYTA), which despite plans within the Government since the late 1990s to privatise it, remains state owned. There are around 43 other telecommunications operators in the country, most providing specialist services. CYTA is financially sound.

Liberalisation of the telecommunications market was introduced in 2001 and involved the creation of a new telecommunications regulator, although its development was seemingly hampered by inadequate resources. The Law Regulating Electronic Communications and Postal Services of 2004 was enacted to harmonise Cypriot legislation on electronic communications with the 2002 European telecommunications regulations. The purpose of the law is essentially to guard against abuse of dominance by CYTA and encourage competition.

The first resulting measures of the regulator related to encouraging the provision of value added services using CYTA's network. Also, CYTA published a Reference Interconnection Offer, providing a detailed description of its interconnection services and relevant tariffs for new entrants. At the same time, CYTA has taken steps to try and limit effective competition. The Cyprus Competition Committee has found against CYTA for abusing its market dominance, especially in the provision of international communications and the provision of mobile telephony. The company has also been taken to task for anti-competitive practices relating to internet services. {Doesn't the experience in Cyprus challenge the Panel's current conclusion that a state-owned entity may take a more responsible view toward compliance than a privately owned entity?}

A few private telecommunications companies have emerged since liberalisation but none so far comes close to challenging CYTA. A noteworthy operator is PrimeTel, which was established in Cyprus in 2003, to develop voice, data and video services operating an island-wide fibre optic network and with international connections. PrimeTel belongs to the Teledeve East group of companies and has a strategic collaboration with the Electricity Authority of Cyprus.

Up until 2003 there was only one GSM provider, owned by CYTA. In that year a second GSM and UMTS mobile network operator was licensed. Today the operators are CytaMobile/Vodafone and Areeba Cyprus (which started in late 2004 but still has a much smaller market share). There are around 12 internet service providers, including Cynet, owned by CYTA.

Cyprus has created a telecommunications regulatory authority in the form of the Office of the Commissioner of the Electronic Communications and Postal Regulation, under the Telecommunications and Postal Services Regulation Law of 2002. The Office reports annually to the Head of State. It is empowered to grant licenses for the operation of telecommunications services and the creation of new telecommunications networks. However, it came into existence largely due to EU requirements and it seems that it lacks full political support to tackle head on CYTA's continued dominance in all areas of telecommunications in Cyprus.

Aware that eventually it is likely to lose market share as a result of liberalisation of the Cypriot telecommunications market, CYTA has been pursuing an ambitious overseas expansion policy, including investing in operations in Greece and the UK. It has also expanded its role in the Eastern Mediterranean through participation in submarine fibre optic cable systems and international telecommunications products. CYTA is small and sees its continuing independence as depending upon this strategy and developing strategic alliances with international operators; for example, it recently signed a Partner Network Agreement with Vodafone (which is its partner in mobile provision within Cyprus).

Telecommunications is now designated by the Central Bank of Cyprus as an industry in which applications for foreign direct investment will be rejected outright on the grounds that further provision is not needed. This would appear to reduce the scope for further privatisation of the telecommunications sector through the development of competitive products to those offered by CYTA.

## **Slovenia**

Slovenia covers an area of 20,253 sq.km and has a population of around two million. It is a relatively rich country with a GDP per capita more than twice that of the other transition countries

of the region. Slovenia's privatisation programme was slow to start because of the inherited Yugoslav system of "social ownership". The main telecoms provider, Telekom Slovenija, remains state owned and apparently there are no imminent plans to privatise the operation.

In legal terms, Slovenia's telecommunications market was fully-liberalised at the start of 2001. The markets for fixed-line local, long distance, and international telecommunications services joined the mobile communications, data communications/internet access, and value-added services markets that were already being opened up to competition. The International Telecommunications Union lists 13 companies as involved in telecommunications services in Slovenia (although another source talks about 122 registered telecommunications operators, of which 11 are not active). Whatever the number, effective competition is limited and Telekom Slovenija remains the dominant provider of fixed-line and mobile services. In part this is because Telekom Slovenija has operated a hard-line approach to agreeing interconnection prices for competing operators. But in large part it is because the new regulatory body, the Post and Electronic Communications Agency (APEK), has been unwilling, seemingly, to force Telekom Slovenija to lower its interconnection charges and remove other barriers to the development of competition. {Doesn't the experience in Slovenia challenge the Panel's current conclusion that a state-owned entity may take a more responsible view toward compliance than a privately owned entity?}

APEK was established in 2001 and reports annually to the Government and the National Assembly of the Republic of Slovenia.

The mobile market now has three licensed network operators. Telekom Slovenija remains dominant in this sector through its subsidiary Mobitel, accounting for around 75% of the market. The next largest operator is SiMobil. Also, Telekom Slovenija is the most important internet service provider. In the summer of 2006 Telekom Slovenije and Slovenian telco Telekomunikacije were awarded 10 year licenses to provide nationwide WiMAX wireless broadband by the Post and Electronic Communications Agency. Prior to this, Telekom held the country's sole WiMAX concession, which was granted in 2002 and covered only the capital city, Ljubljana.

## Conclusions

The experiences of Estonia, Latvia, Cyprus and Slovenia illustrate the importance of the EU Directives in spurring the adoption of the international model for modern telecommunications. This model involves market liberalisation, the creation of a new regulatory structure for telecommunications, and privatisation. However, each Government has advanced this model with differing levels of enthusiasm and each has introduced its own provisions to preserve what it sees as the national interest. While the Estonian Government has been keen to see competition develop against the incumbent operator, to improve services and reduce tariffs, there has been

much less enthusiasm for this in Cyprus and Slovenia. In Latvia the Government appears to have steered middle course on telecommunications reform.

Equally, in none of the countries does it seem that the government has yet given up all of its shareholding in the incumbent telecommunications company. In Cyprus and Slovenia it appears that, to date, there has been no disposal of any shares in the national telecommunications enterprise.

It could be suggested that the experiences of the above four countries chosen are atypical. The paper includes, therefore, an appendix with briefer comments on developments in telecommunications in a number of other small and medium-sized countries.

The main conclusions of the paper relevant to the deliberations of the Scrutiny Committee on the future of Jersey Telecommunications are as follows:

- • Technological change in telecommunications is rapid and the case for having a national telecommunications monopoly supplier has disappeared. Nevertheless, economies of scale still apply and the degree of competition in the provision of fixed line networks tends to be limited. Competition has mainly centred on the provision of value added services (including data services) over fixed line networks and mobile (wireless) services. Competition occurs in mobile services and appears economically viable, as does competition in the provision of certain specialised fixed line services.
- • The management of Jersey Telecom base the case for privatisation on economies of scale and access to the kinds of services that telecommunications users will demand in the future (entertainment, VOIP etc). Their argument is that multinational telecommunications companies will not be willing to provide such services to JT or at least at an economic price. It is evident from the international experience that incumbent telecommunications companies are developing international strategies and strategically partnering in a manner consistent with the arguments of the JT management. However, this seems to be occurring irrespective of whether the telecommunications company is privately or state owned.
- • Telecommunications reform is associated with market liberalisation and the creation of a dedicated telecommunications regulator independent of or combined with the regulation of other utility industries (electricity, gas, airports etc). Jersey's decision to regulate telecommunications through the competition authority, the JCRA, is unusual. [But in no way unique, especially in a small island economy. The Barbarian Fair Trading Commission also has enforcement responsibility in both telecoms and general competition law, stating on its website:](#)

["The Fair Trading Commission assumed regulatory responsibilities on January 2, 2001 pursuant to the Fair Trading Commission Act, CAP. 326B. The Commission is responsible for the enforcement of the provisions of the Utilities Regulation Act, CAP. 282, the](#)

- • Privatisation has (at least so far) not occurred in some jurisdictions, especially if privatisation is defined as the transfer of control of the incumbent telecommunications enterprise to the private sector (transfer of more than 50% of the voting control in the company). Even where countries have now transferred majority ownership to the private sector, this has tended to occur through the sale of tranches of shares over time. It does not appear to have been usual practice for a telecommunications enterprise to be sold off, 100%, in one sale.
- • Where privatisations have occurred involving smaller countries there has been a tendency to bring in a strategic partner as part owner. This has enabled the incumbent operator to tap into the skills and international purchasing economies etc of the strategic partner. Sometimes this has occurred alongside some form of IPO or the introduction of local private investors. In most cases governments have been keen to retain some local interest and in some cases control over their telecommunications enterprise, given the economic and social importance of an efficient and effective telecommunications system.
- • In spite of market liberalisation, the incumbent operator (whether privatised or state owned) continues to dominate especially fixed line services but often mobile services too. Although competition can be expected to erode the incumbent's market share, it is not the case that we should expect that the value of JT will decline precipitously over the next few years based on the international experience.

### **Experiences of a number of other smaller-medium sized countries.**

**Bulgaria:** the Telecommunications Act 2003 provided a firmer basis for the liberalisation of the telecommunications market and the privatisation of the Bulgarian Telecommunications Company (BTC) than had existed previously. The licensing of alternative fixed line operators was permitted and further protection was introduced against abuse by BTC, for example in relation to interconnection agreements. BTC had been put up for sale in 2000, but the disposal had fallen through. In June 2004 the sale of 65% of BTC to the Austrian business Viva Ventures was completed. In January 2005 the remaining 35% of stock held by the Government was sold through an offer on the Sofia Stock Exchange, the Government retaining a “golden share”. This special share enables the Government to veto any strategic decisions concerning the company's future, including a takeover. The sale was facilitated by the grant of a GSM licence to BTC, to allow it to compete against Cosmo Bulgaria Mobile (trading as GloBul), a subsidiary of the Greek telephone company OTE, and MobilTel. In 2005 the three operators received 3G licences following a bidding contest.

**Croatia:** its fixed line network was opened up to competition at the end of 2002. In addition, in January 2005 the incumbent operator, T-Hrvatske Telekom, was required to permit access to its local loop network. Value added network service and internet service providers have been established. In November 2004 a second fixed-line operator, Optima Telekom, was licensed. Since then around a dozen other companies have been licensed to provide fixed line services, although none, including Optima Telekom, has so far mounted important competition to T-Hrvatske Telekom. In mobile services there are now three operators – T-Mobile Hrvatske (a subsidiary of T-Hrvatske Telekom), VIPnet and a relative newcomer jointly owned by Tele2 of Sweden and local investors. All three companies now have 3G licenses. The market is regulated by the Croatian Telecommunications Agency.

**Czech Republic:** Cesky Telecom has been privatised. In June 2005 the Spanish telcoms company Telefonica SA purchased a 51.1% share in Cesky Telecom and has since increased its stake. A new phase of liberalisation of the Czech telcoms market began in May 2005, incorporating the requirements of the 2002 EU Directive relating to firms with “significant market power”. In the market for mobile services there are three operators. Cesky Telecom’s subsidiary, Eurotel Praha, and rivals T-Mobile Czech Republic and Vodafone Czech Republic have all been designated as SMP providers. Cesky Telecom still retains about 95% of the fixed line market and through its subsidiary around 40% of the mobile market. There has been some consolidation in the market in recent years, notably amongst alternative fixed line operators. Telecommunications is regulated by the Czech Telecommunications Office.

**Ireland:** deregulation of the telecommunications market occurred in 1998. Until then the industry was dominated by the state-owned Telecom Éirann. Since deregulation companies such as BT, Telenor and AT&T have introduced competing services by accessing the incumbent’s network. However, Telecom Éirann (now called Éircom) continues to dominate the sector controlling 80% of fixed line telephony. The cable company NTL provides an alternative network in given areas. A regulatory office, the Office of the Director of Telecommunications Regulation, was established in 1997.

Eircom is now privatised. The Government sold virtually all of its shareholding in the company in July 1999 through an IPO. However, subsequently the stock market price of the company’s shares dived and the 500,000 small investors that had invested in the company at privatisation and held on to their shares suffered a significant financial loss. In 2001, as part of an asset rationalisation programme Eircom sold its mobile business to Vodafone. The remainder of Eircom was then subject to competing takeover bids and in June 2001 the company agreed to a takeover offer and the company was delisted from the stock exchange. Eircom became a private limited company

and a subsidiary of Valentia. In March 2004 the company was relisted on the stock market and in July 2005 Eircom purchased the third largest mobile operator in Ireland, thereby re-entering the mobile services business. The latest stage in Eircom's turbulent history since privatisation occurred from November 2005, when Swisscom made an approach to takeover Eircom. This was effectively vetoed by the Swiss Government. In May 2006 Eircom was sold to the Australian investment group Babcock and Brown.

**Lithuania:** market liberalised 1 January 2003. However, Lietuvos Telekomas remains the dominant supplier (latterly known as TEO LT AB). The Communications Regulatory Authority is the principal regulator of the industry. Today close to 50 companies or individuals have been authorised to provide public fixed telecommunications services in Lithuania, most providing retail services. Internet services are not regulated and there are around 115 suppliers providing internet services. By the end of June 2006, 11 service providers were offering public mobile telephone services in Lithuania (three network providers, 4 mobile virtual network operators, and four resellers). In February 2006 three 20 year licenses were awarded for 3G systems, to add to the country's three existing cellular network operators. Today mobile services account for about 47% of all of the revenues from telecommunications.

**Malta:** the national telecommunications service provider was partly-privatised in June 1998 through a 40% sale of Maltacom shares via a public offering, 20% on the domestic market and 20% on the international market. At first Maltacom retained a monopoly in telephone services. But in 2000 a three-year plan was launched to liberalise the sector and a second operator entered the market offering mobile telephone services. Cable television was liberalised in 2001 and in January 2003 international and fixed-line services were opened up to competition. The development of competition is overseen by the Malta Communications Authority, established in 2001. The MCA reports to the Ministry of Transport and Communications, while the shares in Maltacom are held by the Ministry of Economic Services, so as to minimise possible conflicts of interest within government. Malta's telecommunications legislation reflects the EU requirements aimed at eliminating obstacles to a single market in telecommunications services across Europe.

**Moldova:** the telecommunications sector is still dominated by the state-owned fixed-line operator, Moldtelecom. However, there has been some market liberalisation with 24 other operators authorised to provide fixed line services, although only five of these were active by the end of June 2005. The mobile communications market also lacks much competition, being shared between two operators, Voxtel and Moldcell.

**Monaco:** Monaco Telecom is 45% owned by the Principality of Monaco and the remainder of the capital was owned by the French company, Vivendi. It was founded in 1997 following the

privatisation of the Principality's incumbent public telecommunications operator. In 2004 (date to be confirmed) Vivendi's 55% stake was sold to Cable & Wireless (with C&W then agreeing to transfer 6% of the shares to a local financial partner, subject to certain put and call agreements). The purchase gave Cable & Wireless full management control of Monaco Telecom. Monaco Telecom retains exclusive rights to provide fixed line, mobile, internet services and cable services in the Principality. It has an international strategy to help ensure its survival and has invested in telecommunications services in Kosovo and Afghanistan.

**Oman:** telecommunications market remains monopolised by the state-owned company, Oman Telecommunications Company (Omantel).

**Slovakia:** fixed-line penetration is relatively low in the country but mobile penetration is reaching saturation. The market is dominated by the incumbent firm, Slovak Telecom (trading since March 2006 as T-Com Slovakia), although since early 2005 a number of interconnection agreements have heralded the arrival of more competition. Slovak Telecom lost its monopoly of voice telephony at the end of 2002 and by March 2004 there were 17 licensed operators of public telephone services and more than 70 licensed operators to install and operate telecommunications networks (by the end of April 2006 this had risen to 176). A new state-owned operator was set up in early 2001, formed through the merger of the fibre optic infrastructure of six state-owned utilities. Nevertheless, Slovak Telecom retained a 99% share of local and national calls in 2004. The mobile GSM market is run by a duopoly of operators – EuroTel Bratislava (now owned by Slovak Telecom and renamed T-Mobile Slovensko) and Globatel (majority owned by Orange SA, and now renamed Orange Slovensko). Attempts to entice in a third provider failed. Slovak Telecom was privatised in 2000 through a partial share sale with a further 15% of the shares due to be sold at the end of 2001. However, these plans were disrupted by the unfavourable international conditions for the sale of telecommunications stock at the time.

**United Arab Emirates:** the telecommunications market has been effectively monopolised by the state-owned company Emirates Telecommunications Corporation (Etisalat). However, in 2007 the company loses the monopoly it has held for the last 30 years, when a second operator, called "du", will start mobile services in the country. In October 2006 the new regulatory body for telecommunications, the UEA Telecommunications Regulatory Authority (TRA), ruled against Etisalat for anti-competitive behaviour. Etisalat had tried to pre-empt the arrival of competition by offering customers a discount on their mobile services if they signed up for a year. In preparation for competition at home, Etisalat has also been investing in telecoms companies elsewhere, in the Middle East, Africa and Asia. Its ambitious aim is "To be counted among the top 10 telecom operators in the world by 2010".

**Qatar:** the telecommunications market remains monopolised by the state-owned company, Qatar Telecom (Q-tel).

## Appendix 4: Legal advice on the protection of employee terms and conditions

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### ADVICE TO THE SCRUTINY SUB-COMMITTEE IN RELATION TO ASPECTS CONCERNING THE SALE OF JERSEY TELECOM LIMITED

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#### Advice Requested

1. 1. Set out in full in the schedule to this advice.

#### Summary of Conclusions

2. 2. The proposed sale of Jersey Telecom Limited is by way of a sale of its *shares*, so the employees' terms and conditions and collective agreements with the unions remain unaltered in law. The English legislation known as "TUPE" is designed to cater for the situation where a company sells part or all of its *business* operations (rather than the company itself) and the employees would otherwise find themselves dismissed by reason of redundancy<sup>1[129]</sup>. Thus, in the present share sale situation, TUPE style legislation would not be relevant or applicable.
3. 3. There is a theoretical possibility that following its sale by the States, Jersey Telecom Limited could seek to sell its *business*, but in practice that would be present logistical problems and most likely would require separate legislation by the States. Hence, it is extremely unlikely that TUPE style legislation would ever be relevant to the sale of Jersey Telecom Limited. It is also worth noting in passing that TUPE and associated legislation provides little effective protection regarding pension provision in England.
4. 4. Perhaps the "real" question the Scrutiny Panel wishes to answer is to what extent the purchaser of shares in Jersey Telecom Limited could undermine employees' rights post sale? The legal answer (given that this is a share sale situation) is that any new purchaser of the shares is in exactly the same position as the States, so there is no loss of protection or rights. However, the factual concern may be that the Scrutiny Panel fears that a private sector purchaser will be more inclined to attack employees' rights, and the Panel may wish to know what can be done to fortify the employees rights from attack? In that regard, probably the best defence is for the States (presently as sole shareholder) to direct Jersey Telecom Limited to clarify any ambiguities in employees rights in the terms and conditions of employment, so that the employees have directly enforceable obligations against their employer. Other possible avenues for fortifying the employees' rights are also suggested.

#### Significance of a Sale executed by Share Sale

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<sup>1[129]</sup> Further, as Jersey law does not yet include any rights to redundancy payments, the effects of redundancy are harsher in the island.

5. 5. The incorporation of Jersey Telecom with a corporate structure was effected by the Telecommunications (Jersey) Law 2002 and the Telecommunications (Transfer) (Jersey) Regulations 2002. As a result of these changes, there is now a holding company, JT Group Limited, and underneath that there are several subsidiaries, one of which is Jersey Telecom Limited. Jersey Telecom Limited employs the telecommunications workforce formerly employed by the States of Jersey and formerly managed by the States of Jersey Telecommunications Board. It is noted that upon "corporatisation" of Jersey Telecom in 2003, every term and condition of employment and every collective agreement with the workforce was carried across to Jersey Telecom Limited<sup>2[130]</sup>.
6. 6. The States of Jersey are now consulting on the possible sale of Jersey Telecom. It is believed<sup>3[131]</sup> that the form of sale proposed will be a sale of *shares* in either Jersey Telecom Limited or JT Group Limited, as distinguished from a sale of the *business* belonging to either or both companies.
7. 7. The distinction is of vital importance to the relevance of TUPE<sup>4[132]</sup> as set out below, but for the purposes of this advice it makes little difference which entity<sup>5[133]</sup> is being sold, provided it directly or indirectly<sup>6[134]</sup> employs the workforce we are concerned with.
8. 8. A fundamental principle of company law is that a limited company is regarded as a legal person in its own right. A company can sue and be sued, it can own property and it can enter into contracts in its own name and such activities are unaffected by changes in the shareholders' identities or ownership of shares.
9. 9. Thus, since employees of a limited company such as Jersey Telecom Limited<sup>7[135]</sup> look to the company as the legal employer and are not directly interested in what individuals or corporate persons own the shares of the company, it follows that a change in share ownership has no legal consequence for the position of the employees. Their rights and obligations relate to the legal person that employs them, and that has not changed. This principle applies equally to a sale of all the shares, a majority shareholding or just a few shares of a limited company.
10. 10. Thus, as it appears the States intend to sell the shares of Jersey Telecom Limited (or its parent company) and the legal entity which employs the workforce therefore does not change, neither do any of the conditions of employment. The terms of employment of the workforce of Jersey Telecom Limited will therefore not be affected in strict legal terms by the sale of the shares in Jersey Telecom Limited to a new purchaser: however, the Scrutiny Panel's concerns may go further than that and this advice looks into the issues in more depth.

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<sup>2[130]</sup> Pursuant to Article 43 of the Telecommunications (Jersey) Law 2002 and Regulation 16 of the Telecommunications (Transfer) (Jersey) Regulations 2002, all employees of the previous Telecommunications Board became employees of Jersey Telecom Limited, with the same terms, conditions, rights and liabilities associated with their employment (subject to a right on the part of employees to opt out and resign, which had to be exercised before the transfer to the corporate structure became effective)..

<sup>3[131]</sup> From the "Discussion Paper issued by the Minister for Treasury & Resources on the Proposed Sale of Jersey Telecom", which refers *inter alia* to a divestment by the States of its shareholding [page 18; Form of Sale].

<sup>4[132]</sup> Defined below.

<sup>5[133]</sup> Jersey Telecom Limited or JT Group Limited.

<sup>6[134]</sup> Indirectly meaning through ownership of shares in a subsidiary company which employs the workforce such as Jersey Telecom Limited, for example. The shares being sold must ultimately carry with them the contractual rights of employment of the workforce.

<sup>7[135]</sup> It is assumed that Jersey Telecom Limited employs the workforce and the same company will be sold.

## The Significance of TUPE

11. 11. The position is different if a sale of the *business* of Jersey Telecom Limited is made instead. In this context, the sale of the “business” refers to the purchase of all<sup>8[136]</sup> the rights, obligations, assets and liabilities from Jersey Telecom Limited, leaving it as an empty shell<sup>9[137]</sup>. In such a scenario, the company would no longer have any requirement for its workforce, and the employees affected would fall within the definition of “redundancy” under the Employment (Jersey) Law 2005 and might validly be dismissed<sup>10[138]</sup>. It appears there would be no legal requirement for the purchaser of the business<sup>11[139]</sup> to take on the employees presently involved in the conduct of the business<sup>12[140]</sup>, and in fact the law makes clear that contracts of employment do not constitute a form of “slavery” where employees can be bought and sold by employers without their consent. Further, in the UK there are statutory rights to minimum redundancy payments which do not (yet<sup>13[141]</sup>) exist in Jersey, so in the absence of protection employees may be disadvantaged by a sale of the business of a company as distinguished from a sale of the company’s shares.
12. 12. This has led to the introduction of legislation in England & Wales known as “The Transfer of Undertakings (Protection of Employment) Regulations 2006” known as *TUPE* for short.
13. 13. The effect of the TUPE regulations is as follows. Where there is a relevant transfer of a business (which does not include by a sale of a company’s shares<sup>14[142]</sup>):
- (a) (a) employment is automatically transferred (unless the employee objects) with full continuity of service<sup>15[143]</sup>;
  - (b) (b) the employment is transferred on the same conditions – including trade union recognition but excluding pensions;
  - (c) (c) any dismissal arising due to the transfer is deemed automatically unfair (unless the reasons for the dismissal fall into narrowly defined set of circumstances designed to allow *bona fide* business restructuring commonly referred to as ETO reasons<sup>16[144]</sup>); and
  - (d) (d) employee representatives of both transferor<sup>17[145]</sup> and transferee<sup>18[146]</sup> must be consulted.

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<sup>8[136]</sup> Of course, not all the business of the company need be sold – any part of the business might be disposed of.

<sup>9[137]</sup> As distinct from purchasing the shares in Jersey Telecom Limited, in other words buying the “shell” itself which owns the business.

<sup>10[138]</sup> Albeit, that such dismissal would have to be performed fairly, including in accordance with a fair procedure.

<sup>11[139]</sup> As distinguished from a purchaser of the shares, who of course take the employees with the company purchased.

<sup>12[140]</sup> In the absence of protective legislation, it would appear that at common law, when a business undertaking is sold, the new employer is not bound to continue the employment of the employees, under the same or any terms, and nor are the employees bound to continue to their employment: *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] 3 All E.R. 549; applied in *Jersey* 1971 J.J. 1819; followed in *Jersey* 1966 J.J. 679.

<sup>13[141]</sup> It is understood such rights are to be introduced by the States.

<sup>14[142]</sup> For the reasons explained above.

<sup>15[143]</sup> Meaning existing terms and conditions are preserved.

<sup>16[144]</sup> Following the wording of the relevant European Community directive which dictated that the UK had to legislate on this area, the words being “Economic, Technical or Organisational” reasons.

<sup>17[145]</sup> ie: the seller of the business.

<sup>18[146]</sup> ie: the purchaser of the business.

14. 14. The TUPE regulations were introduced to provide protection for employees where the work they do is transferred away by their employer to a third party. However, it is important to note that TUPE does not provide complete protection, because it is acknowledged that there is a public interest in allowing businesses to restructure so that viability can be maintained. Thus:-
- (a) (a) The ETO exceptions permit dismissal of employees in circumstances defined by law; and
- (b) (b) TUPE expressly excludes protection of pension rights<sup>19[147]</sup>.
15. 15. The result of the exclusion of pension right protection from TUPE is that an employee whose employment is transferred on a relevant transfer seems to have no redress if the pension provision given by the new employer is inferior to that with the transferor<sup>20[148]</sup>. The lack of protection for occupational pension rights under TUPE has been a matter of some concern to employees affected by transfers.
16. 16. Accordingly, pension rights are now<sup>21[149]</sup> separately protected in England & Wales by the Transfer of Employment (Pension Protection) Regulations 2005. However, the scope of that protection is very limited. Employees who were members of an occupational pension scheme before a transfer are entitled to have a *scheme* provided by the purchaser, but there is no obligation on the purchaser to match the terms or value of the seller's scheme. The purchaser is free to choose the type of pension scheme (defined benefit, money purchase etc), provided that it meets certain basic standards under the Pension Schemes Act 1993<sup>22[150]</sup>. Earlier proposals that the purchaser's scheme should provide benefits of equivalent value to those of the pre-transfer pension scheme were abandoned. Many employees who enjoyed good defined benefit schemes prior to a transfer find the new legislation gives little additional protection.
17. 17. However, as observed above there is no suggestion that the *business* of Jersey Telecom (alone) is to be sold so strictly, TUPE and the Pension Protection Regulations would not be relevant<sup>23[151]</sup> to a share sale such as the sale of the shares of Jersey Telecom Limited as envisaged by the States.
18. 18. However, absent any contractual provisions restricting it<sup>24[152]</sup>, a purchaser of Jersey Telecom Ltd's shares could theoretically decide to "sell on" the *business* after having purchased the company's shares.
19. 19. The term "theoretically" is used above, because pragmatically, it is considered unlikely that a sale of Jersey Telecom Ltd's business would ever be contemplated without specific legislation being enacted by the States to achieve it.
20. 20. That is because a company such as Jersey Telecom Ltd enters into literally thousands of separate legal arrangements with its customers and suppliers in order to

<sup>19[147]</sup> TUPE 2006, reg. 10 excludes from the automatic transfer of terms and conditions anything to do with occupational pension schemes. TUPE 2006 Reg 10(2) defines this as restricted to provisions concerned with old age, invalidity or survivors' benefits, a clarification apparently designed to ensure that superior redundancy payment schemes linked to early retirement were not included.

<sup>20[148]</sup> *Walden Engineering v Warrener* [1993] IRLR 420 is an example where the English Employment Appeal Tribunal declined to go further than the strict rule of TUPE 1981.

<sup>21[149]</sup> From 6 April 2005.

<sup>22[150]</sup> In many cases, the minimum standard requires the purchaser to continue the seller's relevant contributions to a pension fund, up to a limit of six percent of basic pay.

<sup>23[151]</sup> If it took place in England.

<sup>24[152]</sup> Which would be extremely unusual, not least because it would destroy significant if not all value in Jersey Telecom if its shares could not be sold on to a third party.

conduct its business. Each individual customer with a JT account has a separate contractual obligation with the company. It is not necessarily straightforward to assign the benefits and obligations of those legal arrangements to other parties and if that is necessary, the common method is for a law to be passed by the legislature transferring them. Thus, it is most likely that if, after sale of its shares by the States, Jersey Telecom Ltd wished to transfer its business it would have to request the States to legislate to achieve it<sup>25[153]</sup>. (Which in turn, would effectively give the States a power to prevent it).

21. 21. Furthermore, it is believed that in the long run, TUPE type statutory protection is to be introduced in Jersey, which may provide some additional assurance<sup>26[154]</sup>.
22. 22. Accordingly, when the Minister for Treasury and Resources stated in the debate on Projet P.95/2006 that:-

***'I believe that we can bring into that contract sufficient safeguards at a sufficient level equally as good as would be under T.U.P.E. If I cannot do that, I shall not bring the proposition.'***

in relation to the sale of shares in Jersey Telecom Limited, he was correct – not least because TUPE is not relevant to a share sale situation (and in any event, English legislation provides minimal pension protection).

### The Real Question.

23. 23. Perhaps the real question which the Scrutiny Panel are wanting to know the answer to is whether employment benefits of Jersey Telecom Limited's employees are protected. It is noted that Senator Le Sueur stated, on 7<sup>th</sup> September 2006, before the Scrutiny meeting<sup>27[155]</sup>:-

***'I am willing to guarantee that I will not bring proposals to the States to sell Jersey Telecom unless employment benefits, at their current level, are protected.'***

24. 24. Again, in the strictly legal sense, employment benefits are protected at their current level. This follows by definition because upon a sale of the shares, the employees' rights remain identical. However, that is very different from saying that employment benefits are protected in such a way that they cannot be altered in future. In short, Jersey Telecom Limited is presently capable of varying the employment terms of its employees within constraints set by law, and that position will continue to apply if the shares in that company are owned by a different person.
25. 25. The next question is what variations of the terms and conditions of employment are possible? First, it is vital to note that we have not been supplied with or seen any terms and conditions of Jersey Telecom Limited employees, so this question cannot be answered with precision at present. However, useful advice can be given in relation to the general principles governing variation of employment contracts which then takes us into methods by which variations might be made more difficult for an incoming purchaser of the shares of Jersey Telecom Limited.

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<sup>25[153]</sup> Legislation could easily be drafted in similar terms to Part 8 of the Telecommunications (Jersey) Law 2002, which originally provided for the transfer from the Board to the corporate entities during "corporatisation".

<sup>26[154]</sup> Depending upon present progress and the timescale for introduction.

<sup>27[155]</sup> Source: as stated in our instructions.

- (a) (a) A contract of employment is treated in the same way that all contracts are treated under Jersey law, albeit that there are now various statutory minimums which will operate to govern what is required to be included<sup>28[156]</sup>. In summary, *la convention fait la loi des parties* is an oft-used maxim of Jersey law denoting *inter alia* that contractual obligations between parties arise by agreement between them. The terms of an employment contract may therefore be varied in the same way that any other contract may be so, that is by mutual agreement. Thus, a bi-lateral (i.e. between two people) contract may not be unilaterally varied (i.e. by one party alone without the consent of the other) in the absence of an existing variation clause to this effect within the employment contract.
- (b) (b) Variation clauses work on the basis that the parties originally agreed to allow unilateral variations at the outset<sup>29[157]</sup>. Variation clauses, usually in stated circumstances, are not uncommon though will often be viewed with suspicion by courts and tribunals and numerous arguments may be made against their enforcement. Thus, in practice, in many circumstances the employer has a right to make unilateral variations to its employees' terms and conditions of employment within the bounds acceptable by law.
- (c) (c) Describing the bounds permitted by law in relation to variation clauses is not easy, as the law lacks precision. Variation clauses will often be very widely drafted, and so may sometimes be challenged on the basis of uncertainty or *contra proferentem*<sup>30[158]</sup> (see *Bainbridge v. Circuit Foil UK Ltd* [1997] ICR 541). It might otherwise be argued that the clause permits only minor changes (argued by counsel and accepted by the English EAT in *United Association for the Protection of Trade v. Kilburn* (LEXIS Transcript, EAT 787/84), or that it must only be brought into operation in good faith and inherently requires renegotiation rather than simple unilateral change. Such a clause might also be said to go against the very purpose of a bi-lateral contract, or that reliance on the term in a particular way breaches the mutual trust and confidence between the parties. It is important to note, however, that notwithstanding the availability of such arguments, express terms will often be favoured by the courts for their certainty and variation clauses may be accepted simply because they appear in the contract in black and white. This is perhaps more likely to be the case in Jersey where the maxim *la convention fait la loi des parties* is often referred to and the courts are not used to disregarding contractual terms in the absence of statutes limiting unfair contract terms<sup>31[159]</sup>.
- (d) (d) Even in the absence of a variation clause as described above, the relative positions of employers and employees, and the inherent unequal bargaining power between the two, will often mean that the employee will have less influence on their terms of employment. In practice, employees may either agree to alterations in terms and conditions or fail to object to them within a specified time.

26. 26. Given that variations of Jersey Telecom Limited's employees' contracts of employment may be permissible as described above, the next issue is what steps might be taken to protect them?

27. 27. As correctly stated in the instructions, due to the principle of privity of contract, the employees themselves would not be parties to the contract of sale of the shares of Jersey

<sup>28[156]</sup> Such as to wages, paid leave entitlement, and rest periods: Employment (Jersey) Law 2003.

<sup>29[157]</sup> Theoretically, therefore, the variation is by mutual consent although the employee's consent was to allow future variations rather than the specific variation ultimately being sought.

<sup>30[158]</sup> Against the favoured party, which in relation to variation clauses is most likely to be construed against the employer.

<sup>31[159]</sup> Justice in our Time: The Problem of Legislative Inaction - Timothy Hanson, Jersey Law Review, Volume 6 Issue 1 February 2002

Telecom Limited and therefore would not be in a position to enforce any terms included in it for their benefit<sup>32[160]</sup>. At issue, then, is the mechanism for employee protection (whether in the sale agreement or outside it). The precise rights protected, the best mechanism for those rights and whether such protection will be commercially acceptable to a purchaser would need to be addressed in due course. There are, however, the following possibilities in principle:

- (a) (a) Existing staff contracts could be scrutinised<sup>33[161]</sup> with a view to including in them, prior to the sale, new rights which would give more certainty of the employees' accrued rights and which, therefore, would be more difficult to dismantle. For example, specific rights to a final salary pension scheme of a particular benefit level could be unambiguously included<sup>34[162]</sup>. Whether this is feasible, or economically possible given the desire to achieve the best price possible for Jersey Telecom, would depend on the nature of the specific rights involved<sup>35[163]</sup>. Variation clauses within existing contracts of employment (if any) could be carefully analysed to see if they should be curtailed or even removed completely.
- (b) (b) Prior to the sale, the corporate structure could be revised so as to grant the States a continuing interest in Jersey Telecom Limited by way of a "golden share". This would require amendment to the Articles of Association and probably the 2002 Regulations. The "golden share" would not carry any rights, economic or otherwise, except as necessary to allow the States to veto particular matters of concern. The question here is whether such a continuing interest on the part of the States would be commercially acceptable to a purchaser. Also, whether the States exercised that veto at the time in question would seem to be a matter for the States assembly at the relevant time. The protection afforded by this route could, however, protect future as well as existing employees.
- (c) (c) It could be made a "condition precedent" to completion of the sale that the purchaser enter into binding obligations directly with each of the employees setting out any relevant matters. If the mechanism of a formal condition precedent is used, this means that the sale agreement itself would require those undertakings to be given to the employees by the purchaser before the purchaser was finally entitled to acquire the shares: thus the States would not be obliged to complete the sale until it had evidence that this had been done. In the case of a share sale, the purchaser would not itself be the employer, which would remain Jersey Telecom Limited; accordingly, the undertaking would need to be expressed as an undertaking to procure that Jersey Telecom Limited do or refrain from doing any such relevant matter in the future.
- (d) (d) The desired protection could be written into the sale contract with the States expressed to be acting as agent for present and future employees or alternatively as trustee of the benefit of any rights expressed to be created in their favour. This raises a number of legal issues that would need to be looked into and it cannot be said it would be of certain legal effect, but it would appear to be a possibility in principle. Unlike options (a) and (c) it would, if effective, operate for the benefit of future as well as present employees.

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<sup>32[160]</sup> This is a simplification of the position but suffices for the purposes of this advice.

<sup>33[161]</sup> It is noted that no contracts have been made available or reviewed in giving this advice but it would, for example, be unusual for closely defined pension obligations to be explicitly written into terms and conditions of employment

<sup>34[162]</sup> If they are not already – see above.

<sup>35[163]</sup> And final salary pension rights are becoming notoriously expensive to provide, and would doubtless devalue the sale price significantly.

28. 28. The States are in a position to insist that Jersey Telecom Limited implement any or all of the possibilities outlined in the foregoing paragraph, being the sole shareholder in the company and therefore in a position to control meetings of the company and direct or replace the directors at will<sup>36[164]</sup>.

## Miscellaneous Other Matters

29. 29. In paragraph 18. ~~However, absent any contractual provisions restricting it<sup>[152]</sup>, a purchaser of Jersey Telecom Ltd's shares could theoretically decide to "sell on" the business after having purchased the company's shares.~~ above, it was noted that after the sale of Jersey Telecom Limited's shares, the *business* belonging to the company could be sold on. Our instructions also ask whether the shares could be sold on, and the answer is "yes", subject to any clauses preventing sale (the so called "golden share" method referred to above is the most common mechanism). A further onward sale might affect the States' ability to protect any employment rights as the States would not be a party to the onward contract of sale (and there would be no privity of contract). However, there are a number of mechanisms which might be employed to ensure that the States always retained a veto over future sales and/or required prior permission, so this problem is not insurmountable. The practical problem with inserting such clauses is that they inevitably devalue the sale price of Jersey Telecom Limited.
30. 30. Our instructions ask:- "***The Panel envisages that there may be occasions when a purchaser of Jersey Telecom would, for economic, technical or organisational reasons, wish to vary the terms and conditions applicable at the time of sale, perhaps within 2 years. It would like to know whether the current legal position is that the purchaser would have to seek agreement only with the States of Jersey on such variations.***"
31. 31. At present, there appear to be no legislative constraints upon Jersey Telecom Limited to seek the agreement of the States of Jersey to vary staff terms and conditions, but it is noted that Telecommunications (Transfer) (Jersey) Regulations 2002 had the effect of transferring any collective agreements previously vested in the Board to that company. There may, therefore, be agreements which we have not seen which are capable of creating an obligation to seek States' approval. It is noted that the question is phrased in terms of seeking agreement "only" with the States of Jersey, implying that the question extends to third parties (perhaps employees). As per the discussion above regarding an employer's rights to vary a contract of employment, depending upon the drafting of the employment terms and conditions of the workforce, agreement might be required of the employees. However, if rights are ill defined and/or discretionary (as often happens with bonus payments which are usually wholly discretionary, and pension rights which seldom define precise benefits) the employer may be able to make changes without employee consent insofar as they are not in legal terms taking anything away. The answer to this is for the States to ensure that rights are defined with precision in the terms and conditions of the workforce prior to sale and/or employ some of the other mechanisms set out above to ensure that consultation with the States is required.
32. 32. Our instructions ask:- "***If that were the case, and if both sides failed to reach agreement on the proposed changes, the Panel wonders whether the States of Jersey would be required to commit to potentially expensive court proceedings in order to enforce the original terms and conditions.***"

**Deleted:** 18. However, absent any contractual provisions restricting it<sup>[152]</sup>, a purchaser of Jersey Telecom Ltd's shares could theoretically decide to "sell on" the *business* after having purchased the company's shares.

<sup>36[164]</sup> Absent any rules pertaining to those issues in the memorandum and articles of association of the company, which have not been inspected.

33. 33. Ultimately, the only way for the States to enforce obligations in the absence of other methods is to resort to the Courts to request enforcement of whatever contractual terms are being breached. However, it is common for parties to set out other methods of settling disputes in contract, such as a binding arbitration procedure. The Courts uphold such alternative dispute resolution agreements (known as “ADR”), which are, therefore, binding upon the parties. Often ADR is designed to achieve a resolution at lower cost (generally, by reducing the parties rights to air their disputes so fully).
34. 34. Our instructions ask:- ***“Irrespective of whether or not the purchaser might attempt to alter the terms and conditions agreed at the point of privatisation, the Panel would like clarifications as to the position of the next Minister for Treasury and Resources. Would he or she be legally obliged to enforce the policy of the previous Minister?”***
35. 35. It is believed that this question in effect asks whether a Minister could agree to waive obligations owed by a purchaser to a former Minister/the States with regard to maintaining the employment rights of Jersey Telecom Limited’s employees.
36. 36. The fundamental starting point is that it is a generally accepted principle of constitutional law that the legislature cannot bind a future legislature: it is a fundamental tenet of the British legal interpretation of democracy that the elected representatives must be free to legislate at any given time<sup>37[165]</sup>.
37. 37. States of Jersey Ministers derive their powers from the States itself and as such, cannot exceed any powers of the States. It therefore appears that (in purely constitutional terms) a Minister could not bind a future Minister’s freedom to act.
38. 38. Of course, Ministers do not have absolute freedom to act in all circumstances and will be bound by the private and public law of the Island. However, in the hypothetical circumstance posed, the States would be a beneficiary of an obligation by the purchaser to maintain certain employment benefits for employees. In circumstances where that obligation was owed only to the States/Minister, the States/Minister would have the right to choose to forgo the benefit of that obligation. Accordingly, it is believed that a future Minister would not be legally obliged to enforce the policy of the previous Minister.
39. 39. However, there may be additional circumstances where private law rights owed to individuals could intervene to force a future Minister to exercise his discretions in a particular way. For example, the doctrine of legitimate expectations can arise where the States/Ministers publish a policy which is relied upon by an individual who alters their position<sup>38[166]</sup> on it to their detriment. One can imagine that statements regarding pension policy might be capable of initiating a legitimate expectation in Jersey Telecom employees, but the position is far from certain<sup>39[167]</sup>. In the circumstances, the best advice to the Scrutiny Panel is that such private rights are very dependent on circumstances and cannot be relied on with any certainty. It is therefore prudent to proceed on the basis that a future Minister would not be bound to enforce the employment rights given to Jersey telecom Limited employees.
40. 40. Our instructions ask:- ***“The United Kingdom’s Transfer of Undertakings (Protection of Employment) Regulations 1981 and 2006 (TUPE) is understood to place both obligations and sanctions on all parties concerned in the transfer of an***

<sup>37[165]</sup> Based upon *Dicey’s* model of the British constitution which, although criticised by some, remains the prevailing view.

<sup>38[166]</sup> Usually through the expenditure of money.

<sup>39[167]</sup> There may be some difficulties in finding a change in position within the definition required by law, as the employees would probably still derive the full benefit from their income, but not derive as much benefit from the employer’s contribution, but the employees would not have themselves acted in any different way.

**undertaking, including employees and their representatives. The Panel seeks confirmation as to whether, in the event of an alleged breach of contract or an attempt to vary the terms of a contract, TUPE requires that any negotiations on such matters in the United Kingdom would automatically involve employee representatives, thereby providing a much tighter system for 'guaranteeing' that terms and conditions for employees are met."**

41. 41. In circumstances where TUPE applies in the United Kingdom, it does impose a requirement to automatically involve employee representatives. However, as set out above the sale of Jersey Telecom Limited is being executed by share sale, so TUPE would not apply if the sale were happening in the UK (nor if TUPE style legislation were brought into effect in Jersey). If a sale of the *business* of Jersey Telecom Limited were being effected, it is arguable that the involvement of employee representatives might assist to protect employees in a negotiation situation, but it should also be borne in mind that TUPE does not assist greatly in the preservation of pension rights as described above.
42. 42. Our instructions ask:- ***"In the event that the States of Jersey elected to adopt legislation identical or similar to the United Kingdom TUPE Regulations, the Panel would like to know - a) whether this could provide the required tighter guarantees as outlined above..."***
43. 43. No - the answer immediately above is repeated.
44. 44. Our instructions ask:- ***"In the event that the States of Jersey elected to adopt legislation identical or similar to the United Kingdom TUPE Regulations, the Panel would like to know - ... b) whether the sale of a States owned utility, via mechanisms such as an IPO or a trade sale, would constitute a transfer of undertaking affected by that legislation."***
45. 45. As stated above, TUPE does not apply to any share sale situation such as envisaged with the sale of Jersey Telecom Limited.
46. 46. Our instructions ask:- ***"In the matter of pensions regulations affecting Jersey Telecom workers, the Panel has a series of questions. These are - ...a) what legislative changes have been required to enable existing JT workers to enter or to remain in the PECRS pension scheme post sale?"***
47. 47. It is noted that the document entitled *"Discussion Paper issued by the Minister for Treasury & Resources on the Proposed Sale of Jersey Telecom"* states at page 14 that Jersey Telecom Limited became an admitted body to PECRS. At page 15 of the same document, it is questioned whether Jersey Telecom may remain an admitted member of PECRS following sale, apparently due to the favourable tax position enjoyed by PECRS as a result of there being no private company participating in the PECRS scheme. It therefore appears that the legislation required was simply legislation designating Jersey Telecom Limited in such a way that it could be admitted to the PECRS scheme but that the real impediment to it remaining will be the administrative inconvenience of separating the private sector participants from the public sector participants. Presumably this is why either exit or establishing a new "ringfenced" (ie: separated) scheme are the discussed options.
48. 48. Our instructions ask:- ***"In the matter of pensions regulations affecting Jersey Telecom workers, the Panel has a series of questions. These are - ...b) would it be legally possible to enable persons newly employed by Jersey Telecom following a sale to enter the PECRS scheme?"***
49. 49. As previously advised, the PECRS scheme has not been researched in order to save on costs and due to its complexity, but as the indication is that the difficulty with

PECRS is the private/public sector nature of its participants, unless a mechanism is found (eg. ringfencing) it seems unlikely that new employees could be admitted. But obviously, if a suitable mechanism is introduced, conversely it would appear that (save for resourcing issues) there would be no bar to new employees joining.

50. 50. Our instructions ask:- ***“In the matter of pensions regulations affecting Jersey Telecom workers, the Panel has a series of questions. These are – ...c) In the event that the States of Jersey was able to include the option of continued membership of PECRS for workers as a condition of contract, to what extent would Jersey Telecom workers enjoy a legally enforceable right to become involved in any negotiations, prompted by the purchaser, to change that condition of contract?”***
51. 51. This is answered in the extensive sections above dealing with the significance of the share sale process, TUPE, the real question and the possible mechanisms for providing additional protection.
52. 52. Our instructions ask:- ***“In the matter of pensions regulations affecting Jersey Telecom workers, the Panel has a series of questions. These are – ...d) Following the decision of the States to approve the draft Employment Relations Amendment (Jersey) Law 200- (P.5/2006) earlier this year, is it the case that, when the Law is enacted, any future purchaser of Jersey Telecom will be legally required to recognise the trade union Amicus and would have therefore been unable to make changes to employee terms and conditions without having first entered into negotiations with Amicus?”***
53. 53. When enacted, any trade union which has registered under the Law will have clear legal status and Jersey Telecom Limited will have to recognise<sup>40[168]</sup> such a union under the Law.
54. 54. The Law will not compel the employer to enter into prior negotiations with a union, unless a collective agreement is already in place between Union and employer. If so, and a dispute arises in relation to *inter alia* the terms of employment of one or more employees, a “Collective Employment Dispute” will arise within the meaning of the Law.
55. 55. Presumably, a dispute can only formally arise when the employer makes a proposal, eg. upon presentation of variations to terms and conditions with a request to agree them, which the employees then refuse to agree to.
56. 56. At that point, the parties may mutually agree to negotiate, but if either party does not agree to do so, they cannot be compelled to negotiate. However, it will be open to either party as a last resort to refer the Collective Employment Dispute to the Employment Tribunal. The Tribunal will be able to make a declaration including incorporation of terms and conditions into the employees’ employment contracts which can ultimately be enforced before the Royal Court.
57. 57. Thus, although the Employment Relations Amendment (Jersey) Law 200- will not directly compel Jersey Telecom Limited to negotiate with Amicus regarding disputes over terms and conditions, Amicus would be in a position to force the issue into an adjudication of the legal issues before the Employment Tribunal and that adjudication may in effect be binding. Thus, Jersey Telecom Limited would in fact have an incentive to negotiate in practice (even if only to avoid the threat of a Tribunal hearing).

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<sup>40[168]</sup> “Recognise” in the sense that it cannot ignore the status of any registered union in accordance with the terms of the Law.

Hanson Renouf  
19 Britannia Place  
Bath Street  
St Helier  
Jersey

.....  
**Mark Renouf**  
**Advocate**

15<sup>th</sup> December 2006

## **SCHEDULE: INTRUCTIONS RECEIVED FROM THE SCRUTINY SUB-COMMITTEE.**

On 7th September 2006 Senator T.A. Sueur gave a speech in his capacity as Minister for Treasury and Resources at an open Scrutiny meeting. During that speech the Minister said -

'I am willing to guarantee that I will not bring proposals to the States to sell Jersey Telecom unless employment benefits, at their current level, are protected.'

Records of the States debate on Projet P.95/2006, entitled 'Employee Protection', show that the Minister for Treasury and Resources stated -

'I believe that we can bring into that contract sufficient safeguards at a sufficient level equally as good as would be under T.U.P.E. If I cannot do that, I shall not bring the proposition.'

The Panel has received information which tends to suggest that the Minister may not in fact be in a position to protect the term and conditions, including the pension rights, of Jersey Telecom employees because Jersey does not have relevant legislation in place to provide that protection. It therefore seeks clarification as to the extent to which the Minister could legally safeguard the employment benefits of Jersey Telecom staff, and specific details of the mechanism or mechanisms through which the Minister could deliver on this commitment.

The Panel appreciates that this subject is potentially rather broad. I have therefore outlined some of the more specific questions that the Panel seeks guidance on as part of an answer to the overarching question outlined above.

The Panel's understanding is that, under Jersey law, privacy of contract dictates that only the parties to the contract are entitled to pursue enforcement of the terms within it. In the case of a contract dictating the terms and conditions for a sale of Jersey Telecom, the Panel is concerned that only the States of Jersey or the purchaser could bring an action following alleged breach or variance of that contract. It therefore wishes to know whether parties who may consider that they have an interest post sale, such as employees, would have any right to take action to enforce the terms of such a contract.

In the event that Jersey Telecom is privatised, the new owner or owners would presumably have the absolute right to sell the company on. The Panel is therefore keen to establish whether a further onward sale would affect the ability of the States of Jersey to prevent erosion of any employment rights protected as part of the original privatisation.

The Panel envisages that there may be occasions when a purchaser of Jersey Telecom would, for economic, technical or organisational reasons, wish to vary the terms and conditions applicable at the time of sale, perhaps within 2 years. It would like to know whether the current legal position is that the purchaser would have to seek agreement only with the States of Jersey on such variations. If that were the case, and if both sides failed to reach agreement on the proposed changes, the Panel wonders whether the States of Jersey would be required to commit to potentially expensive court proceedings in order to enforce the original terms and conditions.

Irrespective of whether or not the purchaser might attempt to alter the terms and conditions agreed at the point of privatisation, the Panel would like clarifications as to the position of the next Minister for Treasury and Resources. Would he or she be legally obliged to enforce the policy of the previous Minister?

The United Kingdom's Transfer of Undertakings (Protection of Employment) Regulations 1981 and 2006 (TUPE) is understood to place both obligations and sanctions on all parties concerned in the transfer of an undertaking, including employees and their representatives. The Panel seeks confirmation as to whether, in the event of an alleged breach of contract or an attempt to vary the

terms of a contract, TUPE requires that any negotiations on such matters in the United Kingdom would automatically involve employee representatives, thereby providing a much tighter system for 'guaranteeing' that terms and conditions for employees are met.

In the event that the States of Jersey elected to adopt legislation identical or similar to the United Kingdom TUPE Regulations, the Panel would like to know -

- a) whether this could provide the required tighter guarantees as outlined above, and
- b) whether the sale of a States owned utility, via mechanisms such as an IPO or a trade sale, would constitute a transfer of undertaking affected by that legislation.

In the matter of pensions regulations affecting Jersey Telecom workers, the Panel has a series of questions. These are -

- a) what legislative changes have been required to enable existing JT workers to enter or to remain in the PECRS pension scheme post sale?
- b) would it be legally possible to enable persons newly employed by Jersey Telecom following a sale to enter the PECRS scheme?
- c) In the event that the States of Jersey was able to include the option of continued membership of PECRS for workers as a condition of contract, to what extent would Jersey Telecom workers enjoy a legally enforceable right to become involved in any negotiations, prompted by the purchaser, to change that condition of contract?
- d) Following the decision of the States to approve the draft Employment Relations Amendment (Jersey) Law 200- (P.5/2006) earlier this year, is it the case that, when the Law is enacted, any future purchaser of Jersey Telecom will be legally required to recognise the trade union Amicus and would have therefore been unable to make changes to employee terms and conditions without having first entered into negotiations with Amicus?

## Appendix 5: Will the Value of JT Decline?

The Minister's discussion paper hints strongly that the value of Jersey Telecom is at its peak and that now is the right time to sell. Privatising now, it is suggested, might allow the States to achieve the highest possible value from Jersey Telecom in cash terms for the people of Jersey. Otherwise competition, then falling revenues and increasingly expensive rounds of investment, will erode the value of the company. A full sale of the company to a global, telecoms operator is offered as the only viable way forward.

While the arguments may at first sound highly plausible, the Panel has discovered that the Minister is in fact basing his views on little more than a 'hunch'. During a public hearing he admitted –

***'This is unsubstantiated, just a gut feeling, but I suspect you are going to see greater emphasis on larger companies and less on small companies on a worldwide basis because of the nature of the market.'*<sup>1[169]</sup>**

### The Current Position

Anyone reviewing the recent history of Jersey Telecom could be forgiven for wondering how Jersey Telecom could be regarded in such negative terms. In terms of keeping up with the pace of change in the telecoms industry, JT appears to have performed very well.

On 1st June 2006, JT launched the Island's first 3rd generation (3G) mobile service, thereby offering the prospect of video calls and faster data download speeds. Rollout of this technology was being achieved in a similar timeframe to that in which companies in the United Kingdom, such as Vodafone, were operating (although Manx Telecom had by then begun to operate an even more advanced mobile network).

JT has committed to a programme of investment in Voice over Internet Protocol (VoIP) infrastructure, widely regarded as a highly important maturing technology underpinning next generation fixed and mobile networks. In November 2006 JT announced that it had decided to invest a further £7 million in a new submarine fibre optic cable link. Arguably the only significant area where JT was beginning to lag behind jurisdictions such as the UK was in terms of the broadband download speeds offered on its residential lines, which were rated at up to 2 megabits per second at a time when many districts within the UK were able to benefit from maximum speeds of between 4 – 8 megabits per second. Yet even here JT might reasonably argue that it has performed to a very high standard. For example, its customers do not appear not been

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<sup>1[169]</sup> Transcript of Minister of Treasury and Resources, dated 19th Dec. 2006 - p.27

plagued with the quality of service issues that surfaced regularly in UK media reports during the latter half of 2006.<sup>2[170]</sup>

Funding for JT's ongoing programme of investment had been found without the company having to incur any long-term debt (beyond the 9% preference shares held by the States) notwithstanding that it was free to borrow both from the States and / or from the private sector. This positive state of affairs was acknowledged by the Minister of Treasury and Resources in his discussion paper, which contained the following statement -

***“The company has maintained a strong balance sheet which places it in a sound position to fund investment in its Next Generation Network (“NGN”) and 3G mobile network rollout, whilst allowing it to support a strategy of addressing competition in the Jersey and Guernsey markets arising from the presence of additional operators.”***

Put simply, there is compelling evidence that, in spite of its small size, JT has, in recent years and in both States run and incorporated form, been fully capable of supplying the Island with high quality telecoms products and services at competitive prices. At the same time it has generated significant income for the States of Jersey (over £20 million in tax and dividends in 2006).

If the company has to date been able to offer modern technologies, a high standard of customer service, a good rate of return to the shareholder and has still been in a position to generate sufficient revenues to fund a laudable programme of ongoing investment – then why sell it?

### **Technological Change**

According to the Board of Jersey Telecom, the technological changes facing the company are becoming more and more challenging. The factor that is reportedly driving the market is known as ‘convergence’. Jersey Telecom claims–

***‘what we are seeing is a convergence of technologies, based on the IP world, the internet, where people will have the single device, and we have probably all been hearing about this for 10 or 15 years, but this is becoming a reality now’.***

Convergence has various definitions but it commonly refers to the provision of traditional voice calls, high speed internet access and provision of media content (such as music and TV programmes) on a single network. Some refer to this model as the ‘triple play’, while the provision of wireless access to these services gives rise to the term ‘quadruple play’.

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<sup>2[170]</sup> E.g. see <http://news.bbc.co.uk/1/hi/uk/6145738.stm>

Convergence is based on two simple premises –

- a) a) that customers will want to source all these services from one company,  
and
- b) b) that they want to access that content using a single device.<sup>171[171]</sup>

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In truth, both premises are the subject of widespread debate and even a cursory internet search reveals a sufficient number of papers and media reports to show that even some within the industry question whether the current level of industry hype is justified. In November 2006 the CEO of BT Global Services said –

***'The overall feeling is that because the pieces are moving around, you have to have all the pieces. I personally reject that.'***<sup>172[172]</sup>

Any search would also reveal that convergence has been hyped consistently over a number of years. There were twelve separate references to it in the report produced in 1999 for Guernsey Telecom by industry consultants Analysys, which called for 'rapid action' in order to meet the threat to traditional revenues that convergence posed. Of course, six years on the damage done to JT's profit margins does not appear to have been significant.

Nevertheless, the contention today is that convergence is much more of a threat. At a basic level that threat is greater because of another industry buzzword; '*bandwidth*'.

According to JT Managing Director Bob Lawrence–

***'this industry is all about bandwidth now – [it] is a critical factor... Everything is digital now... That is what is changing... the price of transporting bits is a commodity now, and I think there is even a futures market in it if you want to play in there.'***<sup>173[173]</sup>

In a telecoms context, bandwidth relates to the measurement of the volume of data that can be transferred from one location to another and within a particular timeframe. Increased bandwidth (or, put another way, the wider the data 'pipe') means more data can be pushed along it at a given point in time.

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<sup>171[171]</sup> See 'Convergence, or just a tangled mess of ideas?' – David Perry and Dale Vile [www.freeformdynamics.com](http://www.freeformdynamics.com) Sept. 2006

<sup>172[172]</sup> [www.silicon.com](http://www.silicon.com) – 'Is convergence unstoppable?', 30th November 2006

<sup>173[173]</sup> Transcript of public hearing attended by Board of Jersey Telecom – 25th September 2006 – p.23,45

The reference that 'everything is digital now' is important because it refers to that fact that so many different types of content are being disassembled to the same common denominator (digital bits) in order that they can all be transported along the same line and received by the consumer at the other end. That content currently includes music files, e-mails, business news articles and more. Bandwidth has increased (and is continuing to do so) to the extent that TV programmes and even feature films can be downloaded. Importantly for JT, the combination of increased bandwidth and maturing Internet technology has already reached a point as which it can sustain voice call traffic with increasing reliability.

At the moment the consumer might rely on various devices in order to reassemble those digital bits back into content. TV programmes are watched on a TV. Phone calls are taken on a fixed or a mobile telephone. Music can be physically bought on CD or bought over the Internet using a PC. Businesses can obtain the market data they need from several sources, including TV broadcasts and the internet. The suggestion is that the advent of a converged, high capacity network transferring data using standardized technology leaves the way clear for a single device to receive the content at the consumer end.

### **Convergence – or Not?**

In fact the concept of a single device and a single 'shop' to buy content from are the very reasons why the convergence model, which lies at the very heart of the Minister's contention that the value of JT will fall, has rather vocal critics. Market trends to date also suggest that the prospect of accessing multiple services on a single device may have limited consumer appeal. In July 2006 the number of mobile phone owners in the UK using their mobiles as portable music players was estimated at just 3 per cent<sup>174[174]</sup>. Although this market reportedly shows signs of growth, other recent product developments offered as a result of higher bandwidths and converged networks have been far less successful. The Internet contains conflicting reports on the popularity of mobile picture messaging, while in December 2006 Telefónica reportedly postponed the worldwide launch of its mobile TV service on the grounds that consumers didn't seem particularly interested.<sup>175[175]</sup>

For businesses, information security and operational resilience are both important matters. The convergence model causes fundamental problems for both. If the single

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<sup>174[174]</sup> Survey conducted by m:metrics – [www.mmetrics.com](http://www.mmetrics.com)

<sup>175[175]</sup> [http://www.theregister.co.uk/2006/12/08/telefonica\\_delays\\_tv/](http://www.theregister.co.uk/2006/12/08/telefonica_delays_tv/)

network fails, companies can lose their market data and their ability to speak to customers at the same time, while the existence of a single method of transferring information leaves criminals with only one network to 'hack' in order to access secure data.

Then there is the customer service issue. In a media article, published in November 2006, David Tansley, a technology partner at Deloitte commented –

***'Offering multi-play solutions has its challenges – as customers are more dependent and attached, customer service has to be flawless. Telecoms is not really known for it.'***<sup>176[176]</sup>

In truth, the rate of change affecting the telecoms industry in 2006 – 07 remains high, just as it was five years, and even ten years, previously. Although the current drive for convergence, and the industry consolidation which it is fuelling, appears very real there are definite question marks over whether this market phenomenon will truly become a reality. Yet the convergence concept lies at the heart of the Minister's concern that the value of JT may fall in future years. With this in mind, the Panel has considered the specific challenges allegedly facing JT.

### **Will JT's existing revenue streams decrease through competition?**

It appears that the anticipated loss of market share to C&W Jersey and to Jersey Airtel is the Minister's primary issue of concern. Moreover, the predicted impact of this new competition in the short term is cited as the reason why the Minister wishes to sell, and sell quickly. On 7th September 2006 he said –

***'I believe that we all, or indeed you all, face a far more secure future by selling Jersey Telecom as soon as possible to a larger operator rather than prevaricating and delaying until much of the value of Jersey Telecom may be lost. That delay not only reduces the share price, but more importantly, that delay puts jobs at risk... from an investment point of view the value of Jersey Telecom as a company is inevitably going to decline as its share of the market declines'***<sup>177[177]</sup>

The Minister's argument assumes that the effect of competition from both Cable & Wireless and Jersey Airtel will be particularly detrimental to JT. As previously stated, it also assumes that any potential purchaser, when valuing the company, will fail to take into account any potential future negative effect on market share caused by competition. Third, it assumes that telecoms markets already accessible to JT have limited potential for further expansion.

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<sup>176[176]</sup> [www.silicon.com](http://www.silicon.com) – 'Is convergence unstoppable?', 30th November 2006

<sup>177[177]</sup> Transcript of public meeting held on 7th September 2006 at Hautlieu School, p. 4, 19

## **Market Trends**

In fact the Panel has discovered that the general trend in telecoms markets around the globe is actually one of growth. Furthermore, and as highlighted in **Chapter 2**, the Panel's adviser has explained that incumbent operators in other jurisdictions have tended to retain the largest market share in their respective markets. Although Scrutiny was only able to access accounts summarizing the effect of the first 3 months of competition in Jersey's mobile sector, the Panel's adviser was unable to find any evidence that JT's position in the short to medium term would differ markedly from this trend.

The scenario of new competition in the Island's telecoms sector causing an increase in the number of products and services available to the public (thereby expanding the size of that market) is considered by the board of JT to be a 'reasonable' one, although Managing Director Bob Lawrence considers that there are practical limitations. He explains –

***'[The] market here is incredibly saturated in terms of the level of penetration of service. One only has to look at the mobile [market] where - and I hate it when percentages go this way – [there is] 116 per cent penetration... and the broadband network, we are up to 46 per cent, 47 per cent penetration; [a] very, very highly saturated market.***

*.178[178]*

The Panel nevertheless notes that the Wave Telecom subsidiary of JT has been performing effectively in Guernsey, having already obtained approximately 13% market share of a mobile market<sup>179[179]</sup> which appears to be less saturated than the Jersey equivalent. Staff within the company are well aware of this fact. One JT employee who attended the Scrutiny public meeting held at Hautlieu School put his point of view to the Minister for Treasury and Resources. He said -

***'Going back to the analogy of a corner shop and Tesco, you were saying that Cable and Wireless or a big company like that would simply stamp their foot on us and put us out to dry but at the moment we are competing successfully in Guernsey with Cable and Wireless... what we***

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<sup>178[178]</sup> Transcript of public hearing held with Jersey Telecom on 25th September 2006 – p.51-

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<sup>179[179]</sup> JT Annual Report 2005 – p.12

***are saying is: "Why do you not give us a chance, as a vote of confidence in us as a company, and to go forward and compete?"***<sup>180[180]</sup>

In summary, the Minister's concern that JT's existing revenue streams might decrease significantly appears, in light of international experience, to be somewhat premature. An incorporated JT, backed by committed and loyal staff, might in future have a smaller, but still significant, slice of a larger cake.

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<sup>180[180]</sup> Transcript of public meeting held on 7th September 2006 at Hautlieu School, p. 21

### **Will changes to the industry worldwide make things worse?**

According to the Board of Jersey Telecom, the impact caused by the entry of Cable & Wireless and Jersey Airtel is only a part of the true competition picture. The Managing Director has told the Sub-Panel -

***'Even if we had been left as a monopoly provider in Jersey, the technology, the technological changes, would bring competition into the market. You cannot stop it and you cannot regulate against it and you cannot prevent it.'*<sup>181[181]</sup>**

He was referring indirectly to the growth of Internet based services, and VoIP phone service providers such as Skype in particular<sup>182[182]</sup>.

At a simple level the JT business model was built on earning money from renting telephone lines and from charging for calls by the minute. The advent of the Internet was one of the factors that gradually forced that model to evolve.

Increasingly customers in Jersey are paying a set monthly fee to one of two internet service providers in the Island (including Jersey Telecom). Once that fee is paid, however, users of software such as Skype can make calls over JT lines without having to pay JT another penny. Any additional revenue earned goes to a company existing outside the Island. Accordingly a geographical presence in Jersey is becoming less important in terms of being able to offer telecoms services to Island residents. JT Executive Director Bob Lawrence explains –

***'I am sure that there are many, many people in the Island who are using services such as Skype or Vonage or the Tesco service. Those companies can provide services over the Internet to customers here without having to make any investment at all... [T]he services are carried on our lines, on our broadband network, but there is no investment here and all the profits that are made from those services are taken by companies who exist outside of the Island, so there is no tax take either.'*<sup>183[183]</sup>**

JT has invested heavily in order to be able to offer quality broadband services to practically all consumers in the Island. They have effectively created a network of

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<sup>181[181]</sup> Transcript of hearing attended by Board of JT on 25th Sept. 2006, p.20

<sup>182[182]</sup> See [www.skype.com](http://www.skype.com)

<sup>183[183]</sup> Transcript of public hearing held with Jersey Telecom on 25th September 2006 – p.17

information 'motorways', along which voice calls and many other types of media can travel. If there is a difficulty for JT it is that the company isn't earning revenue from a significant portion of the traffic travelling along those motorways.

This point has not been lost on other telecoms operators worldwide. In 2005 Ed Whitacre, then Chief Executive Officer of US telecoms company SBC Telecommunications (subsequently renamed as AT&T following a successful merger) was asked to comment on how concerned he was about 'Internet upstarts' such as Google, Skype and Vonage. He replied –

***'How do you think they're going to get to customers? Through a broadband pipe. Cable companies have them. We have them. Now what they would like to do is use my pipes free, but I ain't going to let them do that because we have spent this capital and we have to have a return on it. So there's going to have to be some mechanism for these people who use these pipes to pay for the portion they're using.'*<sup>184[184]</sup>**

### **Earning Revenues**

In the case of the telecoms industry, there appear to be at least two options for earning revenue from broadband. Providers of the content travelling along the lines might be charged in return for permission to access the lines or, alternatively, the consumers who receive that content might be billed. It appears that either option is possible, although there are issues at both ends.

Jersey Telecom could, in theory, implement technologies which would control access of certain portions of traffic to its network. Indeed, India appears ready to go one better, having announced plans to stop the sale of VoIP services to businesses in that country<sup>185[185]</sup>. Nevertheless, such activity might be unacceptable from a competition perspective. In the USA, attempts by some service providers to block the Vonage VoIP product prompted a complaint of anti-competitive practice and an investigation by the Federal Communications Commission. The imposition of a fine on one company in North Carolina followed<sup>186[186]</sup>.

In a local context, the JCRA appears to have authority under Article 16 of the Competition (Jersey) Law 2005 to investigate any attempt by a locally based

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<sup>184[184]</sup> 'At SBC it's all about scale and scope': Business Week Online - 7th November 2005.

<sup>185[185]</sup> See <http://economictimes.indiatimes.com/articleshow/726843.cms>

<sup>186[186]</sup> See <http://www.networkcomputing.com/channels/networkinfrastructure/60400413> and [http://news.zdnet.com/2100-1035\\_22-5598633.html](http://news.zdnet.com/2100-1035_22-5598633.html)

telecoms provider to abuse a dominant position. Nothing in the Law appears to preclude the possibility that blocking, by a local operator, of a VoIP service offered by an off-Island company would fall outside the terms of the legislation. What is less clear is the extent to which inclusion of the term 'dominant position' within Article 16 would inhibit the ability of the JCRA to act against any company, other than that with a majority share of the market, that might choose to block outside operators. The term is not defined in the legislation.

A further question that should be asked is: if Jersey consumers were to be blocked by JT from accessing online services such as Skype, TV download services or even Apple's iTunes store, would the companies offering those services be willing to pay a fee of any sort in order to secure access to a market of 90,000 customers?

At the consumer end, the task of obtaining revenue is comparatively easy. Telecom companies already have the necessary billing infrastructure in place and customers are used to paying.

Operators charge customers according to the volume of data received per month. In the UK those caps tend to range from 5GB (Gigabytes) up to an unlimited figure per month. Jersey Telecom has followed this trend, albeit with comparatively generous download limits of 20GB (Gigabytes) of data per month (at £17.99 per month), rising to 60GB (at £34.99 monthly).

The quantity of data necessary to reach a 20GB limit is broadly equivalent to 4000 music tracks or 5 million text only e-mails<sup>187[187]</sup>. However, customers taking advantage of new services offering TV programme downloads at anything approaching standard UK broadcast quality could reach even JT's standard 20GB limit quickly. The average 30 minute programme on Channel 4's TV on demand service is understood to equate to a file size of well over 1GB. Those who download more pay JT more.

The difficulty for JT is that one of its competitors offers broadband connections at the same speed, and without download limits, for similar price to JT's 20GB limited service. What is less clear to the Panel is whether this practice is sustainable in the longer term.

Of course, a third option can also be considered, and it is this option that the Minister's proposal to sell is most closely based on. If a telecoms company either owns the content that traverses its networks it can earn money from charging end consumers for it, as well as taking the monthly line rental fees associated with delivering it.

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<sup>187[187]</sup> Various, including Jersey Telecom Web site January 2007: [www.jerseytelecom.com](http://www.jerseytelecom.com)

## Does JT Need Economies of Scale?

The Minister's discussion paper refers to a *'requirement for economies of scale brought about by the consolidation in the world's telecommunications industry'* <sup>188[188]</sup>. It suggests that the requirement exists as an almost inevitable reaction to competition, liberalization and technological advancement; yet it fails to explain to any significant extent -

- a) a) what the Minister considers those economies of scale to be,
- b) b) why they are of significant value to the company, and
- c) c) why they might only be achieved by the Minister's preferred course of action.

Consequently the Panel has been forced to undertake significant research of its own.

The Board of Jersey Telecom advises –

***'developments in technology, competition and investment [have] reached a stage where the Company on its own may not be able to sustain into the future its unique performance in Jersey without the economies of scale in research and investment, buying power and operational factors available to larger companies.'*** <sup>189[189]</sup>

Although JT is reluctant to quantify the financial benefits that might accrue from a sale (on the basis that the precise nature of any benefit would be dependent upon the size and nature of the purchasing company), the benefits sought appear to fit within seven categories.

### Consumables

The argument is made that mobile handsets and associated other goods are relatively expensive to buy wholesale given the quantities that Jersey Telecom purchases.

Bearing in mind the limited customer base accessible to JT, the actual price of mobile handset prices in the Jersey Telecom retail outlet might have been expected to demonstrate hard evidence of the problem. In fact the position was found to be rather more positive. Although the contract prices for many of the phones offered by JT in January 2007 appear on the face of it to be less generous than those offered to UK

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<sup>188[188]</sup> See Discussion Paper on the Proposed Sale of Jersey Telecom, p.10

<sup>189[189]</sup> Consultation on the Proposed Sale of Jersey Telecom: response of the Board of JT Group Ltd. – p.3

customers, they were found to be competitive against those offered locally by its new competitor C&W under the 'Sure Mobile' brand<sup>190[190]</sup>. In addition, comparison of mobile packages between Jersey and elsewhere is affected by the low cost of sending SMS text messages on JT phones. Moreover, other small retailers in Jersey were sometimes able to offer the same phones, complete with a JT contract, for a lower price than that offered by the company's own retail outlet.

Consumers wishing to purchase their phones outright (without being tied in to a particular contract) could in theory purchase them more cheaply over the Internet. Nevertheless, the price differentials were in many cases rather small. For example, several of the higher value 3G smartphones stocked by JT, including the iMate Jamin (£389.99), the Nokia E61 (£260.99) and the Sony Ericsson M600i (£314.99) could be purchased from one UK online supplier exclusive of VAT and with a shipping charge of under £10<sup>191[191]</sup>; however, the discount available was just £4 for the relatively new to market Nokia E61, increasing to £23 for the older iMate smartphone. Again, JT seems, currently at least, to be punching above its weight.

### **Interconnection**

This economy of scale refers to the ability of larger operators to negotiate lower costs for such items as IP feeds and other such bandwidth connectivity. Access to frame agreements with other operators would apparently lower costs.

The Panel accepts that this argument is plausible, although it has not been provided with a great deal of substantive evidence in support of the assertion. What it has learned is that JT has managed to negotiate agreements with over 200 operators across 100 countries. Managing Director of JT has advised –

***'Each one has to be, in this instance, negotiated separately between Jersey Telecom and the other network players, and 200 in 100 countries sounds impressive, and indeed, we are in all of the major territories that we need to be. But it is still very, very hard for us in comparison to a global player who will take some sort of frame agreement and have agreements with every operator in the world in every country and deploy those across all of its subsidiaries.'***<sup>192[192]</sup>

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<sup>190[190]</sup> e.g. Nokia 6233 3G mobile handset – both JT and Sure currently offer this mid range phone free with a monthly contract to the value of £25 or more.

<sup>191[191]</sup> [www.clove.co.uk](http://www.clove.co.uk)

<sup>192[192]</sup> Transcript of public hearing attended by Board of JT, 25th Sept. 2006, p.31

The Panel considers this to be a particularly laudable achievement and one of which the company and its staff can rightly be proud. Nevertheless, the fact is that the company achieved this as a small company operating in a global market. Neither do the costs associated with achieving that agreements seem to have had a significant negative impact on the profitability of JT.

#### **Access to premium content**

Returning to the issue of content, Jersey Telecom considers that it is too small to compete successfully for major sporting events and other content likely to be of interest to local subscribers. The contention is that JT simply does not have a realistic chance of being able either to acquire control of relevant content or to obtain it through third parties in a manner likely to be of significant financial benefit to the company.

The Managing Director of Jersey Telecom cites Sky as evidence of the size of company operating in the new converging market.<sup>193[193]</sup> It has control of content (in the form of films, television programmes, rights to sports material, etc.) and has recently begun to offer both fixed line telephone services and broadband internet connections. While the Panel notes that the market is generating some particularly large multinationals, it has also learned that there are alternative ways forward.

Companies such as iO Global Limited are forming with a view to supplying content to operators such as Manx Telecom.

The Panel has been advised by JT that it has attempted to negotiate such agreements in the recent past but without success. Unfortunately, for reasons of commercial confidentiality, the Panel is unable to access documentation which corroborates the Board's submission.

#### **Access to exclusive products**

The contention here is similar to that which applies to consumables; companies with an exclusive product prefer to deal with telecommunications companies with a large subscriber base, again to ensure that those likely to place the more valuable bulk orders are satisfied first.

Canadian company Research in Motion, makers of the Blackberry mobile communication device, is one example of such a company. When Cable & Wireless

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<sup>193[193]</sup> Transcript of public hearing held with Jersey Telecom on 25th September 2006 – p.23

began operating a mobile service in Jersey, they offered exclusive access to the Blackberry product line, the unique selling point for which is a mobile e-mail service considered highly attractive to business users. In contrast, Blackberry products have yet to be offered by Jersey Telecom. The Apple iPhone is potentially another headline product, launched during the course of the Scrutiny review. At the time of writing it is understood that Apple Inc. has negotiated an exclusive deal with a US operator and is looking for an equivalent arrangement in the UK.<sup>194[194]</sup> In the event that the iPhone product reaches Jersey, the assertion would be that either of the two new entrants to the market would be in a better position to secure access to the product, and at an earlier stage, than would JT.

The Panel has received limited evidence that this issue is one of concern for JT. It has learned that JT tried comparatively recently to secure access to one particular product line. For 2 years the supplier of the product had apparently concentrated on fulfilling supply contracts with significantly larger operators worldwide. Now that practically all major operators across the globe have the option to stock the product, the company concerned has begun to respond more positively to approaches from JT.

Nevertheless, the Panel's adviser sounds a note of caution on this issue. He observes that global shortages of particular product lines are not uncommon occurrences in the technology sector, as has been demonstrated recently by Sony's decision to delay launching its Playstation 3 games console in Europe.

### **Product development**

Jersey Telecom contends that it spends considerable sums on developing new products and services and that this task could be undertaken more cost effectively and be quicker to market if it could rely on a central research and development pool of the kind operated by a multinational operator.

The Panel has not received evidence which might contradict this assertion.

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<sup>194[194]</sup> See <http://business.timesonline.co.uk/article/0,,9076-2541353,00.html>

### **Brand value**

The Board of Jersey Telecom has suggested that a major brand with a high profile could well strengthen Jersey Telecom's market position.

The Panel accepts that this is a plausible suggestion, although it has not received substantive evidence in support of that view. It is nevertheless generally accepted that the Island's population has a strong sense of identity. Moreover, Jersey Telecom employs over 400 Islanders, who seem on the basis of submissions and oral representations made, to have a particularly strong sense of loyalty to the company and respect for the way in which it has been run. Those staff have families. Consequently a significant percentage of the Island's population have family or friends that work for the company. With this in mind, and having noted the high level of activity at the company's new retail outlet in St. Helier, it is equally arguable that very few companies benefit from a greater local 'brand value' than the current Jersey Telecom. Rather than increasing the value of the JT brand, it is possible that a takeover by a multinational runs the risk of destroying value.

### **New rounds of investment**

This final economy of scale addresses the Minister's argument that the value of JT will decline because increasingly expensive, and more frequent, cycles of investment required to keep pace with technology will erode the company's ability to make a profit in future.

The Board of JT has indicated to the Panel that larger operators tend to be able to obtain network equipment and associated support contracts at a lower cost, specifically because they can submit bulk orders for equipment which present the equipment supplier with a large amount of guaranteed income. On that basis it is again in the interests of the supplier to prioritise its larger customers. A trade sale to a larger operator would apparently solve this problem.

Looking backward there appears to be a shortage of hard evidence to support this contention. To date the company has been able to secure all the infrastructure it needs to offer a high quality fixed line service, the rolling out of a new 3G mobile network, new submarine cable links to other jurisdictions and more. Indeed, the Panel's adviser notes that –

***'... the company appears to have an enviable reputation for technological innovation.'***



That investment in innovation is ongoing. On 25th September 2006 John Henwood, Chairman of Jersey Telecom, told the Panel –

***'We are about to invest many millions of pounds in replacing System X<sup>195[195]</sup> with an Internet Protocol network, to be at the leading edge'.<sup>196[196]</sup>***

What the Panel has found is evidence of a company that, in spite of its size and limited resources, has continually procured the necessary equipment, and the associated support contracts, at prices which do not appear to have affected its ongoing profitability to any significant extent. Certainly it has not resorted to borrowing in order to fund that investment.

It is possible that the performance of Jersey Telecom in recent years may have come as something of a shock to telecoms consultants Analysys, currently a member of the Citigroup consortium charged with advising the Minister for Treasury and Resources on the proposed sale. Back in 1999 Analysys produced a report for Guernsey Telecom, which subsequently led to the sale of that company to Cable and Wireless. In that report, Analysys contended -

***'Guernsey Telecoms, as it stands today, is too small... to meet the dramatic challenges presented by the global telecoms revolution'.<sup>197[197]</sup>***

Back in 1999 Jersey Telecom was a similar sized company, in global terms, to that of its Guernsey equivalent, and yet in 2007, following a continuous programme of significant investment and technological change, it appears to have managed rather well.

Above all what the Panel has learned is that there the need for significant ongoing investment in telecoms infrastructure is nothing new. It was a major issue when operators made the highly significant switch to digital exchanges in the 1980s. It was a major issue when mobile phone services were being rolled out in the 1990s. In the modern era of 3G and broadband it is still a major issue. An inadequacy of funding for investment under the current ownership arrangement does not, therefore, appear to be an argument for the privatisation of Jersey Telecom.

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<sup>195[195]</sup> Jersey Telecom's existing digital telephone exchange system

<sup>196[196]</sup> Transcript of public hearing held with Jersey Telecom on 25th September 2006 – p.22

<sup>197[197]</sup> 'The Bailiwick of Guernsey and the Global Telecoms Revolution' – Analysis, Executive Summary, p.iii

In fact, it may be valid to consider the issue of ongoing investment from an opposite perspective. Under States ownership, JT has continued to invest at a substantial rate in order to meet the expectations of both its business and its residential customers, and in accordance with States strategic objectives regarding ongoing support for the finance industry. A sale to the private sector would undoubtedly increase the importance of the profit motive, while at the same time inevitably reducing the ability of the States to influence the operation of the company from a strategic perspective. This is evidenced by the content of a confidential memorandum of understanding between the Minister and the Board of Jersey Telecom, as referred to in the Minister's own discussion paper. While the Panel has refrained from releasing specific details of the content of that memorandum, it considers it appropriate to disclose that the document acknowledges that the Minister has the opportunity to influence the direction of the company.

Without an element of influence through ownership, the ability of the JCRA to exercise effective control on matters of strategic importance to the Island and its economy becomes far more important. This issue has been considered in Chapter 4.

To conclude, the case for selling on the basis of access to economies of scale is not clear cut. To the extent that action is necessary, it is possible that a form of partnering arrangement might provide JT with the ability to access future technologies in the absence of full privatization. The Panel is not clear how seriously the Board of Jersey Telecom has explored this option.

### **Niche Markets**

The Barclays Bank Telecoms and Technology Review<sup>198[198]</sup> states –

***'privatization and liberalization of the sector, allied to the rapid pace of technological change, have... generat[ed] significant scope for niche market development... and support service provision'.***

The Panel has found evidence that one of the reasons why Jersey Telecom remains such a successful telecoms operator is the enterprising approach of its staff, backed by the Board. Chairman John Henwood explains –

***'I think it is not well known how enormously successful we have been in , for example, SMS (Short Message Service) texting. In August [2006],***

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<sup>198[198]</sup> November 2006 edition

***Jersey Telecom handled one million texts a day. Now these are not texts from Jersey to Jersey or Jersey to Guernsey. These are texts which come into Jersey, are aggregated; we take a tiny fraction of a penny on each message and sent them out again. That is a business which has been developed by the enterprising nature of the people who are managing it.***<sup>199[199]</sup>

He adds –

***'we have invested in providing GSM (Global System for Mobile communications) mobile services to entities like cruise ships and so forth, plying their trade in the South China Sea and in the Baltic. It is those sort of areas that we would seek to develop this business as, if you like, a way of trying to maintain our return on investment as the inevitable decline in the local market occurs.***<sup>200[200]</sup>

The Panel considers that these examples demonstrate admirably the viability and the effectiveness of the company, and its staff, to date. What they also demonstrate is that, just as technology begins to close the door on certain markets and income streams, it also opens up new opportunities for small companies, just as the Scandinavian architects of the VoIP service provider Skype discovered back in 2002.

As a small company, relatively free of the diseconomies of scale (such as long chains of command) that can afflict multinational companies, Jersey Telecom has been able to spot, enter and earn revenue from niche markets.

## **Conclusions**

Ownership of the only comprehensive fixed and mobile network in the Island has provided a reasonably secure cash flow for the States. The Panel, having been afforded the opportunity to study the company's business plan for the next five years, considers that the position may well remain positive. JT does not have any debt on its balance sheet, yet it has been able to continue with a significant level of ongoing investment.

JT's revenues may decrease through the presence of Cable & Wireless and Jersey Airtel; however, international experience shows that both new companies will have a

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<sup>199[199]</sup> Transcript of Jersey Telecom Board hearing on 25th Sept. 2006 – P.51  
<sup>200[200]</sup> Transcript of Jersey Telecom Board hearing on 25th Sept. 2006 – P.51.

difficult task to unseat JT as the Island's No.1 service provider. As JT's own staff seem more than willing to fight for the future of their company, that task will be made harder. On that basis, and having regard to the performance of JT as an incorporated body to date, it seems premature to suggest that the viability of the company in its current form might deteriorate significantly going forward.

The pace of will inevitably affect JT in future years; however, this is far from a new issue. It was a concern when the States decided not to investigate privatisation in the mid 1980s. It was a concern in 1996 when the States took the initial decision to pursue incorporation, and it was a concern in 2000, when the States decided to separate the roles of operator, regulator and owner of the business. During those years, JT has gone from strength to strength.

The Panel has established that there are conflicting views as to the validity and the significance of assumptions made regarding JT's ability to compete and to remain profitable in future years. In addition it contends that, by talking down the future prospects of the company in its current form, the Minister runs the risk of devaluing the very asset from which he seeks to derive maximum financial value.

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