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Deputy Geoff Southern
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Dear Deputy Southern

Proposed Privatisation of Jersey Telecom

The proposed single trade sale of Jersey Telecom is not in the overall best interests of the Island, despite the recommendations from the Minister for Treasury and Resources.

The conclusions from the consultation paper – that competition in the Jersey market is now mature and that Jersey Telecom (JT) should be sold as a single commercial entity - are fundamentally flawed. Even a cursory examination of the evolution of the telecoms market in other jurisdictions reveals the errors in the paper's assumptions.

This submission argues that JT should be split up, with emphasis on providing technical and commercial diversity whilst retaining strategic choices for the States. The paper firstly provides some background context on the telecoms sector, secondly illustrates local issues with respect to lessons from the UK and thirdly comments directly on the particular questions the Panel is debating.

Firstly, some background. To gain a non technical understanding of the issues, the best approach is perhaps to consider what has made the Internet revolution so successful. It has been principally the combination of two developments: the advent of cheap computing power and its connection to widespread communications. Indeed, it has been the *connectivity* between computers that is the distinction between what is around us today and what went before. This combination is technically called convergence and refers to the coming together of any means of communication – fixed line, mobile, wireless etc – and computing.

Hence, it is now less useful to talk about there being separate markets (telecoms and, for example, technology) when in reality they are so interwoven and interdependent.

This is why the role of JT is crucial – in any combined market it is by far and away the largest player and as we stand today, JT is still for all intents and purposes a monopoly business. Until C&W and Jersey Telenet start up, it has 100% of the mobile market, and over 90% of the consumer and business market. Such imbalance will not change overnight. This is not a mature and evenly competitive market situation.

Secondly, to turn to the experiences of the UK. The overbearing dominance of BT after a number of years of deregulation and despite the introduction of competitors such as Mercury was recognised as restrictive to the UK economy. The UK OFCOM regulator (and its predecessor, OFTEL) fully recognised this as it was transparently obvious that such a stranglehold across the telecoms sector would make it very difficult to achieve a balanced competitive framework.

This is why BT was broken up a number of years ago and forced to sell off its mobile business (as mmO_2) and other ancillary parts (such as Yellow Pages). The UK Government saw no downside in

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splitting up the goliath that was BT in order to *promote*, as opposed to simply allow, proper competition.

The same arguments hold true in Jersey. There is no reason why for example JT mobile should be part of the same entity as the fixed line telecoms business.

Further, the argument does not stop at mobile. A major issue for new telecom companies (once regulatory hurdles are removed) is the cost of basic infrastructure provision and particularly with regard to the Local Loop – the so called 'last mile' connection from the incumbent telcoms company's exchange to the customers' premises.

The costs of building the network are high – in the UK, typically £40,000 to £60,000 per kilometre of road dug up (for laying the fibre optic cables necessary for today's high speed networks). As such, new infrastructure based telcoms companies in the UK had either to focus their network build in areas where revenue would support the necessary capital returns or, as in the case of the cable companies' license obligations to the Government, achieve a minimum level of home connections over time. This has meant that, in many areas of the UK, the only fixed line infrastructure is that owned by BT.

As such, in the UK in order to deliver further and wider competition in the telecoms sector, the need to allow new telecom companies 'access' to the underlying BT infrastructure has been paramount. This will be no different in Jersey.

In the UK, BT has had to split its wholesale operations (the part that looks after the actual cables in the ground) and the retail parts (the part that sells to consumers and business). OFCOM's reasons are clear: this is the only way to provide a level playing field by giving equality of access to the cables, it will lead to lower prices and greater choice of products and underpin the UK's competitiveness.

The promotion of competition to BT in the UK has had a major impact in several key areas, notably the cost of telecom services has reduced dramatically and the level of customer service has improved significantly (in terms of both service performance as well as new product innovations). The division of BT into distinct retail and wholesale arms has been critical in allowing this, with BT Wholesale having to ensure that it provides the wholesale services on the same basis to the retail divisions of BT as any other telecoms company.

Again, the argument is equally transferable to Jersey, which is why a single trade sale as proposed by the Minister, is not the best way forward.

Thirdly, to address particular questions.

Concerning financial projections, there has been some speculation concerning the value of JT. What is true is that the prices for telecoms companies have averaged close to 20 times earnings (i.e. profit) for the last year and that a recent bid by C&W for a telecoms company (Keytech in Bermuda) was along a similar valuation. For JT, a reported operating profit of £14.3M and 20 times earnings would suggest a valuation of £286M. If this very significant sum is realisable, it can be argued that the States do not need to divest themselves of the whole of their holding in order to protect themselves in any time of economic catastrophe. Indeed, it could further be argued that in the event of such a catastrophe, the ability to directly stimulate communications would be a key feature of any recovery plan. Such an ability would not be available to the States if its sells JT in its entirety.

Further, by splitting JT, the States may be able to raise more than in a single trade sale. Indeed, a split sale of elements over a period would enable the States to remain flexible over its approach and revise its position if necessary in the light of further developments.

Concerning the development of infrastructure, telecoms is clearly an area of rapid development. It does not appear to be the case that JT is unable to raise sufficient capital to fund developments – in its incoporatised state it is just as able to do so as any private sector operation. With a valuation of £250M+ it is likely that any JT structure could secure the capital needed to build any foreseeable local infrastructure.

What is more important is that the convergence trends are balanced by diversity. Crudely, this means that as convergence will tend to cause consolidation of companies, strong promotion of diversity is needed to ensure continued choice and avoid monopolisation with its inherent anti-competitive behaviour. As noted above, the UK takes the view that despite its huge size, even BT cannot invest in all of the avenues of possible technological development. This is why it has promoted diversity of supplier on the retail side. Hence, the single entity trade sale as proposed is not the best way forward.

Concerning the existing regulatory framework, the JCRA is cited as the mechanism by which competition is ensured. However, despite its good works so far, this is simply not enough. In the UK, OFCOM is receiving comment that the Competition Act alone is not a realistic option for ensuring fair competition as its remedies are too slow and too expensive. In Jersey, witness the recent delays in forcing sharing of basic equipment between JT and C&W – speed is of the essence in the telecoms sector.

The same argument that caused OFCOM to split up the wholesale and retail arms of BT holds true in Jersey. Indeed the JCRA is currently struggling with how to open up the cables – particularly the "last mile" to other providers. The only way to avoid the temptations of cross subsidy, favourable treatment and monopolistic behaviour is to split the wholesale and retail roles.

The point about having to actively promote competition rather than simply allow it is a real one. When there is such a dominant player in the market – and JT is dominant across all of the telecoms sectors – smaller players need positive assistance in order to take on the might of the major player. Competition needs a level playing field and the opportunities to delay access, treat competitive retail providers less favourably than its own and generally frustrate competitors can often be too tempting.

Concerning employee protection arrangements, it is recognised by all that people assets build businesses and it is questionable whether the States wishes to dispense with all of these skills in the telecoms sector.

Concerning other jurisdictions, if the UK is not the route to follow, how has Guernsey fared? Comment even last month ("Our most costly error") was now that Guernsey is perhaps regretting selling a States monopoly to replace it with a commercial which provides less States income and is necessarily subject to less control.

One possible – but fallacious – comment might be that the local market is too small to split JT up, and this would lead to increased costs. This is not true. OFCOM's own efficiency report shows that divestment of the constituent parts was not prohibitively costly or disruptive. And there are no size issues for Jersey – both Bharti (Jersey Telenet) and Newtel know the local market is big enough.

There are arguments against splitting up JT. Is Jersey too small? Size is not an issue, as explained above. Would it add unnecessary cost? UK experiences prove the opposite – OFCOM's own studies show that BT is now more efficient; the efficiencies promoted by competition outweigh any economies of scale type gains. Would it prevent new investment in service? No – quite the opposite is true, as the wholesale provider would work with multiple retail companies providing greater investment, diversity and choice to all users, business or consumer.

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Alternatively, the arguments for splitting up JT are compelling. If left alone, JT's position naturally encourages a monopolistic behaviour in every sector it operates. It is much harder to regulate and is disinclined to diversify. This is particularly important as convergence between telecoms and the other technology sectors means JT's operations overlap even more with other service providers.

In conclusion, the role of telecoms within a converged environment, the interests of the Island economy and experiences elsewhere dictate that JT should be split up. The States could retain ownership of the wholesale element and safeguard the Island future whilst selling its retail elements in order to reduce investment exposure and promote local diversity.

The Minister is advised to take another look at the telecoms sector. The interests of the Island are not best served by selling off JT now as a single entity. These interests are the ones that should and must prevail.

Yours sincerely

Ian Jauncey
Chairman