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Deputy Geoff Southern
Chairman
Telecoms Privatisation Scrutiny Sub-Panel
Scrutiny Office
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Dear Deputy Southern

Structural Separation

The issue surrounding the structural separation of Jersey Telecom has been considered and debated as part of the Minister for Treasury & Resources proposals to seek approval to dispose of the States interest in the Company. The conclusion to that work, after considering specific reports from the JCRA, Jersey Telecom, Oxera, Analysys Consulting and the Chief Minister's Economic Adviser, was that there was no evidence in support of structural separation being the best way forward. This was a position that was agreed with by the Scrutiny Sub-Panel and its advisor, David Parker.

It is therefore with considerable concern that the Board of JT Group Limited finds it needs to re-state its position on this issue and to remind interested parties of some facts associated with the subject.

Structural separation remains at the heart of the JCRA's representations and it continues to proclaim its belief that the structural separation of Jersey Telecom into a wholesale network company and a retail service provider would be the most effective method of regulating Jersey's telecommunications market. The JCRA's championing of its separation cause appears to be a matter of faith since it has failed to present any coherent evidence to support the application of structural separation to Jersey Telecom.

It is crucial to examine why the JCRA could be such a fervent proponent of structural separation. It is based on a simple truth: that a vertically integrated operator competing with other operators in the downstream market has a clear and unambiguous incentive to favour its own retail functions ahead of those of its competitors. This is undeniably true – and can be observed in every competitive vertical market in the world – but a key question is whether this by itself makes the case for structural separation? The answer is an unambiguous and categorical no, and there are a number of reasons for this.

First, a problem with incentives only arises where it is acted upon in a way that is damaging to consumers, competitors or a particular policy goal. There is no such problem in Jersey's telecommunications market. The JCRA, like other regulators,

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has effective powers to prevent unfair discrimination and the application of these powers is evidenced through, amongst other things, the access products available in the market and the structure of dealing with the wholesale operation by a separate division of the Company. The efficacy of the existing powers is indicated by the fact that there has not been a single case of unfair discrimination found against Jersey Telecom since it was first licensed by the JCRA. This outcome is not the result of a weak regulator; it is the result of Jersey Telecom appropriately living up to its obligations. Thus, if the existing safeguards already work, no additional benefits can be claimed for the more interventionist and entirely unjustified structural safeguard.

Second, structural separation is far from costless. There is clearly the one-time transactional cost of separating the integrated business, which will run into millions of pounds. More importantly there are lost economies of scale and scope as one small business is split into two even smaller ones requiring the duplication of many functions and significantly diminishing the opportunity to spread fixed costs over the wider business. This loss is of course not just a loss to the companies but will flow through into higher product prices for consumers. It is worth underlining that the reason for the Board's support for the sale process lies in the potential to achieve some economies of scale in the ever-consolidating world of telecommunications. The structural separation of the Company would be a move in the opposite direction and would turn a small telecommunications company into an insignificant one for no benefit and a great deal of cost.

Third, loss of integration will hinder the coordination of upstream and downstream activities. It is likely that the pace and scope of innovation in product development and customer experience will suffer as a result. Detractors may claim that the splitting of the network and retail elements would see a network develop to the benefit of all retail providers. This makes it appear that Jersey Telecom's retail requirements do not play a major role in the guiding of network developments, something that could not be further from the truth. For any commercial entity in Jersey, separated or not separated, there are economic realities that come from dealing with an addressable market of 90,000 people, something that seems to be entirely lost on those who support the structural separation of the Company.

Fourth, mandatory structural separation necessarily involves the regulator, like a surgeon, choosing precisely where to make the cut from amongst many possible options. The communications sector is probably one of the most dynamic, fast moving and unpredictable. It is characterised by massive technological and product change. In this environment, and the improbable outcome that structural separation could actually be justified, the incision would have to be absolutely precise. Going back to make changes after an unexpected technological development may be very costly indeed, and to an island economy so reliant on connectivity, this is not a matter on which to gamble.

Weighing up these costs and benefits, in the balance it is hard to conclude that structural separation would be good for Jersey. Indeed, in small markets it is inevitable that the cost per person is going to be higher than in larger markets while the same cannot be true for the benefit per person. In the JCRA's view, this is not the case, and it relies on studies which *suggest* that the value of separated units in Europe and Australia would increase by comparison to the existing consolidated

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units. The JCRA's references to these reports, prepared for jurisdictions with populations of 500 million people and 20 million people, respectively, does not question the appropriateness of attempting to shoe-horn this theory such that it applies to a jurisdiction of 90,000 people.

Those who are supporting the separation of the Company are doing so through broad generalisations that are unhelpful in moving the debate forward. Such an approach also appears to give some truth to the lie that a problem exists in regard to access to Jersey Telecom's network. This could not be further from the truth and arises not from those parties that are actually taking advantage of the regulated access products offered by Jersey Telecom (for example Cable & Wireless and Bharti Airtel) but from apparently self-serving and ill-founded evidence provided to the Scrutiny Sub-Panel by Newtel. It is important to point out that Newtel has not actually taken up any of the access products offered by Jersey Telecom and neither has it raised any concern about those products. Therefore, to rely on questionable evidence as a basis on which to re-define the structure of Jersey's telecommunications industry is, frankly, absurd.

The European Commission and the European Regulators Group have published their findings on when operational or functional separation (not structural separation) might be appropriate. They have concluded that this might be the case as a remedy of last resort if other regulatory measures can be shown not to work and if it can be demonstrated to be proportionate to the scale of the market problem. There are no circumstances in which they recommend the use of structural separation.

This truth is entirely at odds with a statement contained in a press release issued by the Scrutiny Sub-Panel where it is stated, "EU telecom regulators are moving to mandatory structural separation". The EU telecom regulators are doing no such thing and such blatant misinformation from a States' body is both unhelpful and inflammatory.

Yours sincerely

John Henwood.

JOHN HENWOOD
CHAIRMAN – JT GROUP LIMITED