

RESPONSE OF THE BOARD OF JT GROUP LIMITED



Introduction

The Board of JT Group Limited^[1] (the Company) welcomes the opportunity to comment on the Discussion Paper issued by the Minister for Treasury & Resources (the Minister) on the proposed sale of Jersey Telecom.

The structure of this response follows that of the Minister's Discussion Paper.

Obligations of the parties

Before turning to the Discussion Paper itself, the Board considers it important to outline the obligations of each of the three parties involved in the decision on whether to sell the Company: the States of Jersey, the Minister for Treasury & Resources, and the Board of Directors. This will ensure all interested parties are mindful of the framework in place since the bringing into force of the Telecommunications (Jersey) Law 2002 (the Telecommunications Law) and the Companies (Jersey) Law 1991 (the Companies Law) when assessing the Discussion Paper and the Board's response to it. A summary of each party's obligations is as follows:

- The States of Jersey owns the entire share capital of the Company and has allocated its responsibility for operating that shareholding to the Minister under the terms of the Telecommunications Law. Nevertheless, under the same law, the States retained for itself all powers relating to the disposal of shares or the changing of rights or security interests over those shares;
- Having passed the Telecommunications Law, the States of Jersey requires that the Minister "act in the interests of the States as holder of securities". This legally obliges the Minister to maximise the value of the States' shareholding in the Company and to exercise the States' interest therein solely on a commercial footing; and
- The independent Board of Directors of the Company is appointed by the Minister (representing the shareholder, the States of Jersey). These directors are legally obliged to operate at all times in the interests of the Company under the terms of Article 74 of the Companies Law "Duties of directors".

This structure was put in place to meet the States' objective of splitting the operation from the regulation of telecommunications by removing itself from the direct control over the former, while making separate arrangements for the latter through the establishment of the Jersey Competition Regulatory Authority (JCRA).

In the context of this framework, the Board believes the performance of the Company and Jersey's economy to be synonymous and the States of Jersey has benefited from a world-class network far in excess of what might be expected from the market size as a result. The Board is of the view that this should continue and believes that if the sale is conducted in the right way then the interests of the Company and the Jersey economy can continue to be jointly promoted. Therefore the sale is not just about securing the highest price, consideration must also be given to the sustainability of Jersey's vital infrastructure.

Regulation in Jersey's telecommunications market

The Discussion Paper notes that without a robust regulatory framework, the sale of the Company could not be considered an option for the States of Jersey and the Board agrees with this view.

While the Board is on record as having some concerns about the policies being implemented by the JCRA, the Company has available to it mechanisms in the Telecommunications Law to challenge such decisions. In extremis, it is only the Royal Court that will be able to consider whether the Board's position on such matters is justified and this will only become apparent if and when any JCRA decision is disputed to that extent.

The primary duty of the JCRA is to perform its functions in "such a manner as it considers is best-calculated to ensure that (so far as in its view is reasonably practicable) such telecommunications services are provided, both within Jersey and between Jersey and the rest of the world, as satisfy all current and prospective demands for them, wherever arising."^[2]

The Board agrees that the framing of this primary duty and the framework established by the States for the purposes of regulating the industry should allow for proportionate and sensible regulatory decisions to be made.

Consumer protection

The Board believes that there are three key elements that go toward ensuring the protection of consumers in a liberalised telecommunications market: the operation of the marketplace, the obligations contained in licences issued by the JCRA (principles further developed by the application of the Competition (Jersey) Law 2005), and the powers of the Minister for Economic Development.

Dealing with the first of these, the reputation of any company in the marketplace is derived from a number of factors, one of which is the level of service that it provides its customers. The availability of services from other operators, both those that are licensed locally and those that offer services from a base outside of the Island, means any organisation that does not offer the required level of service will face the penalty of losing its customers to an alternative provider. The emergence of credible local competition, which is likely to become much more visible by the time any sale process is initiated, will ensure that consumer protection issues are taken seriously.

In addition to this, however, are the obligations placed upon licensed operators by the JCRA. As referred to by the Minister in his Discussion Paper, there is a standard set of Public Service Conditions in each operating licence issued. These deal with such matters as universal service, public emergency calls, public payphones and consumer protection. Where it is considered by the JCRA that the required standards are not being achieved, it has the legal right (and indeed obligation) to make demands of operators such that its concerns are addressed. These powers are enshrined in the Telecommunications Law but they have been further strengthened by the bringing into force of the Competition (Jersey) Law 2005. The wide-ranging nature of the Competition (Jersey) Law 2005 and the obligation contained therein which requires the JCRA to have regard to European Community precedent, provide further support to the JCRA when it is deliberating on any changes to its current set of public service conditions.

The final element of importance in relation to consumer protection issues is the role of the Minister for Economic Development. The Telecommunications Law authorises this Minister to give written directions to the JCRA in respect of principles, procedures, or policies to be followed in relation to the implementation of any social or environmental policies regarding telecommunications. This establishes an overriding requirement that the JCRA must take into account in its regulation of the telecommunications market and would oblige operators to ensure that the direction issued to the JCRA is fully complied with. It would then fall to the JCRA to devise a system for meeting the costs associated with any social or environment obligations identified as being essential by the Minister.

It is as a result of these three elements, that the Board considers the current framework to be sufficiently robust that government ownership of any operator is not required.

Essential infrastructure

The Minister requested responses on his view that the continued provision of essential telecommunications facilities on the Island would not be impacted by any decision to divest of the States' ownership of the Company.

In defining what is "essential" in this context, it is important to factor in the heavy dependency of the Island's economy on the finance industry. This industry in turn makes demands on the infrastructure, in terms of resilience and sophistication, far beyond what might be expected simply from the population size and demographic profile. The Company has over many years adapted its investment programme to accommodate these special requirements. This strategy ensured that the finance industry, as well as other commercial users, could develop unconstrained by any connectivity or telecommunications restrictions. In addition, while a particular investment was sometimes only justified financially by reference to the requirements of business customers, the benefits of that decision were derived by all subscribers. This is evidenced in the resilience and quality of the network in place today and means that the universal service provided by Jersey Telecom is of a quality far higher than that which is experienced in similar sized jurisdictions.

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. The Board believes that a sale to a larger, possibly global, telecommunications company would be in the best interests of the Company and of Jersey as a whole. It is therefore imperative that appraisal of the prospective post-sale framework of the telecommunications industry in Jersey must take into consideration the stability and contribution likely to be made by the purchaser, and the possible impact on investment levels of price competition and narrowing margins.

Market structure

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.

Pace of change and economies of scale

Prior to incorporation on 1 January 2003, the Company operated as a trading committee of the States of Jersey and it was legally obliged to enforce a statutory monopoly under the terms of the Telecommunications (Jersey) Law 1972.

The bringing into force of the Telecommunications (Jersey) Law 2002 has completely changed the shape of the marketplace, in that the States agreed to authorise the JCRA to licence alternative providers of service. This brought an end to the concept of a statutory monopoly in Jersey's telecommunications market.

Incorporation necessitated the maximisation of shareholder value as the primary focus of the Company. The stiff competition in its traditional market, which will inevitably lead to some losses, necessitated the implementation of new strategies by the Company.

The Board considers that within its current structure as a small independent telecommunications operator, the implementation of these new strategies will achieve the desired outcome in relation to shareholder value. However, the lack of any significant economies of scale mean that the strategy adopted by the Board, and the likely outcome, could be further enhanced if the Company had access to such economies.

Against this, the Company's relatively small size has brought a number of important benefits – in particular, its proximity to its clients has enabled it to respond quickly and imaginatively to demands and expectations in its core market, and to anticipate technological changes. A larger organisation, with competing global demands and far longer chains of command, may find this much harder to achieve.

On balance, however, the Board would support the Minister view that the Company would be better equipped to compete successfully if it could benefit from access to such economies of scale from a purchaser able to provide those economies in larger, preferably global, markets. The Board recognises that this might preclude some bidders who might offer a higher price in the short term, but believes that price is just one factor to be taken into account in the sale process.

Jersey Telecom as a strategic investment

While it is inappropriate for the Board to comment on the investment strategy of its shareholder, the States of Jersey, it is without question that the level of risk associated with its investment has increased since the liberalisation of the telecommunications market on 1 January 2003 and the licensing of other operators that has taken place thereafter.

Employee related matters

The Board recognises the interests of the employees as a fundamental element of any decision on the matter of disposing of the States' interest in the Company.

The success of the Company is primarily attributable to the abilities of its employees, and the interests of the Company are directly linked with the ability of its employees to deliver results. It is for that reason that the Board believes that the interests of its staff must be properly safeguarded.

The Board believes that the pension rights of existing employees should be met through the continued participation in a ring-fenced element of the Public Employees Contributory Retirement Scheme (PECRS), and it believes that the requirement for such an outcome should be made clear in any negotiations with potential buyers and enshrined in any sale and purchase agreement.

In regard to the terms and conditions of employees, should the States' interest in Jersey Telecom be divested then the Board believes that any transfers should only take place on the basis of there being no material change to prevailing terms and conditions of employment. The Board is also of the view that any collective agreements reached between the Company and the employees or its representative organisations should continue to be binding on any new owner.

The Board's opinion therefore is that a minimum set of employee-related obligations should be incorporated into any agreement to sell the Company. However, the Board is also of the view that there is no need to await new legislation on such issues. Employees in Jersey Telecom are attuned to life in a commercial environment and it is widely recognised that there are no lifelong guarantees in regard to job security. However, there are defined terms and conditions, as well as disciplinary and other procedures (with associated compensation) agreed with the employees and their representative bodies and it is the continued application of this culture that plays a pivotal role in managing the Company's human resources.

The Company is of the view that such matters must be central to deliberations on a possible divestment and any discussion that takes place with interested parties.

The sale process

The Minister considers two matters under this heading split into the categories of purchasers to whom the shareholding could be sold and the percentage ownership that should be divested.

On the first of these, the Board agrees with the Minister's assessment that a trade sale to another telecommunications operators should be preferred over a sale to a purely financial investor or a process whereby shares in the company would be offered to the public. The basis of this view is the access to economies of scale that would result from being part of a larger telecommunications operator; a sale to either a financial investor or the public would be unlikely to achieve the same outcome.

In terms of the percentage ownership that should be divested, the Board would have a clear preference for a sale of the entire shareholding. This view is based on similar reasons to those set out in the Minister's paper but is quite obviously dependent on the details of any offer.

In particular, the Board is of the view that a partial sale would only be beneficial to the shareholder if it were to be the case that some significant restructuring would lead to a substantial increase in value over time. The Board believes that the Company would not benefit from any major restructuring at this point in time. Additionally, because the regulatory environment is advanced and competition is intense, the future value of the Jersey-based revenues is increasingly under threat and the maintenance of a partial shareholding in the Company will not lead to any change in that position.

Advocates for a position whereby a 'golden share' in the Company is maintained, must consider the implications of the Competition (Jersey) Law 2005 already referred to. The obligation on the JCRA to

have regard to European Community precedents may result in it having to take action against the States if the shareholding was considered to be in contravention of the Competition (Jersey) Law 2005. It should not be discounted that alternative suppliers operating on a commercial basis may successfully argue for such action to be taken^[3].

In these conditions, the Board sees no particular benefit in the maintenance of a reduced shareholding in the Company.

Structural separation

The Board wishes to respond to a number of speculative comments published by some interested parties on the matter of structural separation, since the publication of the Minister's Discussion Paper.

Structural separation refers, in extremis, to the breaking up of the Company into many detached parts without any ties between them, for example, one part owning the access network and another owning the retail elements of the business.

The Minister's Discussion Paper is noteworthy in this connection, as it highlights the importance of access to economies of scale for the Company to be able to compete successfully. The implementation of structural separation would remove the limited economies of scale that are currently available to the Company and on that basis alone this alternative is illogical.

In addition, the Company already operates under licence conditions that oblige it not to show undue preference or unfair discrimination regarding the provision of access to other operators. This represents a far more proportionate response to any perceived issues arising from its current organisation and business proposition.

Summary of the Company's views

JT Group Limited is a long-established business with an excellent track record of delivering strong, sustained financial returns to the States while providing a modern, resilient infrastructure geared to the needs of international financial institutions as well as a wide range of other business and domestic clients. It is a business that punches well above its weight.

The Board supports in principle the proposed divestment of the Company by the States. It believes that in the medium term, access to the in-house expertise and greater economies of scale available from a larger telecommunications group would enhance its overall capability and its ability to participate effectively in an increasingly competitive market.

What matters is to ensure that any change of ownership builds on the Company's core strengths and achievements, rather than nullifying them. There are therefore, in the Board's view, a number of important considerations for the States prior to embarking on any sale process, and some key preconditions that must be met if the change of ownership is to be successful in the longer term. These can be summarised as follows:

1. The States must be satisfied that it can realise an amount commensurate with the enterprise value of the business. This involves taking a view on the prospective returns from the Company versus those from any alternative investments acquired with the sale proceeds.
2. In choosing between potential buyers, the States should ensure Jersey Telecom's ability to provide the Island with continuing world-class telecommunications facilities is enhanced - in short, that the buyer should bring more than just money to the table. It should also ensure that any change of ownership would not prejudice the competitive regime it has established, for example by leading to market dominance and undue pricing power. Bids from competing businesses should therefore be scrutinised with special care.

3. The States should consider requiring a commitment from any preferred buyer to maintain investment levels. Given the size and sophistication of the key finance industry client base, the maintenance of a minimum “essential” infrastructure implies service and resilience standards well above those that might be suggested purely by demographics. Therefore while price is a key element of any criteria on which ownership in the Company might be divested, the continued ability of Jersey Telecom to deliver a world-class level of service will be crucial.
4. So far as possible the States should seek to minimise the risk of local market demands and expectations being drowned out as a result of the Company being absorbed into a highly centralised international conglomerate with different divisions vying for resource. Equally, it would be undesirable for the Company to be hollowed out by removal of key functions and the resources to discharge them. Other things being equal, this suggests that a relatively decentralised group would be a more appropriate parent than one with a rigid global strategy and hierarchy.
5. To reduce the inevitable uncertainty during what may be a protracted sale process, the States should give an early assurance to all staff that their existing terms and conditions will be fully safeguarded.

As set out in the opening paragraphs of this response, the Board has responsibility for operating at all times in the interests of the Company and this will be the case until such time as a divestment is concluded (or indeed thereafter), should this be the course of action adopted by the States. The Board’s clear view is that the best interests of the Company are closely aligned with the best interests of the Island - and this must be considered when assessing the merits of any particular approach.

The achievement of the most beneficial outcome for all stakeholders will require the combined knowledge of the Company and the considerable skill and experience of the Board. In this connection, the Board naturally expects that it will be kept fully apprised of the position as the Minister considers the responses to the Discussion Paper.

^[1] JT Group Limited is the holding company of Jersey Telecom Limited, Wave Telecom Limited and a number of additional non-operating property holding subsidiaries.

^[2] Article 7(1), Telecommunications (Jersey) Law 2002.

^[3] The European Commission brought an action in the European Court of Justice against the Kingdom of Netherlands in June 2004 on the basis that its shareholding in the incumbent telecoms operator (KPN) of 20% and a golden share was contrary to Articles 43 and 56 of the EC Treaty.