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Assemblée des États

Economic Affairs Scrutiny Panel

Jersey Telecom - Privatisation

Supplementary Report



Presented to the States on 29th January 2008

S.R.3 /2008

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1. Executive Summary

The proposition P153/2007 'JT Group Limited ("Jersey Telecom"): Proposed Sale has been brought to the States by the Treasury and Resources Minister following reconsideration of his initial proposition to sell JT 'P.28/2007'.

In response to the initial proposition the Economic Affairs Scrutiny Panel formed a Sub-Panel to review the sale proposal. The Sub-Panel presented its findings to the States on 6th March 2007 in Scrutiny Report S.R.5/2007. Our report made five recommendations, of which the two most important, and the Treasury and Resources Minister's responses to them, form the basis of this supplementary and hopefully final report.

- **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 are asked to decide whether to sell.**

There is widespread agreement amongst all stakeholders involved in the telecommunications market that the powers and resources of the JCRA do indeed need to be reviewed. The Economic Development Minister is in the process of setting up such a review. The Sub-Panel's views are summed up as follows:

Recommendations

1. The Panel recommends that the JCRA be given the fullest powers of inquiry, determination and fining in order that a fully competitive marketplace can be achieved.
2. The Panel remains convinced that the proposed review of the powers and resources of the JCRA must be completed and any recommendations are in place before the States debate the sale of Jersey Telecom.

3. Irrespective of the proposal to sell Jersey Telecom, the debate on separation needs to be resolved. The issue of separation and the powers required to enforce the appropriate level of separation, need to be fully resolved before consideration is given to the sale of Jersey Telecom.

Key Findings

1. The Panel is convinced that a fully competitive marketplace is the key to economic success in the telecommunications sector.
 2. It will be very difficult, if not impossible to enforce separation following the sale of JT into the private sector.
- **A comprehensive cost-benefit analysis of the economic and social implications arising from a sale of Jersey Telecom should be completed before the States decide whether to sell the company.**

In an attempt to address the concerns raised by Scrutiny and the comprehensive cost benefit analysis , the Minister has produced a list of assurances pertaining to the 'sale' and the 'process' of the sale, the **Panel's conclusions from this supplementary review show that these assurances cannot be guaranteed. Thus:**

Recommendation

4. Provisions should be placed in the Telecommunications (Jersey) Law 2002 to protect the continuity of telecommunications services.

Key Findings

3. The possibility of the JCRA introducing effective gearing controls into the licence conditions is severely limited.
4. Any attempt to control gearing may be subject to legal challenge and in any case will reduce the price achieved through sale.

5. The Panel has no confidence that any mechanisms can be put into place to protect against excessive gearing of Jersey Telecom once sold; it believes that such a risk is unacceptable given the strategic importance of telecoms to business activity on the Island.
6. The Panel has found no evidence that the current laws can be used to protect the Island's telecoms skills base from the threat posed by downsizing or outsourcing.
7. Employee terms and conditions cannot be adequately protected through contractual obligations, as any obligations placed on the initial sale may not be passed on in any subsequent sale.
8. The JCRA cannot provide any protection for employee terms and conditions through licence conditions.
9. The potential use of RUDL to place any conditions on any sale of Jersey Telecom is open to legal challenge.

Recommendation

5. **Consequently, as a result of the evidence examined, the Sub-Panel recommends that the proposed sale of Jersey Telecom should not proceed at this time. Furthermore it recommends that a lengthy period of stability should be guaranteed to the management and employees of Jersey Telecom following this protracted period of uncertainty.**

2. Sub-Panel Membership

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

[Senator B. E. Shenton was obliged to resign his position on the Sub-Panel following his appointment as Health and Social Services Minister in September 2007]

3. Panel Advisor

The Panel's Advisor, Dr. David Parker, is a Research Professor in Privatisation and Regulation at Cranfield School of Management, University of Cranfield, UK

Legal advice was given by Hanson Renouf Barristers and Advocates.

4. Abbreviations

BT	British Telecom
JCRA	Jersey Competition Regulatory Authority
JT	Jersey Telecom Group Limited
MNP	Mobile Number Portability
Oxera	Oxford Economics Research Associates
RUDL	Regulation of Undertakings and Development (Jersey) Law 1973, and associated regulations
TUPE	Transfer of Undertakings (Protection of Employment) Regulations (UK)

5. Introduction

In July 2006, the Treasury and Resources Minister formally proposed that Jersey Telecom Group Limited (JT) should be sold to a private company. As a result, on July 26th 2006, the Economic Affairs Scrutiny Panel formed a Sub-Panel to review the proposal. It produced its report; 'Jersey Telecom – Privatisation', SR5 /2007 which made the following 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.**
- 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.**

In response to the prime recommendation, to produce a full cost benefit analysis of the economic and social implications of the sale, the Treasury and Resources Minister set up a Steering Group which commissioned Oxera and the States Economic Advisors to undertake additional analysis into the possible sale of Jersey Telecom. Its key findings are summarised in the set of 'Sale and Process Principles' given by the Treasury and Resources Minister, in the sale proposition; P.153/2007 JT Group Ltd ("Jersey Telecom"): Proposed Sale. The principles are reproduced in Appendix 1.

These principles amount to a set of assurances that the areas of concern highlighted by Scrutiny Panel in SR.5/2007 can in fact be safeguarded. This supplementary report is an evaluation of the extent to which these assurances or safeguards can be delivered. During the course of later hearings the issue of the separation of the company was also introduced.

In order to fully investigate the possible effectiveness of the Minister's assurances, the Sub-Panel has sought both technical and legal advice on the following main areas of concern:

- The powers and resources of Jersey Competition Regulatory Authority (JCRA)
- Powers of Separation
- Gearing controls
- The effectiveness of Regulation of Undertakings Legislation (RUDL) to protect the Islands skill base
- The protection of employee terms and conditions / pensions
- The effect of onwards sale on any contractual obligations
- The protection and development of the Islands telecommunications infrastructure

These areas of concern are discussed in sections 6-11 of this report.

The Sub-Panel also received submissions, oral and written, from:

- The Economic Development Minister
- The Treasury and Resources Minister
- The JCRA
- Jersey Telecom Group Limited
- Newtel Solutions
- Unite the Union

6. Powers and Resources of the JCRA

The introduction of the Telecommunications (Jersey) Law 2002 and the Competition Regulatory Authority (Jersey) Law 2001 has liberalised Jersey's Telecommunications market. Since this liberalisation in 2001, competition has been introduced in this sector and there are now three fixed services competitors and two additional mobile operators. Jersey Telecom, the dominant incumbent operator, incorporated in 2003 and now effectively functions as a normal commercial company.

The introduction of competition has led to some improvements in economic efficiency and benefits to consumers, for example, increased consumer choice, new services and lower prices. However, deficiencies in current regulatory powers are inhibiting the realisation of the full benefits of competition. For example, the mobile sector still needs the issue of Mobile Number Portability (MNP) to be resolved. On the subject of MNP, the Economic Development Minister stated:

“Number portability is a pre-requisite to effective mobile phone competition. It is the right, in my view, of a customer to be able to keep their number and to change it to another operator. Until we get full number portability available, not with weeks of delay or days of delay but literally hours of being able to be implement it, you will not have effective mobile telecommunication competition.”¹

The issue of MNP has been resolved in most other jurisdictions throughout the world and has been for several years. However, in Jersey this argument has continued for two years and still has not been resolved.

¹ Scrutiny Public Hearing Transcript, 17th December 2007 –Minister for Economic Development (page2)

It is now widely accepted that the key to economic success in this sector is competition and that the ownership of Jersey Telecom is largely incidental. Experience in most jurisdictions has shown that where competitive conditions have been created, competition leads to increased growth of the telecommunications market. Although this results in a decrease of market share for the previously dominant incumbent operator, the increased growth of the market compensates for this loss of market share. Newtel Chairman, Mr P. Funk, informed the Sub-Panel that:

“There is a very significant market for telecoms services here. Our estimate is that it is roughly £140 million a year and growing at a rate of about 7 per cent.”²

The Panel remains unconvinced by the Treasury and Resources Minister’s insistence that a rapid sale of JT must take place before it loses value. Evidence from around the world and in Jersey contradicts this. The key is the establishment of a truly competitive market, initially through granting significant regulatory powers to the JCRA.

Thus, the Panel understands that significant improvements are required to the regulatory framework. Newtel have commented that the powers of inquiry, determination, ability to fine and enforce separation are required. Mr P Funk, stated in relation to the powers available to the JCRA:

“Part of the lack of their powers is the power of inquiry, part of it is the ability to determine.”³

Powers of inquiry enable the regulator to function in proactive manner rather than having to wait for a complaint and act after the event.

The power to determine gives the regulator the ability to rule that any anticompetitive practice shall cease with immediate effect and to impose fines

² Scrutiny Public Hearing Transcript, 18th December 2007 – Newtel Solutions (page 3)

³ Scrutiny Public Hearing Transcript, 18th December 2007 – Newtel Solutions (Page 8)

from day one should that ruling not be complied with. Operators still retain the right of appeal, but have to comply from the point of instruction.

“That power in Ofcom’s hands is absolute. From that day on that is the ruling. BT has the ability to appeal, they have the ability to take it to another forum, but in terms of the market condition it has been corrected as of that day in terms of the view of the regulator”⁴

At a public hearing in January 2008, Executive Director of the JCRA, Mr. C. Webb commented on the current powers available to them for telecommunications regulation:

“Under the Telecoms Law right now our only remedy for a breach of a telecoms licence obligation is essentially a nuclear option of withdrawing Jersey Telecom’s licence. Now Jersey Telecom is the universal service provider, people need telephone service so realistically that is not really an option”⁵.

The need for a review into the powers and resources available to the JCRA for telecommunications regulation has now been widely accepted and indeed forms part of P.153/2007. At a public hearing on 17th December 2007, the Economic Development Minister confirmed:

“At the moment the regulator does not have the powers that I would wish them to have in order to make regulatory decisions and follow them through and ensure that they happen.”⁶

He also said that:

⁴ Scrutiny Public Hearing Transcript, 18th December 2007 — Newtel Solutions, - Peter Funk (page 9)

⁵ Scrutiny Public Hearing Transcript, 8th January 2008 – JCRA, (page 6)

⁶ Scrutiny Public Hearing Transcript, 17th December 2007 – Minister for Economic Development, (p 5)

“The experience of number portability and the J.C.R.A.’s ability to enforce that early has certainly taught us of the need to improve the regulatory powers of the J.C.R.A., improve their fining abilities and all the rest of it.”⁷

Key Finding - The Panel is convinced that a fully competitive marketplace is the key to economic success in the telecommunications sector.

Recommendation

The Panel recommends that the JCRA be given the fullest powers of inquiry, determination and fining in order that a fully competitive marketplace can be achieved.

Proposed Review of the JCRA

In response to the overwhelming need for increased powers for the JCRA the Economic Development Department are in the process of commissioning a review into the powers and resources of the JCRA.

Following correspondence with the Economic Affairs Scrutiny Sub-Panel (Telecoms Privatisation), the draft terms of reference as published in P.153/2007 - JT Group Ltd (“Jersey Telecom”): Proposed Sale, have been revised so that they focus solely on the powers and resources of the JCRA as a telecoms regulator. The new terms of reference are now in line with the Panel’s published recommendations in Scrutiny Report S.R.5/2007, published in March 2007. On the subject of the proposed review, Mike King, Chief Officer, Economic Development Department, said:

“Now we have completed those terms of reference, we will now be going out to talk to the National Audit Office and potentially others, ..., to make sure that we are getting the

⁷ Scrutiny Public Hearing Transcript, 17th December 2007 – Minister for Economic Development, (p 25)

right people to look at it because the issues that have been raised are material issues.⁸

At the time of writing, the Panel does not know who will be undertaking this review or when they are likely to report.

The Panel finds this state of affairs most unsatisfactory and is of the opinion that the debate on the sale of Jersey Telecom should not proceed in the absence of this work. Its position is similar to that of the Economic Development Minister, when asked on the 17th December 2007 by Deputy G.P Southern:

“Can I just ask as a final question to what extent you, as Minister for Economic Development, support the Minister’s wish to go ahead with the sale of JT at this time?”⁹

Senator P. F.C. Ozouf replied:

“The issue of who owns JT is a secondary issue in my mind. I have been and am now increasingly of the view that there is more work to be done, irrespective of the sale ... I would have spent the time on working out the structural nature of the market. That work continues.”

Recommendation

The Panel remains convinced that the proposed review of the powers and resources of the JCRA must be completed and any recommendations are in place before the States debate the sale of Jersey Telecom.

⁸ Scrutiny Public Hearing Transcript, 17th December 2007 – Minister for Economic Development (p 18)

⁹ Scrutiny Public Hearing Transcript, 17th December 2007 – Minister for Economic Development (p 43)

7. Powers of Separation

In order to create a truly competitive market where previously there was a dominant or monopoly operator, the issue of separation is critical. It is seen as the only way to provide full competition in the marketplace, by giving fair and equal access to infrastructure and services to all telecoms providers. In an opening statement at the January 2008 public hearing, JCRA Executive Director, Mr C. Webb stated:

“... the amendments proposed in Proposition 153, while useful, do not address the fundamental issue of fair and equal access to the telecommunications network currently owned and operated by JT ... Such issues can be addressed with the separation of JT’s retail operation to its wholesale network.”¹⁰

He went on to say:

“Restrictions currently mandated by the J.C.R.A., such as equal access provisions in JT’s licence and accounting separation obligations, seek to address issues of access but they cannot remove the underlying incentive to discriminate.”¹¹

There are three levels of separation open to regulators:

Accounting separation

Accounting separation is where the retail and wholesale accounts of the operator are separated. This aims to eliminate cross-subsidisation. However, it is resource intensive for both the operator and regulator and the incentive to

¹⁰ Scrutiny Public Hearing Transcript, 8th January 2008 – JCRA - Mr C Webb (Page 2-3)

¹¹ Scrutiny Public Hearing Transcript, 8th January 2008- JCRA - Mr C Webb (Page 2-3)

discriminate is not removed. This is the system currently in place in Jersey's telecommunications market.

Functional separation

Functional separation splits the wholesale and retail operations into separate entities yet they both remain under the same corporate ownership. This is a halfway measure as it does not remove the corporate incentive to discriminate and it may be costly to regulate. An example of functional separation is the current system operated in the UK by BT which was implemented after 23 years of attempting to get a level playing field. Although BT still owns the network and retail operations, the network is now run separately from the retail aspects and has been re-branded as a separate entity; 'BT Openreach'. The BT Openreach operation then sells services to all retail operators including BT.

Structural separation

Structural separation splits the operation into two separate corporate entities. After splitting the wholesale and retail services of an operator, like Jersey Telecom, the wholesale provider should provide services to all retail operators equally and invest in the infrastructure to cope with increased demands. Disadvantages of structural separation include the loss of economies of scale, increased operational costs and the one-off cost of separation. These are particularly relevant to Jersey Telecom because of its relatively small size.

7.1 Separation Issues - Background

Before the Treasury and Resources Minister lodged P.153/2007, several studies into the possibility of separation were undertaken. The feasibility of structurally separating Jersey Telecom was examined by the JCRA, Analysys Consulting Ltd, Jersey Telecom and Oxera. Each of these came to different conclusions (summarised below). However, in general all but the JCRA were against the structural separation of Jersey Telecom. The conclusion of States Economic Advisor drawn from these reports (and other sources) is given in Annex 3 of proposition P.153/2007.

Jersey Competition Regulatory Authority Report

On 2nd October 2006, the Economic Development Minister commissioned the JCRA to undertake a study into ‘*The structure of Jersey Telecom which best promotes competition in telecommunications and thereby economic growth as a whole*’. This report was presented on 10th January 2007.

The JCRA report did not conclusively recommend a particular option for Jersey Telecom, but it did indicate that they believed the benefits of structural separation could be significantly greater than the costs. However, they did conclude that:

“the current regulation (in particular, accounting separation) is not optimal from the point of view of promoting effective and sustainable competition.”¹²

The JCRA also state that Jersey has a unique opportunity of restructuring its incumbent telecoms operator as it is still in States ownership and add:

“Restructuring does not preclude the ultimate sale of JT but, once sold without restructuring, that opportunity is likely to be lost for future generations.”¹³

Jersey Telecom Representation

On 22nd December 2006, Jersey Telecom made representations on structural separation. This report concludes that:

“structural separation represents significant risk for no benefit whatsoever and that the most appropriate course of action would be to utilise regulatory tools such as accounting separation to manage conflicts, perceived or otherwise.”

¹² Structural Separation Representations from Jersey Telecom, 22nd December 2006. Annex A2.6 P.153/2007

¹³ Annex A2.5 P.153/2007. JCRA: *Proposed Sale of Jersey Telecom, Advice to the Minister for Economic Development under Article 6(4) of the Competition Regulatory Authority (Jersey) Law 2001 on The Structure of Jersey Telecom which best promotes competition in telecommunications and thereby economic growth as whole, 10th Jan 2007.* (page 123 of P.153/2007)

Analysys Report

During the course of 2006, the Treasury and Resources Minister commissioned Analysys to undertake a review on the possibility of separating aspects of the Jersey Telecom business. On 16th February 2007, Analysys presented their report titled, 'Perspectives on structural separation'. The overall conclusion of the Analysys report is that any form of structural separation would be costly:

“whilst various forms of structural separation could be implemented any form of structural separation is likely to incur significant costs and inefficiencies.”¹⁴

Oxera Findings

In its contribution to the report of the Steering Group in June 2007, Oxera had the following to say on structural separation:

“... in principle, vertical structural separation into entities facing markets with different competitive dynamics may reduce the scope of regulation required. This is because it removes many of the incentives for an incumbent monopolist in the wholesale market to discriminate in favour of, or against, any particular supplier in the retail market. However, actually achieving these benefits is not straightforward.”¹⁵

It is apparent to the Panel that whatever the merits or otherwise of separation, the issue is one that requires urgent resolution. Fresh evidence received by the Panel and summarised in the following section suggests that this issue is of critical importance and cannot be ignored by the Treasury and Resources Minister.

¹⁴ Final Report for Treasury and Resources Department, Jersey. Perspectives on structural Separation. Analysys, 16th February 2007

¹⁵ Possible sale of Jersey Telecom: Additional analysis Prepared for States of Jersey by Oxera, July 20th 2007 (page 220 of P.153/2007)

7.2 Separation issues - Update

The Panel has heard evidence that Jersey has a long way to go before we have a fully competitive telecoms market and that this issue needs to be resolved irrespective of any decision on the possible sale of Jersey Telecom.

The Economic Development Minister indicated to the Sub-Panel that some form of functional or structural separation is likely to be implemented, when he stated:

“I would draw their attention to the E.U. regulatory powers that are going to give all regulators the power to force structural separation, and we are no different here.”¹⁶

When questioned by Deputy Southern about the current lack of powers available to the JCRA to enforce proper competition. The Economic Development Minister informed the Sub-Panel that:

“I can envisage that there will be break up provisions in the future Competition Law in Jersey”.¹⁷

However, both Jersey Telecom and the trade union that represents the workforce of Jersey Telecom, Unite, believe that structural separation could be detrimental to telecom service provision. National Officer, Mr P. Skyte detailed the union's objections to structural separation in a submission to the Sub-Panel, in which he stated that structural separation:

“... would constitute a drastic, disruptive and damaging course of action.”¹⁸

¹⁶ Public Hearing Transcript, 17th December 2007 – Minister for Economic Development (page 20)

¹⁷ Public Hearing Transcript, 17th December 2007 – Minister for Economic Development (page 12)

¹⁸ Unite Submission on the proposed structural separation of Jersey Telecom. January 2008

Jersey Telecom deem that the costs of separation and the increased operational costs need full consideration, they maintain that structural separation is widely regarded as a regulatory measure of 'last resort' when other regulatory measures have failed. Mr. J. Henwood, Jersey Telecom Chairman, stated that:

"... structural separation is widely regarded as a regulatory remedy of last resort to be used only where there is a clear failure of other tried and tested regulatory practice. There is no such failure in Jersey."¹⁹

This view point was disputed by the Economic Development Department, the JCRA and Newtel Solutions. On the topic of network access to the fixed line market, Mr. M. King, Chief Officer, Economic Development stated:

"Well, there are issues from the other operators, yes, that have been brought to our attention and I am sure they have been brought to the attention of the J.C.R.A. Have they been resolved yet? No, they have not."²⁰

In an opening statement by the JCRA at a public hearing on 8th January 2008, Executive Director, Mr. C. Webb stated:

"Furthermore a dominant incumbent operator like J.T. has a natural incentive to discriminate against new entrants for network access. Problems with network access have arisen in Jersey ... Such problems not only hurt new entrants but directly harm consumers."²¹

The problems encountered by Newtel Solutions were presented to the Sub-Panel by the company Chairman, Mr. P. Funk:

¹⁹ Letter from John Henwood, Chairman, Jersey Telecom Group Ltd, to States Deputies, dated 14th January 2008.

²⁰ Scrutiny Public Hearing Transcript, 17th December 2007- Minister for Economic Development (p 13)

²¹ Scrutiny Public Hearing Transcript, 8th January 2008 – JCRA (page 2)

“...their retail division is often able to install services faster than their wholesale division is committed to deliver services to us. So there is a discrimination in the customer’s mind as to our relative services. More importantly, the cost differential between the wholesale and retail rate is what determines many of our services and the profitability of them. J.T. has the ability to set prices at the retail level.”²²

The JCRA have effectively said that the States should not be talking about selling Jersey Telecom at this time as the structural separation issue should be revisited first. They stressed that any form of separation would be much harder, if not impossible, to impose following a sale.

“The States of Jersey has, indeed, a greater opportunity than the UK to restructure appropriately JT because it is still in States ownership. Restructuring does not preclude the ultimate sale of JT but, once sold without restructuring, that opportunity is likely to be lost for future generations.”²³

Key Finding – It will be very difficult, if not impossible to enforce separation following the sale of Jersey Telecom into the private sector.

²² Scrutiny Public Hearing Transcript, 18th December 2007 – Newtel Solutions (page 3)

²³ Proposed Sale of Jersey Telecom, Advice to the Minister for Economic Development under Article 6(4) of Competition Regulatory Authority (Jersey) Law 2001 on The Structure of Jersey Telecom which best promotes competition in telecommunications and thereby economic growth as a whole. 10th Jan 2007 (page 123 in P.153/2007)

Recommendations

The Panel do not take a view on whether or not Jersey Telecom should be separated, nor do they recommend which method of separation would be most appropriate, but the Panel recommends that:

Irrespective of the proposal to sell Jersey Telecom, the debate on separation needs to be resolved. The issue of separation and the powers required to enforce the appropriate level of separation, need to be fully resolved before consideration is given to the sale of Jersey Telecom.

8. Gearing

High levels of gearing (equity to debt ratio) can increase the risks of a company becoming insolvent. It can also be used as a mechanism to reduce a company's tax contributions.

Jersey's finance sector and the Island's economy would face serious problems should Jersey Telecom ever face insolvency. This particularly applies to private equity funding, but equally may apply in the case of purchase by a global operator which seeks to structure its debt to maximum advantage. Once a company is in such a situation of financial difficulty it is too late for the regulator to act. Because the regulator's prime duty is to maintain the continuity of service, removing the licence is not an option. It is therefore imperative that the regulator has a range of powers that enable them to act before the company reaches such levels of financial difficulty.

Lessons can be drawn from the example of Telecom Italia, that demonstrate the limitation of contractual obligations on onwards sales and the possibility of regulatory capture through excessive debt. In his 'Case study of Telecom Italia 1997-2007', Dr. M. Florio, Professor of Public Economics, Milan University, demonstrates the worst dangers of privatisation. Telecom Italia was one of the most successful telecoms operators in Europe prior to privatisation, but following three onward sales it is now regarded as one of the worst. Professor Florio attributes this decline, in part, to the high levels of gearing. He states:

“The most important Italian privatisation has ended by putting in danger the stability of a fundamental piece of the country's industrial system.”²⁴

²⁴ Massimo Florio, *Telecom Italia 1997-2007: A Case Study in Privatization Failures*, 2007

8.1 Licence conditions to control gearing

In the '*Process Principles*' of the proposition, the Treasury and Resources Minister effectively gives assurances that the States will not sell Jersey Telecom until '*appropriate measures are in place to ensure that, following a sale Jersey Telecom does not become over-gearred.*'

In Annex 5.4 of the proposition, the advantages and disadvantages of various mechanisms used to control gearing by UK regulators are discussed in a paper titled 'Gearing Control – Provisions from the UK regulated sectors'.²⁵

The suggested mechanisms are as follows:

- i. Limit on level of financial indebtedness
- ii. Credit rating requirement
- iii. Limitation on licensee's activities and investments to regulated activities
- iv. Prohibition on acting as guarantor
- v. Restricting dividend payments outside the regulated entity
- vi. Requirement to maintain the listing of a financial instrument.

However, the presentation suffers from two major drawbacks:

- a) at no stage has the Treasury and Resources Minister indicated which of these mechanisms would be the most appropriate to put in place,
- b) these mechanisms to control gearing are conditional on the JCRA's ability to place the necessary conditions in the telecoms licence.

As licence conditions are open to a consultation process there are no guarantees as to what gearing controls may go into a licence.²⁶ Even if the appropriate levels of borrowing can be assessed should a company exceed them and put itself in danger of insolvency the regulator can only impose a fine thus making the risks worse. In addition, the JCRA are regulators and not

²⁵ Annex A5.4 page 288 of P. 153/2007

²⁶ Scrutiny Public Hearing Transcript, 8th January 2008 - JCRA- Mr. C. Webb (page 21)

financial experts, therefore they are not best placed to decide what a reasonable and proportionate level of debt may be. The JCRA Economic Adviser, Mr. T. Cassells, added:

“We are not experts at issues of equity and debt. We would have to acquire that expertise and those resources.”²⁷

At a public hearing in January 2008, JCRA Executive Director, Mr C. Webb discussed the problems faced when assessing if the level of debt requested for investment in new technology is an appropriate level of debt:

“But in the situation I raise I am not sure we have the legal basis to say you cannot go above a certain level of gearing to roll out a new service.”²⁸

Additionally, regulatory decisions dictating acceptable gearing levels are open to challenge by the licensee. Mr. C. Webb stated that, in the absence of guidance from the Economic Development Minister specifically setting out unacceptable levels of gearing:

“I do not believe the J.C.R.A. has the inherent ability under the law to itself regulate gearing levels or prescribe a no-go in gearing.”²⁹

Key Finding – The possibility of the JCRA introducing effective gearing controls into the licence conditions is severely limited.

The Panel has sought both legal and technical advice³⁰ on the potential effectiveness and costs of each of the suggested mechanisms. A summary of each of these methods of gearing control are given in appendix 5. In general all

²⁷ Mr T Cassells, Economic Adviser, JCRA - Public Hearing Transcript 08-01-2008 (page 21-22)

²⁸ Mr. C. Webb, Executive Director, JCRA - Public Hearing Transcript 08-01-2008 (page 20)

²⁹ Mr. C. Webb, Executive Director, JCRA - Public Hearing Transcript 08-01-2008 (page 19)

³⁰ Technical advice was sought from Dr.D. Parker and Ofwat (UK water services regulator)

of the suggested mechanisms have significant disadvantages and they are likely to significantly reduce the potential sale value of Jersey Telecom.

The Sub-Panel's legal advisor has stated that any licence condition:

“to restrict JT’s commercial activities to regulated activities would be likely to be a disproportionate and unreasonable restriction on JT’s commercial freedom, and may, in any event, reduce the value which the States of Jersey could derive from the sale of the company”³¹.

Key Finding – Any attempt to control gearing may be subject to legal challenge and in any case will reduce the price achieved through sale.

In addition to the question of suitable regulatory mechanisms, the Economic Development Minister raised concerns about the lack of transparency and timely delivery of Jersey Telecom's financial information for regulatory purposes. He says:

“If the regulator is to make informed decisions about access to the network and informed decisions about the R.O.I. (Return on Investment) arrangements, they need proper financial information. ... it is not in J.T.’s interest to necessarily be entirely accurate and timely in respect of the costs of providing the network versus the retail. The J.C.R.A. has needed to raise its game in terms of getting the right information in order to make regulatory decisions”³².

³¹ Second Advice To The States Of Jersey Scrutiny Sub-Committee In Relation To Aspects Concerning The Sale Of Jersey Telecom Limited - Hanson Renouf Barristers and Advocates 19.12.07

³² Scrutiny Public Hearing Transcript, 17th December 2007 – Minister for Economic Development- (p14)

Summary

Following the privatisation of Jersey Telecom, the integrity and future development of the Island's telecommunications infrastructure may be put at risk by high levels of debt. The possible consequences to Jersey's economy of such risks may be catastrophic, therefore the likelihood of such scenarios occurring needs to be minimised.

In his advice to the Panel on suggested mechanisms to control gearing as set out in Annex 5.4, Dr. D. Parker stated:

“ in my view it is absolute crucial that all the protective provisions should be put in place before privatisation proceeds if telecom users in Jersey are not to be put at risk.”³³

The Treasury and Resources Minister has suggested a variety of mechanisms, designed to reduce the risks associated with high levels of debt. However, they all appear to have some disadvantages and may be costly to implement or operate. There are also difficulties in the implementation and regulation of such licence conditions. The Treasury and Resources Minister agrees that there are inherent difficulties in controlling gearing:

“As I say, at the moment I am not convinced that I have the right solution or that there is even a right solution for this one. It is simply an issue which is flagged up for which we do need to find a solution before the time comes.”³⁴

Key Finding - The Panel has no confidence that any mechanisms can be put into place to protect against excessive gearing of Jersey Telecom once sold; it believes that such a risk is unacceptable given the strategic importance of telecoms to business activity on the Island.

³³ David Parker Advice to Scrutiny, dated 16th November 2007

³⁴ Scrutiny Public Hearing Transcript, 18th December 2007- Minister for Treasury & Resources (Page 2)

9. Protection of the Island's Skills Base

A major expense for any company is its staffing and training costs. Currently there is a healthy training and apprenticeship base within Jersey Telecom. According to figures given to the Panel by the Economic Development Minister in December 2007, Jersey Telecom employ 434 staff of which 97.7% are locally qualified, 0.5% J-category and 1.8% non-locally qualified.

The maintenance of a highly qualified local workforce forms one of the Island's Strategic Objectives as outlined in the States Strategic Plan. Telecommunications staff must be part of this objective.

It is likely that under private ownership staff and training costs will be assessed and reduced where possible to increase profitability. Therefore, one of the prospects following a sale is that there will be a reduction in training and apprenticeship opportunities within Jersey Telecom. Additionally, the Sub-Panel is concerned that the new owners of Jersey Telecom may utilise skilled staff from outside the Island which would in turn reduce the training opportunities for local residents.

Jersey Telecoms employees are amongst the most highly trained and specialised staff on the Island. The importance of maintaining this skills base is vital to our major industry, the finance sector.

9.1 Outsourcing and downsizing

To the extent that private sector firms focus primarily on the maximisation of profits, owners of Jersey Telecom will seek to employ whatever skills mix is most cost efficient for their business. If there are additional costs involved in either employing high skilled workers in Jersey or in obtaining the required level of skill from a qualified Jersey resident, multinational companies are likely to have the greatest opportunity to minimise costs. Employment can either be moved off the Island or can remain on the Island but be filled by imported

labour.³⁵ That fact that labour costs in Jersey are high cannot be contested as the following transcript reveals:

Senator T.A. Le Sueur:

“You are working on the assumption, I think, that Jersey’s cost base is inevitably going to be higher than elsewhere.”³⁶

Deputy G.P. Southern:

“Are you going to deny that publicly?”

Senator T.A. Le Sueur:

“No. But if one looks at good economic argument, ultimately over a period of time things will tend to balance out.”

The current mechanism for controlling the employment mix in Jersey is the Regulation of Undertakings and Development (Jersey) Law 1973 (RUDL) and associated regulations, which clearly restrict the importation of labour into the workforce. However, it does not seem likely that RUDL will be effective in preventing a private company from moving some of its operation off-island if this proved cost effective.³⁷ A global telecoms operator is likely to find that outsourcing off-island will produce reductions in cost.

Furthermore, RUDL can play no part in a company’s decision to simply downsize its staff. Simple downsizing of the total workforce has been the chosen route of Private Equity take-overs following privatisation this possibility remains and major concern for the employees. Unite, National Officer, Mr. P. Skyte stated:

³⁵ Possible sale of Jersey Telecom: additional analysis. Prepared for the States of Jersey, July 20th 2007.Oxera [Annex 5.2 P.153/2007 page 262]

³⁶ Scrutiny Public Hearing, 18th December 2007 – Minister for Treasury and Resources. (page 26)

³⁷ Possible sale of Jersey Telecom: additional analysis. Prepared for the States of Jersey, July 20th 2007.Oxera [Annex 5.2 P.153/2007 page 263]

“Unite has serious concerns about the activities of Private Equity firms, including their focus on a relatively short time frame for return on investment and propensity to restructure businesses, threaten existing pension provisions and cause substantial redundancies.”³⁸

The use of RUDL to attempt to protect the telecoms skills base in Jersey would place significant additional costs on any potential purchaser, which would be reflected in a reduction in the sale price. In addition, any such attempt may be subject to legal challenge.

At the public hearing on 17th December 2007, the Economic Development Minister had this to say when questioned about the use of RUDL to protect the Island’s skills base:

“I think one needs to be very careful about the heavy hand of the State, just simply trying to dictate to businesses what is best for them.”³⁹

He later added:

“The future of economic growth, the rising standard of living, is based upon open markets and light touch regulations.”⁴⁰

This light touch approach to RUDL contradicts the assurances given in P.153/2007 by the Treasury and Resources Minister.

Key Finding - The Panel has found no evidence that the current Laws can be used to protect the Island’s telecoms skills base from the threat posed by downsizing or outsourcing.

³⁸ Unite Submission on the proposed structural separation of Jersey Telecom, dated January 2008

³⁹ Scrutiny Public Hearing Transcript, 17th December 2007 – Minister for Economic Development (p 36)

⁴⁰ Scrutiny Public Hearing Transcript, 17th December 2007 – Minister for Economic Development (p 36)

10. Protection of Employee Terms and Conditions

In the 'Sales Principles' of P.153/2007, the Treasury and Resources Minister promises to not to commit to a sale of Jersey Telecom, unless the existing rights of Jersey Telecom's employees are adequately safeguarded. As previously stated in the Scrutiny Report, S.R. 5/2007 'Jersey Telecom Privatisation':

“The Panel is very concerned that the Treasury and Resources Ministers 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 Treasury and Resources Minister proposes to deal with this critical issue.”

The Treasury and Resources Minister has still not provided any details as to how he proposes to fulfil his assurance of safeguarding the existing rights of Jersey Telecom employees. The Sub-Panel therefore sought further legal advice on the possible protection of employee rights through contractual obligations and sought a legal update on the areas previously explored by the Panel. The advice received re affirmed the Panel's concerns and it stated:

“Such contractual obligations can be made legally binding. However, the Panel needs to bear in mind that as a matter of privity of contract, the employees will not be in a position to enforce the agreed terms unless some legal mechanism is given to them to do so. As for the States, there is no guarantee that a future elected chamber or appointed Minister would choose to avail themselves of the right to enforce those obligations and it is

most unlikely they could be compelled to do so (see 2006 advice)."

Key Finding – Employee Terms and Conditions cannot be adequately protected through contractual obligations, as any obligations placed on the initial sale may not be passed on in any further sales.

At a Public Hearing on 18th December 2007, the Sub-Panel asked the Treasury and Resources Minister about contractual obligations and how the Minister envisaged such obligations could be carried forward through future sales of Jersey Telecom. Senator T. A. Le Sueur responded:

*"I would say it gets proportionately more difficult as you further the distance. It is no substitute to having proper regulation, proper regulatory powers so what I want to do is to have proper regulatory powers and on top of that impose whatever conditions I believe are appropriate to a purchaser and whether they can be bound to an ongoing purchaser. One has to be realistic in terms of you cannot bind a person 50 years down the line."*⁴¹

Deputy G.P. Southern went on to ask:

"So it is dependent on licences and licence conditions and the ability to regulate those licences?"

To which Senator T. A. Le Sueur responded:

"Yes"

The protection of employee terms and conditions is not a matter for the JCRA under the Telecommunications (Jersey) Law 2002. The Minister is wrong to think that employee terms and conditions could be protected in this way. There are no grounds for introducing such terms into Telecoms Licences.

⁴¹ Scrutiny Public Hearing Transcript, 17th December 2007 – Minister for Treasury and Resources (p 28)

Key Finding – The JCRA cannot provide any protection for employee terms and conditions.

The Sub-Panel understands from work undertaken in its previous review, that although legislation similar to that of the UK's Transfer of Undertakings (Protection of Employment) regulations (TUPE) could be brought in, such legislation would not provide complete protection. The Panel also understands that, TUPE legislation does not extend to protection of pension provisions nor does it apply to a sale by transfer of share ownership.

All contractual obligations are likely to reduce the value achievable for the sale of Jersey Telecom. Contractual obligations relating to the protection of employee terms and conditions are no different and may significantly reduce the sale price; this is further explored in the following chapter.

11. The Effect of Onwards Sale to any Contractual Obligations

The Treasury and Resources Minister has given several assurances about the proposed sale, some of which are likely to be met through contractual obligations. However, as mentioned in the previous chapter, privity of contract provides that a contract cannot confer rights or impose obligations arising under it on any person or agent except the parties to it. In effect any contractual obligations in the initial sale agreement cannot necessarily be passed on to any subsequent owners of Jersey Telecom.

In the proposition ‘Process Principles’ the Minister gives assurances about the selection process for a suitable buyer for Jersey Telecom:

“to only propose that the States enters into definitive and binding agreements with the selected buyer to effect a sale, if appropriate measures are in place to ensure that the initial and any subsequent purchaser of Jersey Telecom is an entity of stature with an established reputation and track record”⁴²

The Minister may be in a position to vet the suitability of the initial purchaser. However, the principle of privity of contract means that he will not be able to intervene in any subsequent sale.

As we shall see further on in this chapter, the option of using RUDL ‘change of beneficial ownership’ powers is also uncertain.

The Treasury and Resources Minister has also given assurance that he can control gearing in a similar manner, as we have demonstrated in Chapter 8, we believe that these assurances are groundless.

⁴² P.153/2007 JT Group Ltd (“Jersey Telecom”):Proposed Sale (page 47)

Additionally, any contractual obligations relating to onward sale will reduce further the value of the initial sale of Jersey Telecom. However, the Economic Development Minister has been asked to look at the way that conditions could be put on a RUDL licence under 'Change of beneficial ownership provisions' which would have regard to issues such as gearing⁴³.

The Economic Development Minister gave the following example:

“We are taking advice on the ability to use ‘Reg of Uns’ under the beneficial ownership arrangements. Take the theoretical example, J.T. is sold to Company B plc and in Jersey for a subsequent sale of J.T. from Company A to Company B you require Reg of Uns approval under certain circumstances for a change of beneficial ownership. That triggers a requirement of an approval and therefore the ability of the Minister to put conditions on that change of beneficial ownership. You will be well aware of our previous track record in using beneficial ownership provisions for dealing with some issues in the fulfilment industry.”⁴⁴

To which, Deputy G.P. Southern questioned:

“Which has yet to be challenged under Human Rights Law and awaits ...”

Senator P.F.C. Ozouf replied:

“Ministers take advice in respect of human rights and make decisions ...”

⁴³ Scrutiny Public Hearing Transcript 17th December 2007 -Minister for Economic Development (P 29-31)

⁴⁴ Scrutiny Public Hearing Transcript 17th December 2007 - Minister for Economic Development (p 30)

Deputy Southern then raised concerns that putting such conditions into a RUDL licence may lead to a challenge and another legal case, he asked:

“But again when we are dealing with a large multinational, a large global operator, you start putting conditions on your R.U.D.L. licence I think you are opening yourself to a challenge and another legal case.”⁴⁵

Chief Officer, Economic Development Department, Mr. M. King answered:

“I think you may very well be right”

Any attempt to use licence provisions to prevent any onward sale of a business to a 3rd party, is not only contentious but is open to legal challenge. No faith can be placed on this to safeguard the State’s interest in the future ownership of Jersey Telecom.

Key Finding – The JCRA cannot provide any protection for employee terms and conditions through licence conditions.

Key Finding – The potential use of RUDL to place conditions on any sale of Jersey Telecom is open to legal challenge.

⁴⁵ Scrutiny Public Hearing Transcript 17th December 2007 - Minister for Economic Development (p 31)

12. The Protection and Development of the Islands Telecommunications Infrastructure

In the proposition ‘*Sales Principles*’, the first assurance given by the Treasury and Resources Minister is that he will only sell Jersey Telecom if ‘*Sufficient arrangements are in place to protect the Island’s consumers and ensure the maintenance of the Island’s essential telecommunications infrastructure.*’ Yet, the Treasury and Resources Minister has put forward the sale of Jersey Telecom as the only way to protect the future of telecommunications in Jersey.

The Sub-Panel disagrees, evidence presented to the Sub-Panel indicate that it is competition that is key to a successful telecommunications industry. A competitive marketplace drives technological advances and diversity of services, which in turn leads to increased market and company growth. However, such levels of competition have not yet been achieved in Jersey and there is a need for improvements in the regulatory framework to facilitate the necessary levels of competition. Mr. P. Funk, Chairman of Newtel, explained to the Sub-Panel how functional separation of BT’s wholesale and retail sectors has improved competition, lowered prices and lead to increased service levels;

“The number of BT exchanges that were equipped with competitive equipment had increased from somewhere around 30 per cent to 70 per cent, again in 3 years, which shows that under the proper regulatory umbrella competition can grow very, very steadily. BT’s share of the broadband market in the U.K. has fallen dramatically. However, in absolute terms they have retained their position.”⁴⁶

The Economic Development Minister voiced his concerns that the current service provision is less than satisfactory, even with Jersey Telecom under States ownership:

⁴⁶ Scrutiny Public Hearing Transcript, 18th December 2007 – Newtel Solutions (Page 7)

“If I am honest with you, I think there is some work to be done on that in terms of our internet speed. We do not have an Island at the moment that can boast the same level of broadband internet access that you get in other places.”⁴⁷

These current deficiencies in service levels further the case for improved regulation and competition to produce a level playing field in the marketplace. The future protection and development of the Island’s telecommunications infrastructure depend on the powers given to the JCRA in Article 16(1)(b) of the Telecommunications (Jersey) Law 2002 which concern:

- (i) provision of specified telecommunications services;
- (ii) connection of specific apparatus to the system; and
- (iii) connection of any other specified telecommunications system.

The JCRA can only do this effectively if they have the required powers to inquire, determine and fine as outlined in chapter 6. Furthermore, they also require powers to separate if only to ensure that any future owners of Jersey Telecom are motivated to cooperate in freeing up the market.

It must also be noted that all these provisions are subject to the caveat that the powers have to be exercised by the JCRA in a reasonable and proportionate manner. This applies to the issue of gearing, contractual obligations in the first and any subsequent sale and indeed to the issue of the suitability of any potential buyer. All of these areas may be subject to legal challenge.

Any limits on the ability to dictate gearing levels may affect the capacity to prevent insolvency. Although there are conditions in the Jersey Telecom licence pertaining to insolvency and cessation of service, the Panel are concerned that there are no direct provisions in the Telecommunications (Jersey) Law 2002 that are directed at protecting the continuity of service should Jersey Telecom face insolvency. As continuity of our

⁴⁷ Scrutiny Public Hearing Transcript, 17th December 2007 – Minister for Economic Development (p 41)

telecommunications infrastructure is imperative to our economy, the Sub-Panel recommends that such a provision should be considered in the review of the powers and resources available to the JCRA.

Recommendation

Provisions should be placed in the Telecommunications (Jersey) Law 2002 to protect the continuity of telecommunications services.

Appendix 1

The Proposed Sale and Process Principles Sale Principles

Table 1.

<p>The Minister will commit to propose a sale of Jersey Telecom only if it is consistent with the following principles:</p>
<p>(1) Sufficient arrangements are in place to protect the Island's consumers and ensure the maintenance of the Island's essential telecommunications infrastructure.</p>
<p>(2) The best possible basis is provided for the long term growth and development of Jersey Telecom.</p>
<p>(3) The existing rights of Jersey Telecom's employees are adequately safeguarded.</p>
<p>(4) The best price is obtained on behalf of the people of Jersey, consistent with the above three principles, with the proceeds reinvested in the Strategic Reserve.</p>

Process Principles

Table 2.

The Minister also commits to a smooth and well executed sale process in accordance with the following principles:	
(1)	<p>Selection of an appropriate buyer for Jersey Telecom.</p> <ul style="list-style-type: none"> • The qualification of trade buyers and investors to participate in the process will be based on transparent and clearly defined criteria. Such criteria would include demonstrated expertise in various sectors within the telecommunications industry and a track record of revenue and profitability for a number of years in the case of trade buyers; demonstrated investment profile and track record compatible with the Island's interests, availability of funds of certain size thresholds, demonstrated ability to create value with regards their investments to qualify to participate in the process • The shortlisting of bidders will be based on criteria inclusive of the ability to meet the sale principles as detailed 1 to 4 above including those with regards to employee issues, investment in infrastructure, bidder credibility and valuation
(2)	The Minister intends to propose the sale of the entire shareholding in Jersey Telecom, but may, if appropriate, propose the sale of a reduced shareholding, representing no less than a majority stake in Jersey Telecom.
(3)	The Minister intends to propose selling the shareholding in Jersey Telecom as a single entity in its current form. [Subject to the requirements of the JCRA as set out on the following page.]
(4)	The Minister intends to place conditions on the sale to protect the terms and conditions of employment of Jersey Telecom employees.
(5)	The Minister will only propose that the States enters into definitive and binding agreements with the selected buyer to effect a sale, if appropriate measures are in place to ensure that, following a sale, Jersey Telecom does not become over-g geared.
(6)	The Minister will only propose that the States enters into definitive and binding agreements with the selected buyer to effect a sale, if appropriate measures are in place to ensure that the initial and any subsequent purchaser of Jersey Telecom is an entity of stature with an established reputation and track record.
(7)	The Minister will only propose that the States enters into definitive and binding agreements with the selected buyer to effect a sale, if the sale process attains at least the fundamental valuation of Jersey Telecom as quantified by the Minister's professional advisers.
(8)	The Minister will also take all necessary professional and legal advice before proposing the sale to the States.

Appendix 2

Proposed Terms of Reference for the Review of JCRA's Powers and Resources

DRAFT TERMS OF REFERENCE

1. Per the Steering Group and Oxera, the review should focus on the powers available to the JCRA, both current and potential. In this regard, areas of focus can be:

- (i) Has the JCRA used the powers currently at its disposal effectively in its past efforts to regulate telecommunications in Jersey?
- (ii) Does the proposal to give the JCRA the ability to fine (as per Page 40 of P.153/07) go far enough? If so, how should this be constructed?
- (iii) Are there other powers, in addition to the ones that are currently proposed in P.153/07, that should be added to make the JCRA a more effective regulator?
- (iv) Is the statutorily prescribed consultation process appropriate in all instances? Can or should it be streamlined in certain instances?

2. Per the Steering Group and Oxera, the review should focus on the resources available to the JCRA. In this regard, areas of focus can be:

- (i) An assessment of the skills, qualifications and competencies of the JCRA's current telecommunications regulatory staff, and an assessment of whether this staff is sufficient to meet the workload of regulation of telecommunications in a privatised environment, or whether additional resources likely will be required.
- (ii) An assessment of whether the JCRA has sufficient flexibility in resources (both personnel and financial) to deal with different issues in telecommunications as they arise.

Appendix 3

JCRA Statement as Presented at the Public Hearing 08th January 2008

Mr. C. Webb (Executive Director, Jersey Competition Regulatory Authority):

Good morning. My name is Chuck Webb and since October 2007 I have been Executive Director of the Jersey Competition Regulatory Authority. As you know, prior to that I was the J.C.R.A.'s (Jersey Competition Regulatory Authority) Legal Adviser. I am joined today by my colleague Terry Cassells, who is the J.C.R.A.'s Economic Adviser.

This is the third time the J.C.R.A. has appeared before the Economic Affairs Scrutiny Panel concerning the potential privatisation of Jersey Telecom. This has proved to be an important and complex issue for Jersey and one that deserves detailed scrutiny and analysis.

The current proposition to privatise Jersey Telecom is set out in the 2007 States' Proposition 153. This proposition was due to be debated on 15th January and while this debate has been delayed, 153, as far as I know, currently remains the proposition on the table. Proposition 153 highlights the critical role played by the J.C.R.A. in regulating Jersey's telecommunications sector. Indeed it is highly unlikely the issue of J.T.'s (Jersey Telecom) privatisation would even be considered by the States, absence the presence of the J.C.R.A. and its regulation of telecommunications in Jersey.

Proposition 153 stresses the need for an effective regulatory environment and, to this end, the proposition recommends giving the J.C.R.A. the power to levy financial penalties against telecommunication operators for infringements to the Telecommunications (Jersey) Law 2002. In addition the Steering Group's expert adviser, O.X.E.R.A. (Oxford Economic Research Associates) recommends streamlining the law's required consultation processes. Naturally

the J.C.R.A. supports these proposed changes as both the power to levy fines and streamlining the required consultation process would further facilitate our ability to effectively regulate telecommunications in Jersey.

It is important to note that O.X.E.R.A. urges that these changes be made regardless of the future ownership of J.T. However, we would like to stress 2 important considerations concerning these proposed changes.

First their implementation requires amendments to the Telecommunications (Jersey) Law 2002. While we have been in touch with E.D.D. (Economic Development Department) concerning these proposed changes and we understand E.D.D. also has contacted telecoms licensees concerning them, amendments to the law in Jersey naturally take time.

Second, and more fundamentally, the amendments proposed in Proposition 153, while useful, do not address the fundamental issue of fair and equal access to the telecommunications network currently owned and operated by J.T.

In Jersey's current regulatory environment, competitors for J.T. in the provision of fixed line telecommunication services rely on J.T.'s network to provide services to their customers. Thus, in vital areas such as fixed line telephony and broadband new entrants are both customers of and competitors to Jersey Telecom. In this current environment it is very difficult to achieve real choice and competition in telecommunication services. Furthermore a dominant incumbent operator like J.T. has a natural incentive to discriminate against new entrants for network access. Problems with network access have arisen in Jersey and indeed such problems have been recently reported in the *Jersey Evening Post* and described to this panel by Newtel. Such problems not only hurt new entrants but directly harm consumers of telecommunication services in Jersey. Restrictions currently mandated by the J.C.R.A., such as equal access provisions in J.T.'s licence and accounting separation obligations, seek to address issues of access but they cannot remove the underlying incentive to

discriminate. It is also important to know that these issues of access and discrimination exist regardless of the future ownership of J.T. Such issues can be addressed with the separation of J.T.'s retail operation to its wholesale network. Now the key concept underlying separation is one of independence, that is independence of the wholesale network from retail operations. Separation can take many forms. In the J.C.R.A.'s view the States of Jersey currently has a unique opportunity to examine structural separation of J.T., the division of retail and wholesale units into separate ownership.

We believe that structural separation would be the most effective remedy to ensure the provision of real choice and high quality telecommunication services in Jersey and, indeed, it may even maximise the value of J.T.'s privatisation to the States. Short of structural separation, there can be operational or functional separation; a division of retail or wholesale units but not under separate ownership. For the reasons stated in our report on structural separation, we maintain a functional separation would not be as optimal as structural separation. However, should this panel and the States wish to explore the option of functional separation in greater detail there are various models that could be examined. With these thoughts in mind, Terry and I now stand ready to address any questions you may have.

Appendix 4

Brief Description Mechanisms Used in UK Licences to Control Gearing

Limit on level of financial indebtedness

A licensing provision to limit the level of indebtedness is not straight forward. Companies need financial flexibility and it is difficult to define what an acceptable level of gearing would be. If such a provision were in place what action could the regulator take if it were broken? If the future owner(s) of Jersey Telecom breached such a licence provision by taking on unmanageable levels of debt, the future of the telecoms infrastructure may not be protected by imposing financial penalties or taking legal action, which would exacerbate the problem.

Credit rating requirement

Credit ratings are used by regulators to ensure companies maintain an investment level rating or higher. Credit ratings are an opinion, not a fact of financial stability and there are ways in which a company can maintain an investment grade credit rating and still be highly geared. According to the advice given in Annex 5.4:

“a credit rating may be unduly burdensome and costly for a small company such as JT (and indeed may well not be available to a company of JT’s size)”

Additionally, the experiences of Ofwat have indicated that additional ‘cash lock-up’ provisions are required to prevent cash or assets being transferred to an associated company if the credit rating were at risk of falling below a trigger level. Without this provision, it would appear that the regulator is powerless to intervene until the rating has fallen below an investment grade rating.

Limitation on licensee's activities and investments to regulated activities

In addition to the JCRA's comments above regarding gearing licence conditions, the Sub-Panel's advisor, Dr. D. Parker commented on the use of licence conditions to reduce the risks of insolvency by limiting Jersey Telecom's investment activities. He agreed that provisions should be made to limit the use of Jersey Telecom's assets as collateral for loans taken out by other companies in a group structure. However, both he and the Panel's legal advisor informed the Panel that such conditions may reduce the value which could be derived from the sale of Jersey Telecom.

Prohibition on acting as guarantor

This is a method of reducing the risk of insolvency by prohibiting the licensed company from guaranteeing the debt of other companies. Such a licence condition may impact upon the buyer's expected financing or structuring of the Jersey Telecom Group.⁴⁸

Restricting dividend payments outside the regulated entity

The Panel was advised that in principle, payments of dividend outside the regulated entity could be made subject to a requirement of prior consent from the JCRA, which would not be withheld unless the payment was inappropriate having regard to the need to ensure that sufficient monies were available to meet the company's liabilities on an ongoing basis.⁴⁹

Requirement to maintain the listing of a financial instrument.

The Panel was advised that any such licence condition could be enforceable, provided they are not unreasonable or unworkable⁵⁰. However, as with a credit rating requirement (discussed above), the warnings regarding the cost of maintaining a particular grade of listing for Jersey Telecom could make this system unreasonably onerous for Jersey Telecom.

⁴⁸ Annex A5.4, page 289, P.153/2007 JT Group Limited ("Jersey Telecom"): Proposed Sale

⁴⁹ Advocate Mark Renouf: Second Advice To The States Of Jersey Scrutiny Sub-Committee In Relation To Aspects Concerning The Sale Of Jersey Telecom Limited, 19-12-2007

⁵⁰ 50 Advocate Mark Renouf: Second Advice To The States Of Jersey Scrutiny Sub-Committee In Relation To Aspects Concerning The Sale Of Jersey Telecom Limited, 19-12-2007