STATES OF JERSEY

JT GROUP LIMITED: RESTRUCTURING OF ENTERPRISE (P.96/2017) – COMMENTS

**Presented to the States on 13th November 2017
by the Council of Ministers**

STATES GREFFE

COMMENTS

Summary

The Council of Ministers does not believe that this Proposition provides the necessary detailed rationale or evidence, or been subject to sufficient examination, to be supported. It is proposing radical change, including the breaking-up of a States-owned company, without, for example, a cost benefit analysis.

Background

The proposition is effectively asking that –

- JT Group Limited (JT) be restructured into 2 separate entities, JT Retail limited and JT Infrastructure Limited, both initially to be wholly owned by the States;
- that a Telecoms Strategy detailed in the schedule be used as a foundation for developing the States' telecommunications strategy; and
- the Board of JT be requested to conduct a detailed review of the Group's off-Island activity to evaluate their long – term benefit to the company.

The report justifying this proposal, which is one page long and the proposed Telecommunications Strategy is 2 pages long, would result in the most fundamental and far-reaching changes to the structure of Jersey's telecommunications industry in the Island's history.

The proposal is made without providing any detailed or proper analysis of the industry and the marketplace in which it operates, or any evidence as to why such a radical change is needed. Furthermore, there is no evidence of consultation with, or support from, any of the operators or stakeholders in the market or of CICRA, which is the organisation that has the statutory obligations for oversight of the telecommunications market under the terms of the Telecommunications (Jersey) Law 2002. There is no detailed Cost Benefit Analysis to provide the necessary evidence to support what is a radical proposal.

These and a number of other issues are set out in more detail as follows:

Timing of this Proposition and work already underway

Why has this Proposition been brought now when Ministers are a substantial way through developing a Telecoms Strategy to implement a coherent policy on the sector's future? This is due to be brought before the States during the first half of 2018.

The Telecoms Strategy is being developed following recommendations from the Review of Competition and Regulatory Framework, completed in 2015. The reason for this commitment is that the industry is acknowledged as a key enabler for the growing digital sector, as well as the majority of businesses; and Islanders that now use the technology and guaranteed high quality connectivity as a fundamental element of their day-to-day operations. The strategy being developed will support a number of aims from the States' Strategic Plan 2015 – 2018, including –

- increased focus on new, high potential growth sectors;
- productivity-led growth across all Jersey's economic sectors; and
- competition helps contain prices in key markets.

To co-ordinate the development of the strategy, a Telecoms Strategy Steering Group has been convened with representation from the Economics Unit, Treasury and Resources Department and Digital Jersey, as well as the Chief Minister's Department.

Oxera have been retained to support the development of the strategy, given their extensive economic expertise and understanding of the Island's economy. The work has been split into 3 phases –

- Phase 1 – consultation with key stakeholders;
- Phase 2 – making trade-offs and agreeing an overall vision for the sector; and
- Phase 3 – completion and publication of strategy and associated action plan.

Phase 1 and Phase 2 have now been completed. Phase 3 is currently under way.

The scope of the strategy is wide-ranging to ensure that telecoms policies achieve a number of objectives. Included in the scope of the project is the fibre roll-out (94% complete), mobile broadband, next-generation technology, social policy objectives, and using telecoms to support the digital sector and wider economy.

This proposed Telecoms Strategy will be brought to the States in early 2018. It will be evidence-based, fully consulted upon, and the financial implications understood and identified. That is the time when any decisions about the future of JT should be considered.

Rationale behind this Proposition

The report attached to the Proposition states: "What is clear from the strategy is that the best value for the Island is obtained from separating the wholesale and retail sales of the company. This compares with the approach being taken to BT by OFCOM.".

In fact, the strategy proposed does not make it clear why it is the best value to the Island. Indeed, it appears to be just a very prescriptive list of activities to be undertaken without any justification as to why they should be undertaken, or any identification (or evidence) of the benefits that would result. No cost implications are mentioned, despite the likelihood of these being substantial.

By way of example, it proposes suppliers and equipment to be used (Huawei and AT&T) without providing any information about why they should be used, the cost of implementing the change, nor the practicalities/risks involved in such a change. At present, JT does not use these companies or their equipment in its network. Approving the proposed technical strategy without a full understanding of why it is needed or how it would work is highly risky. JT's intricate and reliable network is the result of highly skilled and carefully planned engineering work tailored for the Island over many years.

What is being proposed, effectively, is not comparable to the approach taken to BT by Ofcom. With BT there has been a legal separation of a network subsidiary (i.e. 'Openreach') from its parent. This arose principally out of a lack of investment in fibre, which is clearly not an issue we have in Jersey.

This is not what is being proposed here, which is structural separation, involving CICRA ordering the transfer of the assets of private companies or private entrepreneurs and moving them into a States-owned company. It would also involve the significant technical integration challenges of collapsing multiple distinct networks into one. The costs of such a move will be significant and if resisted by the other parties, will likely result in legal challenges and bills. To propose such a significant move without appropriate engagement with those involved in running any of the networks or provision of telecoms services who own such assets, risks significant reputational damage for Jersey as a place to do business and invest.

The alternative justification for structural separation would be in relation to transparency issues, non-discriminatory issues, or issues in relation to equivalence in the supply of certain telecommunications services. It is noteworthy that there are no such issues logged with either JT or CICRA.

The States considered such issues when it approved the Telecommunications (Jersey) Law 2002, at which point independent regulation was established and alternative providers licensed to provide services (investing in their own infrastructure, if they so decided). Fifteen years later, and following multi-million pound capital investments by JT and other operators into their own infrastructure (underground networks, fixed and mobile networks, mobile access network, data centres, interconnection, business purchase transactions, etc.), it is hard to determine the rationale to try and roll back these investments.

Lack of consultation/evidence

This issue has been referred to earlier but is extremely relevant in terms of the decision the States is being asked to make. The views of the other companies involved and affected by this proposal have not been provided as part of the Proposition and Report. Indeed, it is not known to what extent they are aware of this proposal and if they have in any way contributed to its development.

As presented the proposals and the strategy in the Proposition are heavily influenced and shaped by unnamed "independent entrepreneurial experts in the Island". This seems at direct odds with Senator S.C. Ferguson's own statement in her report: "As an engineer, I am concerned that at the moment we are receiving opinions filtered through politicians and are not considering the broader technical issues and future prospects.".

It is difficult to understand how the States Assembly can realistically consider this Proposition and approve such a narrow and prescriptive Telecoms Strategy based, as it is, on such a brief and non-detailed report. The report asks that, "Acknowledgement of the fact that this is the optimal policy for the company, similar to the recommendation by Ofcom for BT, will also enable the changes to take place more swiftly and therefore be less costly.". No supporting evidence is provided to support the request, nor is any clear evidence of the failure in the market that is driving such a radical proposal clearly articulated. It should not be under-estimated what a radical proposal is being made. This makes the absence of any Cost Benefit Analysis all the more surprising and a major omission.

The work that is currently being undertaken by the Telecoms Strategy Steering Group has, however, involved consultation with those affected parties. This has involved extensive engagement with stakeholders, including Ministers, States Members, telecoms companies, development agencies, consumer groups, business groups and CICRA.

As a result, the Telecoms Strategy that will be presented to the States will be comprehensive and wide-ranging. It looks at all aspects of the market, current and future, and is intended to provide a framework on which to develop policies to deliver that strategy. Structural separation is one policy aspect aimed at promoting greater retail competition. The draft of the Telecoms Strategy considered by the Council of Ministers does not identify structural separation as a required policy aim of the strategy.

Indeed it identifies that best practice regulation indicates –

- structural separation is one of the more intrusive forms of regulation which should only be considered as an instrument of "last resort", to be used only when other forms of regulation have not been effective in addressing market failures;
- structural separation is an extreme solution as it involves a costly and risky transition that requires the creation of a wholly new company;
- structural separation results in the weakest incentives to invest and innovate for the network division (which in turn, may require further regulatory intervention); and
- structural separation, once implemented, can be very expensive to undo.

It concludes that the conditions for adopting any "heavy-handed" form of intervention do not appear to be currently present in the case of Jersey.

This is consistent with previous reports on the matter of structural separation, when this issue was considered in 2007. At that time reports from Analysys Mason, PwC and Oxera concluded variously that the structural separation was "likely to incur significant costs and inefficiencies" (Analysys Mason); "is a high risk strategy" (Oxera); and represents significant risk for no benefit whatsoever" (PwC).

Value destruction/cost of implementation

The report states that a separated retail side of the business could be sold or even floated on the C.I. Stock Exchange to raise funds. It also states that the only financial and manpower implications are that it will be necessary to produce separate accounts for the retail and infrastructure businesses, and that since the accounts are audited this should present minimal problems.

The Council of Ministers finds it difficult to understand how such statements can be justified. It is not realistic to assume that both companies would be able to operate with the same management teams and Boards once split in the manner envisaged in the Proposition. There would need to be a clear separation of management and oversight of the retail and wholesale businesses in order to provide the transparency and integrity required. This would include a need to separate accounting, administration, IT, marketing, accommodation, etc.

This will inevitably add significant costs. Financial and manpower implications would not therefore be limited to producing separate accounts and contained within existing budgets as the Proposition identifies.

The Council of Ministers believes that the additional costs to the businesses arising from this proposal will adversely impact the value of the company, the dividend being received, and the efficiency of the current operation.

Off-Island activity

The challenges for JT in terms of managing the issues of scale have been well-explained and consistently communicated to States Members as part of its annual updates (most recently at its update on 6th June 2017). Jersey is a small market in global telecommunications terms, which in simple business and financial terms would not support the level of investment in infrastructure that is needed to meet the demands of local businesses and domestic customers. It needs to generate sufficient funds off-Island (currently over 60%) to aid this investment in order to maintain the benefits to the local market (e.g. reasonably priced tariffs).

These off-Island businesses are therefore key elements of the performance focus undertaken by the JT Board. This is a core Board responsibility and is what they do regularly and diligently.

Conclusion

On the above grounds, in particular, the far-reaching nature of the proposals, the absence of analysis, and the impending Telecoms Strategy, the Council of Ministers asks the Assembly to reject this proposition.