STATES OF JERSEY

Economic Affairs Panel

Telecoms Review Sub Panel

FRIDAY, 17th NOVEMBER 2006

Panel:
Deputy G.P. Southern of St. Helier (Chairman)
Senator B.E. Shenton
Deputy J.G. Reed of St. Ouen
Deputy J.A. Martin of St. Helier
Deputy G.C.L. Baudains of St. Clement
Dr. D. Parker (Panel Adviser)
Miss S. Power (Scrutiny Officer)

Witnesses:
Mr. J. Davey (Collins Stewart)
Ms. L.J. Howe (Collins Stewart)

Deputy G.P. Southern of St. Helier (Chairman):
Before we start, I would just like to draw your attention to the notice in front of you which covers the conditions under which we meet and ask you to introduce yourselves, just for the sake of the recording so that we know who is on which microphone.

Mr. J. Davey (Chief Executive, Collins Stewart):
Okay. My name is John Davey. I am the Chief Executive of Collins Stewart in the Channel Islands.

Ms. L.J. Howe (Collins Stewart):
My name is Laura Jane Howe. I am a graduate trainee from college.

Deputy G.P. Southern:
Thank you. We met before and we discussed your proposition before and the purpose of this meeting today is to get your contribution on the record, as it were. I would like you to start, if you would, by summarising your submission and your thoughts on the privatisation of Jersey Telecom.

Mr. J. Davey:
Okay, lovely. The reason I wanted to summarise our opinion was that we have had no formal contact with the Treasury or advisers to the States in any way. We have had typical Jersey grapevine feedback,

that politician A thinks it is a bad idea, or politician B thinks it is a speculative kite-flying exercise. We are slightly disappointed in that in the sense that we feel we have come forward with an alternative proposition that at least deserves exploring before it is dismissed. But it seems to us, from the outside, to have been dismissed before being explored, so we are quite pleased to have this opportunity to air the idea in public. What I thought I would do is give you an overview of our position on page 2, which is essentially our credentials for delivering a local solution, and hopefully when people have seen our credentials they will not dismiss it quite so easily as we have done this before. We support the sale of Jersey Telecom and we will give you the reasons why. We think the argument for a trade sale is very one-dimensional. We think it is not in the best interest of the Island. We think there are alternative solutions, one of which is well established and has been completely ignored. We think Jersey Telecom is a very successful company and we think it should be a local company serving local customers with local shareholders. Then we go on to give an example of Northumbrian Water which is a similar transaction we did some time ago which was a £389 million transaction. So, in terms of our credentials, we are the leading stockbroker in the UK (United Kingdom). FTSE250 listed a market cap of £1.8 billion. We are a pretty big organisation; 3,000 staff worldwide. The Channel Island business is a member of the stock exchange: Channel Island Stock Exchange and London Stock Exchange. We have got about £3 billion of assets. One of our strengths is locality and we are the main player in local shares. I think our credentials of delivering a local solution -- if you look at our fundraising ability in 2006, so far we have raised £1.6 billion for people who are selling their companies, selling them on to the stock exchange. So, a transaction the size of Jersey Telecom is not a particular big transaction for us. We have done some of the largest fundraising in the UK and I have given 3 examples, all of which are the same style of transaction that we are talking about here and they range from Northumbrian Water to PD Ports in size, so the size of Jersey Telecom is not a particularly big bite for us to swallow in terms of doing the transaction. We support the sale of Jersey Telecom because we think the price is being undermined. We think the price is being undermined by competition. It is essentially a schoolboy error in terms of introducing competition before you go to sell an asset. It would be a case study in how not to sell something, broadly speaking. But now that has been put in train, we do think the price will be damaged, quite quickly in fact. We think there is muddled thinking in terms of regulation. It seems to me a nonsensical ideological experiment in the way the regulatory environment is being conducted in Jersey. We think Jersey Telecom is being seen as a dominant player but it has got one hand tied behind its back in trying to defend itself from the big boy in the playground, which is Cable & Wireless, not Jersey Telecom. We think the staff morale is being damaged. It is creating uncertainty for key clients. It is giving you entirely predictable outcomes like the mobile mast fiasco. The whole process needs to be accelerated and brought to a conclusion one way or another, if you are going to end up with a sensible price for this asset at the end of the day if you are going to sell it. So, one of the reasons we support sale is the risk profile has been fundamentally changed. We also think there is a very naïve assumption that the market will decide, that the market is efficient, and I have given you my personal quote on the next page which I could give you lots of quotes as to why the market is not efficient. We work in markets all day, every day. We know markets are not efficient. They are slightly efficient but they are not completely efficient. But this is a quote from the Lex column in the FT which talks about: "If there was a collective noun for telecoms companies, or telecommunications, it would be 'idiot' in terms of describing the behaviour of telecoms historically." Jersey Telecom has been spared the madness of the late 1990s/early 2000 in terms of 3G licences. Marconi -- I could use Cable & Wireless as an example as to the way it conducted itself in the late 1990s or early 2000. I think that is unfair, as a side issue because they have got new management. The new management is good. They have spent a lot of time cleaning up the mess they inherited. But you could throw a whole page full of examples of telecoms companies behaving badly. My personal favourite is Greece's mobile operators giving away free fridges to customers which I think is slightly eccentric but it does prove my point that telecom companies are not rational in the way they behave. In terms of a trade sale, we think the Island is very one-dimensional. It is focused on this idea of economies of scale. They do exist in certain situations but in small complex markets I think the diseconomies outweigh the economies. There is also this sort of naïve assumption that all economies of scale are good. Economies of scale come with consequences. Often they mean job cuts; they mean undermining of management flexibility; they mean reduced trading, reduced investment over time. It is very naïve to assume economies are scale are good, therefore we must have them. There are some economies of scale I do not think the Island would want, broadly speaking. There are certainly no economies of scale in customer service or staff retention and anyone who has had to deal with an Indian call centre knows that very well. In any case, you cannot have a conversation about economies of scale without talking about the disruption that goes with economies of scale in terms of integrating businesses, and anyone who has had to integrate businesses knows this disruption. However clever, however well planned you are, there is always disruption. You just cannot have the debate without talking about diseconomies and disruption. We do not think a trade sale is in the best interest of the Island and I put down a number of individual points. I will not go through them line-by-line but I think there is significant integration risk and you are jeopardising stability within the telecommunications industry. The economy and the finance industry are completely dependent on stability in telecommunications. If you look at any marketing material from any of the big banks, from the Island itself, stability of communications usually features quite early on in that in terms of attracting finance and retaining finance. I have had to do business in finance industries with very bad telecommunications infrastructures and it is a big negative in terms of attracting people to the Island. So, I think the States are playing a relatively dangerous game here with the lifeblood of the economy. As I say, I will not go through each one but we could fill a page with reasons why we think it is a bad idea for the Island to undertake a trade sale. On the next page I have used a quote that has been attributed to Terry Le Sueur from the JEP as to why we think a global firm would be bad for the Island. I will leave you to read that in your own time. So far it appears to us there are 3 methods of sale on page 10 which are being looked at. One is private equity. They tend to be relatively short-term investors; they tend to use high levels of debt; they tend not to have a reputation for investing in the businesses they own; they tend to be looking for a quick exit. There are exceptions. There are some very good private equity firms but as a general categorisation. So, we would rule out the idea of private equity because we think you would be in exactly the same situation in 3 or 4 years time while they were looking for an exit as to who are they going to sell it to, et cetera. The idea of trade sale seems to be completely pinned on this idea of economies of scale. The third alternative which is an initial public offering - a floatation on the stock market - is seen as having uncertainty in terms of timing and price, and that is true. There is uncertainty in terms of timing and price but the alternative method has not even been mentioned in any of the paperwork we have seen so far. It is a well-established alternative which is the accelerated IPO (initial public offering) which is something we invented and trademarked and is being done by a number of other firms apart from ourselves so it has become a relatively established activity. This is where a special purpose vehicle is set up to buy Jersey Telecom in its whole - in its entirety - and the special purpose vehicle is then floated on a stock exchange. We have chosen the Channel Island Stock Exchange. You could float it on any stock exchange but we think there are strategic benefits for the Channel Islands from floating it on the Channel Island Stock Exchange. AIPO (accelerated initial public offering) solves all of the criticism of an IPO in terms of it gives you certainty on timing; it gives you certainty on price. We think it has a substantial advantage over a trade sale because it gives you certainty of stability insofar as there are no integration risks of Jersey Telecom into another business. You buy it intact as whole. The other thing about an AIPO - which is why we are surprised we have not been invited at least for a conversation - is in all of the AIPOs we have done, they have delivered the highest price to the seller. Okay? One of the bits of feedback we have had is that we are trying to buy the business on the cheap; one of the grapevine bits of feedback. But the AIPO has been used in competitive auctions against private equity, against trade buyers, and in each case it has delivered the highest price. So, we think it is a mechanism that it should at least be considered if price is your only -- as a government, your only consideration. An AIPO can also be done on a very tight timescale and has been done on tight timescales. The reason an AIPO is possible is because Jersey Telecom is a successful company. You would not be buying a bad asset. Whilst government are typically seen as bad investors in an asset, they have been a good shareholder of Jersey Telecom over time and Jersey Telecom has been a very successful company. It has got a strong position within the Channel Islands. It has heavily invested in terms of its infrastructure. It is not years of under investment to make up. It has got predictable cash flows, or currently has predictable cash flows, but if the business continues to be undermined in terms of staff morale and customer uncertainty, the price will get damaged by that the longer this process gets drawn out. We think it has got growth potential in certain niches and I suppose because it is not a suitable investment for the strategic reserve, because the risk profile has changed, does not mean it is not an attractive investment for other types of investors. We take a bit more of an optimistic outlook on the future of Jersey Telecom. We think it does have some challenges in the short term which will affect value in the short term but if we can get staff and management to rise to the challenge we have in mind, that over the medium to long term this will turn out to be a successful investment. We think that is much lower risk than the unproven alternative of jeopardising the lifeblood of the economy in an integration with a global firm. So, really a local company with local ownership would build on Jersey Telecom's existing strengths. Local control reduces exposure to technology risk by giving the company choice. I think if we can retain a highly motivated local workforce with employee ownership within the company that is a strong competitive tool. We think there are some side effects of listing on the Channel Islands Stock Exchange which would be very good for the Channel Islands in general. It would strengthen local capital markets; it would be very good for the Channel Islands Stock Exchange. I put in this idea of the Government retaining a blocking stake to protect value; maybe capture value later on and avoid embarrassment selling at the wrong price. But I think the Government needs to be careful as to the amount of a blocking stake or how that is organised because public market investors are very distrustful of governments as shareholders generally. I put a quote in from the Channel Islands Stock Exchange that listing Jersey Telecom on the Channel Islands Stock Exchange would be very good in terms of re-enlivening local capital markets. Over the last few years we have lost lots of local companies who have been taken over and disappeared and local capital markets have withered and died. Our plan for Jersey Telecom would be to use that as a foundation on which to rebuild capital markets locally and that would have a number of benefits for the economy in general. I have then gone on to use Northumbrian Water as an example. As I say, it is almost a 400 million AIPO done in a competitive tender against other buyers. Similarities: high quality business, high quality management, capable of secure and growing dividends and a market leader. The potential differences really were that Jersey Telecom would have profound benefits for the external economy or the local economy, much lower debt requirement and put a lower strain upon regulation. I think a trade sale will create regulatory strain by giving you a dominant player which is a global dominant player rather than a local dominant player. I have really summarised that we think a sale is probably now likely although you are in a much better position to take that view than we are, being on the inside, but we feel it is likely. We think a trade sale is a fundamentally bad idea. An alternative method can guarantee certainty on timing and price and a local solution we think has much better benefits for the local economy. I have left you with Northumbrian Water as an example. It also talks about the process of an AIPO which is essentially a 4 stage process but you can flick through that in your own time.

Deputy G.P. Southern:
Thank you very much. That was --

Mr. J. Davey:
Quick.

Deputy G.P. Southern:
-- remarkably efficient. I think that is the word, "efficient". Can I just check one thing before we go any further? Your emphasis is on local ownership. How do we restrict to local ownership? Are we permitted to do that? The law certainly says you are not supposed to.

Mr. J. Davey:

Yes, I do not think you need technically to do it. There is a predominance of investors. When you have a local company and we could use CI Traders as an example. Anyone can buy CI Traders. It is listed in the UK. Because it is a local company it tends to attract local investment. People go into the shops; they use the services. They sort of understand it. There is a bias towards local. We would certainly look to have a strong domination of local investors on the share register at day one and they would go from myself - I am prepared to invest a year’s salary in this - to my firm that is prepared to invest £5 million in this, to a long tail of people, some of which would invest £10,000, some would invest £20,000, some would invest £1 million. It would be a very long tail of people. Once the company is floated, you cannot guarantee it will always remain in local share register but there is a dominance of local shareholders because of local interest. We would put some UK investors on the share register, UK investors who tend to buy this type of asset. There are some UK investors who are on the share register of Jersey Electricity, CI Traders, et cetera. They look for what they regard as undervalued niche-type businesses. So, it would not be wholly local but it would be a broad mix dominated by local.

Senator B.E. Shenton:

I think it is fair to say you can also offer shareholder incentives, can’t you? Shareholders receive discounts or something.

Mr. J. Davey:

You can and it is, in local markets, a common idea to bind customers to local customers who are also staff. You tend to use a lot of incentives. We would like to see staff very heavily incentivized in terms of this and we would do that in probably 3 ways. We would give the staff some shares in the company for free, with some basic conditions. They remain employed and they are basically reasonable members of staff but we would put together a package which would give some staff shares. We would also link some staff bonuses associated to the performance of the company to shares and we would probably run a scheme where the staff invested some of their own money. It is completely at their discretion but if staff did invest some of their own money we would probably match it with equity in the business. We want staff to get up every morning earlier and go to bed later believing that they own a little piece of this business. You tend to work harder in that sort of environment. That is a very, very powerful competitive tool. It is a tool we use within our own business to compete with firms with 100,000 staff ,with massive balance sheets, every day.

Deputy G.P. Southern:

You talk about a good investment in the longer term; perhaps not necessarily in the shorter term. Would you like to expand on what you see as the assets of this particular company and why you think it is a good investment?

Mr. J. Davey:

Well, I think it will turn out to be a good investment, partly depending on the price that is paid for it. Absolutely true and, if the States is to avoid embarrassment, the first thing to do is get the right price, so a transparent and fair price at the start. If you are going to sell something the first thing you do not do is you do not advertise to everyone that you think the long-term value is going to be crushed by competition, because the starting point for everybody's price is right at the bottom, not at the top of the range. Then you do not get yourself into a position where you might only have one or 2 buyers, neither of which are suitable to you so you have got to go and beg other people to buy it off you. So, I think there is a fundamental price problem developing here and the concept of £200 million as a price I find is a complete fantasy price. If this is left to unfold in a way that it appears to be unfolding, you will be very lucky if it starts with a one, and that is probably before the pension issue is sorted out. So, the longer this goes on, the more damage there is going to be. It seems to me that the regulatory environment comes into context here as well where Cable & Wireless is allowed to cherry-pick the higher margin customers, broadly speaking, and the more they are allowed to cherry-pick the higher margin customers, the more damage that will be done to Jersey Telecom over time. So I think in the short term the company is on the back foot. It is going to have low staff morale and it has got some serious short-term challenges. But we would be prepared to put our own money into it on the view that we believe this local concept works. We have got examples of it. It is a gut feel that it works. We think staff will rise to the challenge and the Islander generally does not mind supporting the underdog in certain situations and we also think within the finance industry it is not all about the lowest price product. It is about service and that has been our own example when we recently put in a VoIP (voice over internet protocol) system where we used Jersey Telecom to do Jersey, Guernsey and the Isle of Man, although our headquarters, if you like, offshore is in Guernsey so we used Jersey Telecom. We went with them because they had the most engineers, they were prepared to work at the weekend, they were prepared to work at night, they never batted an eyelid about the level of service we required because for us it was absolutely crucial. If you take a phone system away from a stockbroker you basically kill the business, so it was not about price. As it happens, they were competitive on price but it was not about price; it was about their ability to deliver the outcome. It is a bit of long rambling answer. I think in the short term the company has some serious challenges and those challenges are about the company being shot in the foot by people who should be more supportive of it, in my view. The price will reflect those short-term challenges but if we can overcome those challenges, the medium to long-term attractions we think are quite interesting. This is a company that could throw off reasonable dividends. It can compete on service and locality. It has got some niches it can grow into, so we take a bit more of an optimistic view over the medium to long term but not in the short term. We are prepared to put our money on that. If we are wrong, our investors, people who buy shares, their share price will go down but it will not have a negative impact on the Government if the Government had sold its stake.

Deputy G.P. Southern:

Sure. You talk as well about the Government retaining a blocking share, a blocking stake. What sort of size of share are you --

Mr. J. Davey:

You can do that. It has been done in the past by governments with one share which is referred to as a "golden share" which only comes into play if the company is being taken over. If you want to sell in whole, retaining a golden share will not have dramatic impact on the price. It will have some impact on the price because it has got you hanging around in the background in one way or another but it will not destroy the price. The bigger the stake you have, the more impact it will have on investors. But if you wanted to retain a physical stake, then I would say 25 per cent would be the -- if you go above that you start to spook public market investors.

Senator B.E. Shenton:

Senator Ozouf has asked the JCRA (Jersey Competition Regulatory Authority) to examine the issue and advise on the best way to privatise. Now, I would liken that to Churchill asking Hitler to advise on the D Day landings. I cannot get my head around it at all. I mean, do you ask the regulator to advise on a privatisation?

Mr. J. Davey:

No. If you want a plumber you go to a plumber; if you want an electrician you go to an electrician. So if you want to advise on selling a business, you go to somebody who sells businesses for a living. You do not go to somebody who regulates businesses for a living. Frankly, I am not entirely convinced on the way regulation is being applied to the local marketplace. I think there is very little evidence so far that it is being applied effectively in terms of Jersey Telecom. I think it is disruptive. I think it is certainly very expensive. I think it is much more dangerous than people realise. So, no, I would not invite the JCRA in to advise on the sale of the business. I mean, I do not know them so it is not a particular attack on them but it is just about going to a plumber or an electrician.

Deputy G.P. Southern:

But presumably you would expect at some stage to be talking to the advisers to the Treasury, Citibank advisers, about your thoughts.

Mr. J. Davey:

The phone is there. We have had no calls from anybody. We will either be ignored completely and disappear, because you cannot force a solution on people. But I think it is pretty poor that an idea is dismissed before it is even looked at. Basically, I would have thought we would have been welcomed and thanked for coming up with an innovative idea that might get the highest price and might have some strategic benefits rather than being ignored. So, the call is there. They are welcome to phone any time they like.

Deputy J.G. Reed of St. Ouen:
One has to ask: if your view is that Jersey Telecom has a medium to long-term future and is a reasonably good investment, why do you then support the States disposing or get rid of or selling off Jersey Telecom?

Mr. J. Davey:
I suppose if your question is can Jersey Telecom survive under States ownership - if I phrase it a different way - then I think, yes, it can. If it has got a relationship with its shareholder which is flexible and nimble and understands the issues the company faces, I think the States have a conflict of interest through the JCRA as to being the shareholder. But I think, yes, it can survive. I think there are risks associated with the price of the value of the asset over time. That leads you back to is it suitable for the strategic reserve? What are the risks to you if in 5 years time I am wrong, or in 10 years time I am wrong, and the share price is 50p or 30p? Then you will have suffered that if you continue to retain Jersey Telecom as an asset. If you sold it to us we will suffer that risk. Equally, our investors will suffer that reward if the share price is £2.00 in 5 years time and they have doubled their money. So, it is about the risk you are prepared to have with an investment rather than the performance of the company.

The Deputy of St. Ouen:
Obviously we know or are aware that Jersey Telecom is now incorporated and has been for a couple of years. Do you believe that there is a difference between an incorporated company and a privatised company? In other words, why are you concerned? What are the concerns that you have over Government having an incorporated utility?

Mr. J. Davey:
The Government owns Jersey Telecom. The Government is currently setting up an environment where Jersey Telecom can be beaten to death by external parties while it has got one hand tied behind its back. You know, you are destroying your own value and that is not a rational sort of mechanism of behaviour. So, if you want to be in a competitive environment and the environment has changed by the introduction of competition, if you are going to be in that environment I think you need savvy shareholders or you need savvy management; you need nimble management; you need management who are prepared to compete outside the box, to think outside the box. It is not a criticism of the Government because the Jersey Government, as a shareholder up to now of Jersey Telecom, has been a very good shareholder. It is not a broad attack on the Jersey Government in any way whatsoever. It is a broad attack on this current situation where I think you are in a pickle. You have put yourself in a pickle and I would not bet

on you to get yourself out of the pickle, personally. Not you personally; obviously a broad statement of the Government, so I do apologise.

The Deputy of St. Ouen:

I would like to move on a bit. I hear your views regarding the support for the sale. In the consultation document that the Treasury Minister produced he comments on IPOs and his view is that it would not be likely to achieve best value for States investment. It is a costly exercise and in order to ensure sufficient demand for shares a discount on the overall value of the company would be necessary. Now, obviously you have made or differentiated between IPO and this accelerated IPO. Could I have your comments on the comments the Minister has made and whether you believe that is correct or not, and why is there such a difference between the accelerated IPO and the IPO that the Treasury Minister is commenting on?

Mr. J. Davey:

I think his comments are wrong. I think his comments are broadly right in relation to an IPO but they do not recognise the fact that public market investors require a different set of returns to buy an asset than somebody like a trade buyer or somebody like a private equity buyer. Typically public market investors require a lower return on assets in terms of buying an asset. An AIPO is much quicker, much cleaner. It is not a broad offering to the public. It is a narrower offering so the costs of doing it are lower. It is quicker and the way the deal is structured -- for example, we might use different share classes; we might use a preference share class. Investors in preference shares require relatively high income, no capital gain, very low sort of return profile. So, you can structure to target different types of investors to get your overall return requirements lower. So, I think they are broadly right as a comment on an IPO. Clearly no thought has been given to an AIPO which, when we have done the transactions we have done and the examples I have given you, they have all led to the highest price for the seller.

The Deputy of St. Ouen:

How do you support your comment that it has achieved the higher price?

Mr. J. Davey:

Well, each of them are public transactions out there that were in, in some cases, competitive auction so I mean I have not brought proof with me but it is a provable to Citibank. We can prove it to Citibank if they want to come in and talk about it. I think this does go beyond price but before I can just lead on price, if the expenses of doing a transaction are quite high, it does not really matter if you get a higher price. It is the net return that is important here. Clearly we would not be putting our money into this if we were not trying to make some money over time. That is what we do for a living so we are not embarrassed about that and if we are right we think we will make good money over time. If we are wrong, we will not. This is the fundamental reason why I am sort of frustrated that no one wants to talk about this. If we float Jersey Telecom on the Channel Islands Stock Exchange and we are fundamentally wrong and all the investors are fundamentally wrong about our view, what will happen is in 5 years time Cable & Wireless or British Telecom or someone else can buy it for half the price. You are no worse off by doing this transaction. You can still have a trade sale and if we are wrong, in 5 years time the shareholders will be clamouring for a trade sale. They will be desperate for somebody to take them out at 50p because they have lost half their money. So, you know, you are no worse off with this transaction. You can just have a trade sale in 5 years time or 10 years time if we are wrong. But once you have done a trade sale and Jersey Telecom has been integrated to a global provider, ripping it out of the global provider, if the global provider itself is taken over? Quite possible. No loss of consolidation in the telecoms industry in general. If the global provider decides to sell its Island-based business, ripping all that out again once you have lost those skills is bordering on impossible. So, I think, you know, price is important but I also think the strategic outcome is important. I think our solution gives you a better strategic outcome and it has got a good chance of getting you the highest price.

The Deputy of St. Ouen:
With the system you are proposing, obviously we are speaking about trade sale on one hand and then you say your selected investors on the other. Would there be any limit to the share-ownership of individual investors and what is to stop a global telecommunications operator buying 80 per cent of the share?

Mr. J. Davey:
Yes. At floatation, the mechanism to stop them doing that is the status of seller having an override by saying: "No more than 10 per cent to any one shareholder." That is very easy for us to do with the States. At floatation you can have that override. Once the stock is floated there is no guarantee that a global telecommunication provider is not prepared to pay the shares -- as opposed to £1.00, to pay £1.50. It will depend on whether the shareholders are willing to sell at £1.50. The only thing that will protect you from that later event is a golden share which gives the States a majority vote if there is a takeover. That way you get to approve a takeover or not, depending on who that potential buyer is.

Deputy G.P. Southern:
Can I just come in on golden share? I understand they are not permitted in the EU (European Union) nowadays. How do you stand with that?

Mr. J. Davey:
Well, we are not in the EU, as I understand it.

Deputy G.P. Southern:

So, we could still go that route?

Mr. J. Davey:
Yes. And yet, while they are not permitted, they do exist in scenarios, lots of scenarios, in fact.

Deputy G.P. Southern:
You obviously see JT (Jersey Telecom) as an entity, and a viable entity going forward. Other people are talking about selling off in parts or stripping it down and splitting it up after privatisation. What is your take on that?

Mr. J. Davey:
I think it is a big economy solution to a small economy problem. It is back to a sort of intellectual fiddling. I do not think it is workable at all, actually, and I do not think if you got a few experts in a room on the subject I would be prepared to bet £10 that they dismiss it within an hour as viable within Jersey. I am not an expert in that infrastructure split but it just seems a big economy solution for a small economy problem. It just does not seem a viable… There is a whole series of these things which, to the outsider looking in, appear sort of Amateurville really. This whole structure of introducing competition, then deciding to sell the asset, then being worried about the price, and then suddenly having a competitive situation, and then: “I tell you what, we will split it into 3 or 4.” It is not a logical, well thought out -- this is a “cart before the horse” type situation.

Senator B.E. Shenton:
I was going to agree; it is an absolute shambles.

Mr. J. Davey:
From an Islander’s perspective, it is tragic to watch. The people I feel sorry for are the staff of Jersey Telecom. Some of them have been there 10, 20 years; it is their life’s work; they have got mortgages; they have got kids. They are not even allowed, as a company, to effectively respond to the situation they are in. They are sitting passively watching all this go on around them. I empathise with them and as an Islander I think the whole thing is tragic. It is like watching a car crash unfold. It does not impact me on a day-to-day basis and if the worst case scenario happens it will impact the Island in 5 or 10 years time, maybe a bit longer, but it is impacting those individuals every day and the longer you leave this … Cable & Wireless must be chuckling, they must be struggling to contain their laughter as they cherry-pick the biggest customers or the higher margin customers while the staff of Jersey Telecom are distracted at all levels. They are distracted in terms of competition; they are distracted in terms that: “We might be sold, we might not be sold. Are we going to be sold to Cable & Wireless?” A farce would be a pretty good description of the whole situation.

Senator B.E. Shenton:

The route that the Treasury seems to be looking at seems to be very much a trade sale whereby they sell it to Bharti, Cable & Wireless or some other. You will be well versed with the fact that the telecommunications market is changing. Do you want to just comment on the fact that there is a risk? Bharti is 10 per cent owned by Vodafone. You sell it to Bharti you might end up selling it to Vodafone ultimately. Do you think there is a strategic risk to the Island in going with a trade sale in as much as you do not know who the ultimate owner will be in 5 years?

Mr. J. Davey:
I do but my sort of strategic fears are more at the micro level, more immediate: the disruption of integration; the relocation of key functions off-Island; HR; accounting. The simple stuff. Technology maybe. So my sort of things are more immediate but there is that strategic risk over time and if you sell it to a trade buyer who suddenly gets itself into trouble - as they have in the past - or you sell it to a trade buyer who is subsequently taken over and there is a lot of consolidation in global telecoms in general, there are those strategic risks. But I suppose my concerns are a bit more immediate, really.

Senator B.E. Shenton:
Also Jersey Telecom has been diversifying with Wave Telecom in Guernsey which is still loss-making, although they would argue it is profitable on an EBITDA (Earnings before Interest, Tax, Depreciation and Amortization) basis and also they are looking at, is it, telecoms on cruise ships and so on and so forth. Do you think these are unnecessary distractions or do you think these are businesses that would -- if you floated the company that they should carry on concentrating on?

Mr. J. Davey:
Yes. I think the strategy should be to defend the home market. Where I think they are being constrained in trying to do that is by this sort of belief that they are the dominant player well, not really, if you look beyond the end of your nose. The dominant player is a global player; not a local player in terms of resources and ability to put competitor pressure. So, I think they should be free to defend their home market. At the same time, I do think they should look for profitable niches outside in a sensible and controlled sort of way. All of our experiences of Jersey Telecom have broadly been very good, and certainly the ability and willingness of the staff to come in at weekends and evenings is, I think, a good competitive tool. So, I think they should continue to look at those. If things get so bad, however, you would look to roll back from some peripheral activities to defend your home market because I think if you cannot defend your home market you do have a major issue.

Senator B.E. Shenton:
Finally, Vodafone, for example, have got a track record of taking minority stakes in companies. As I said, in Bharti; Verizon they had got a stake in but they sold it. What about the idea of doing an accelerated IPO but with someone coming in with a strategic alliance and taking a small stake?

Mr. J. Davey:
Quite possible. One of our ideas is that in a fast-moving market a small independent company can be quite nimble in terms of adoption of technology or not. Being tied to a group of technology or group technology decision can be a bad situation, so it can be nimble in terms of taking on technology; it can be nimble in terms of working in partnership with people. So, you would look for alliances as an independent company, one way or another.

Deputy G.P. Southern:
Could you just expand on that? How do you see that partnership approach working?

Mr. J. Davey:
I think it has really got to be decisions made by the management, in truth. What we are looking to do here is to facilitate a transaction and put the company in a position that we think it should be in. Unfortunately then it is up to the staff and management to rise to that challenge. What you would not want to necessarily do as a shareholder is to dictate to the management on a day-to-day basis to what their strategy would be. They seem quite capable of competition in terms of our evidence of them in Guernsey. Quite capable of competition against an unfair background, some people might say, but quite capable of competition. The cruise ship idea; they seem to have enough innovation internally to be able to do that. As I say, we think it is a successful company.

Deputy G.P. Southern:
Management at JT have currently left me with the impression that partnership is not a way forward. It seems to suggest that they have asked and nobody is interested.

Mr. J. Davey:
Yes. Is that the board or …? Just the board or the management?

Deputy G.P. Southern:
That is at board level.

Mr. J. Davey:
Just the board level. Yes, well, I cannot speak for the conversation because I was not there but I suppose my answer to them would be: “Have you looked hard enough?” but I cannot say. I do not want to criticise them on the basis that I think they have put together a successful strong company, so no criticism I have got carries any weight in that respect.

Deputy G.P. Southern:
Yes, sure.

The Deputy of St. Ouen:
You have spoken about the JCRA and competition and putting the cart before the horse and so on and so forth. However, the alternative view the Treasury Minister again made in his consultation document is that because we have now got this robust regulatory framework - in his words - we are then able to consider a sale because the consumers are protected. Could you just elaborate on your view that you have regarding the regulatory authority? You have expressed some concerns already but how your view might differ from the one expressed by the Minister?

Mr. J. Davey:
I suppose I would start by saying you did not need a competition law or competition regulatory authority to encourage Jersey Telecom to cut prices to certain sectors of the economy as the shareholder. You could have just asked the management and said: "Look, we want you to do that, otherwise we will introduce a competition authority; otherwise we will introduce competition." It would have been the best management mechanism, as a shareholder, to encourage them to make those changes if you are particularly worried about services in one area or prices in one area. It would have been easy to do in a consensual way. You now have a regulatory authority which I think is expensive; may be doing significant damage to the lifeblood of the economy; is certainly taking action where it does not know the outcome. There are certain unknowns in all of this and it is a bit like pulling on the lever. You do not quite know whether that will happen or will it happen much worse than you think or not as much as you think? So, it seems to me an element of experimentation in all of that. I think a locally-owned company has to behave well in its local market because it has got nowhere else to go, broadly speaking. I think there is a self-regulatory mechanism there. If it behaves in such a way as you have seen with CI Traders and the fallout it had with the supermarkets; people stopped shopping in the supermarkets. People will stop using Jersey Telecom until the management changes its tactics. So, I think there is a self-regulating mechanism there which means there would be less need for intervention from the regulatory authority as long as the regulatory authority did not have a particular ideological view on how a market should work. So, I think, again, you can get all the outcomes you are looking for in a slightly different way.

The Deputy of St. Ouen:
In your view, are we headed down the route of licensing other telecoms operators on the Island? Obviously an alternative may have been we would have had a regulated natural monopoly.

Mr. J. Davey:
Yes.

The Deputy of St. Ouen:
Do you believe we have passed that point?

Mr. J. Davey:

Unfortunately yes. Unfortunately. I say that because the concept of a natural monopoly is a very basic economic fact and when you have got a natural monopoly you have got to regulate your natural monopoly in a sensible sort of way. That needs to be a consensual relationship between the natural monopoly and its shareholder or the natural monopoly and the independent authority that is going to regulate it. You cannot have a hostile -- and I am not in Jersey Telecom; I am not in the Competition Authority. But from the outside in I do not see much consensual working here between the Regulator and one of its subjects. So, I would have stuck with the natural monopoly if I would have had -- you are asking me for an economic view. I would have stuck with the natural monopoly and I would have regulated the natural monopoly in a consensual way, either as a shareholder or, if I wanted an independent authority, with an independent authority in a consensual way. I think you are way past that now. I think it is probably a question for Jersey Telecom whether they have been fairly treated by the Regulator and how they feel about the position they have been put in in terms of fighting off a global trade firm with one hand tied behind their back. The question for them is whether it is working. I do not think the current mechanism is working at all.

The Deputy of St. Ouen:

One other area I would like to touch on and go back to is the golden share, blocking share-type issue, because we are aware - and I think you mentioned it - in the early 1990s a number of public companies were privatised and good fortunes were made initially from buying shares and then selling them on. If we were to support your view and look at maintaining a sort of local company, local flavour, local investors, how do you see that working in practice using, say for instance, the blocking share-type idea?

Mr. J. Davey:

I think the best way to avoid embarrassment on-selling something at the wrong price is to make sure you have got a fair and transparent pricing first and that you understand the basis on which the pricing has been made and the assumptions. Just because a share is £1.00 today and £2.00 in 2 years time does not mean it has necessarily been sold at the wrong price. Maybe the assumptions were wrong or the circumstances changed. So, I think you have got to focus on getting a transparent and clear price and that is one reason why I would invite anybody in to the bidding process, anybody who is going to create competitive tension. Even if you thought our idea was the worst idea in the world, you would want us sitting at the table, even if you had no intention of selling it to us whatsoever. You would want us sitting there just to get the price up so you did not have one other bidder. I would have expected to have been invited straight round even if I was being used as a stalking horse. So, I think the first thing is to get the proper pricing first time round. The only other way to avoid embarrassment or to participate in the future success of the company, if you believe more in our view, is to retain, not a golden share but 25 per cent of the company.

The Deputy of St. Ouen:

Treat it like you would an investment?

Mr. J. Davey:

Yes. So, as an investor, if I put myself as a manager of the strategic reserve I reduce my risk by 75 per cent and I continue to retain 25 per cent risk but the net position is much safer.

The Deputy of St. Ouen:

Going on from the share thing, could you expand on what you claim to be the side benefits of listing Jersey Telecom on the Channel Islands Stock Exchange and what that might add to our economy?

Mr. J. Davey:

One of the issues with the Island economy - both Jersey and Guernsey - is the imbalance between finance and other activities. That is a fundamental longstanding problem. There are ways to close that imbalance. One would be to help create local capital markets, which they have done in the UK; they are doing in other island economies like Malta through the creation of the equivalent of a UK venture capital trust where there are tax benefits for investors to put money into a venture capital trust, which can only invest in small companies which are non-finance related. The Maltese Government is doing it. The Maltese Government has gone further by putting its own money in but actually you do not have to do that; you just have to create the effective tax break and that would be one on a long list of things. Jersey Telecom would also be one of a long list of things that we would do to create local capital markets if we had that influence to do that. Local capital markets will mean that people who want to start a business or buy a business can come locally to raise money for that and it is the creation of entrepreneurial spirit; it is the creation of a share ownership culture. The Channel Islands Stock Exchange has also been something we are involved in at foundation which has turned out to be pretty successful so far. It is on the cusp of growing dramatically. It is now recognised by the UK; it is recognised by the SEC (Securities and Exchange Commission) in the US as a recognised stock exchange which means anyone can invest in it and it is really poised for dramatic growth. With that it brings jobs locally in terms of the legal profession, the accounting profession, the stock-broking profession. Jersey Telecom would just be one thing we would use to help rebuild capital markets if we were able to set up that strategic plan.

The Deputy of St. Ouen:

I know I am straying a little bit but obviously we are very aware of the tax change to zero-ten. We are trying to look to enhance the income generated on the Island to pay for services and so on. Would your proposal and developing that Channel Islands Stock Exchange help or not?

Mr. J. Davey:

No, I do not think it specifically would. I think it would be about general improvement in the finance industry. The Channel Islands Stock Exchange at the beginning was not really taken seriously but locally, oddly enough, there are more overseas parties that use the Channel Islands Stock Exchange than there are local people who use it but it is growing rapidly. I do not think it would have any particular benefit from that other than the general health of the -- it is a very strategic asset for the finance industry. Generally there are, for example, a lot of Cayman funds listed on the Channel Islands Stock Exchange. There are a lot of Irish funds becoming listed on the Channel Islands Stock Exchange. So, I think it is just about health of the finance industry in general.

Deputy G.P. Southern:
We have heard from Telecom's management about economies of scale. We are obviously exploring what that means, in concrete terms, with them. You talk about diseconomies of scale. We would like to explore that a little further with us?

Mr. J. Davey:
Yes. I mean, if you just phone any insurance company which has got call centres in India, or any large, global, bureaucratic sort of organisation, about your billing or something along those lines, they are easy, tangible, day-to-day examples of diseconomies of scale. There is the assumption that economies of scale are universally positive. There are certainly some economies of scale you do not want in terms of technology skills and expertise coming off-Island, for example, and I would ask you to think about the price of some of those economies of scale generally. I do not think it is necessarily a good thing for the Island. It is a euphemism of the job losses, skill reduction and other things. There are clearly economies of scale but I think the disruption and the long-term damage could be good examples of diseconomies of scale. If you are a manager of a business you tend to be successful if you are close to your marketplace and if we were Jersey Telecom we would want to be close to a local market so we know the issues our local customers are suffering. If we then have to go to somebody somewhere else in the world for a decision through 7 or 8 different committees, it slows things down. Much easier just to pop out and see Mr. X in his business and solve his problem for him there and that comes from being close to markets. So, that would be my most obvious examples of diseconomies of scale: decision making and flexibility; nimbleness.

Deputy G.P. Southern:
I think we may have covered all the issues that we sought to cover.

The Deputy of St. Ouen:
I just have one final one. As a layman, understanding the accelerated IPO is extremely difficult, I have to tell you. You speak about there is a certainty of timing of price with this accelerated IPO. Could you just expand on that?

Mr. J. Davey:
Sure. In a normal IPO what happens is you go out to the marketplace in the hope of raising the money. Sometimes it takes months; sometimes it takes weeks. You do not know if you are going to find it. You

go out to find the money. In accelerated IPO you have already got the money so the difference here was we sit at the table with any buyer you want to have. We have got the money in our pocket. We know how much we can go up to so we can sit in that same situation with any trade buyer and say yes or no, where with the old fashioned IPO you would have to say: "Well, I think I can get you X but you need to give me a couple of months to find out and I may or may not be able to do it." In the accelerated IPO it is accelerated because you come to the table with the money in your pocket so you have got pre-commitments from people to go up to a fixed price. I put the broad mechanism on page 19 and you will see initial due diligence, data room access. It is no different to any other buyer. We want the same access the trade buyer would have because they have got to establish a price; we have got to establish a price. There is no difference whatsoever. Then we sort of confirm in our own minds the structure we are going to use; preference shares, ordinary shares, convertible bonds or whatever that structure might be. You draft a prospectus. You do your confirmation due diligence, sale and purchase agreement, same as anyone else, and you make a firm offer. So, we can sit at the table and make a firm offer alongside Cable & Wireless, Bharti, anybody else, and either our price is good or our price is not good. If you are going to do this I think there is a conundrum here. There is talk about: "We must have the best price." Well, actually, will you take the best price if it is a strategic disaster? I do not think the 2 objectives are compatible; they are mutually exclusive. So I think what you need to do is personally get rational about is it just price or is it a mixture of price and strategic outcome? If it is just price, we might embarrass you, the States generally, which is the thing you do not want to do. We might offer you the highest price. So, I think you need to sort of work out really what the objective is.

Deputy G.P. Southern:
The objective of the high price presumably excludes somebody like Maquarie coming along and saying: "Ah, nice little jewel."

Mr. J. Davey:
That is the question: does it? Does it? If private equity turn up with the highest price - actually because the returns are quite high with private equity, an AIPO is almost guaranteed to, if you want to, generate the higher price. Unless you let private equity fill it with debt, and that is the tool of private equity because public market investors tend to have a lower return on requirement than private equity generally. So, I think you need to work out is it price or strategic outcome or a mixture of the 2 and how are you going to determine that. I think that is the conundrum; you are snookered there really. But the mechanism is different from an IPO largely because you come to the table with the money in your pocket and you know you have got certainty of financing, broadly speaking.

Deputy J.A. Martin of St. Helier:
I am sorry I did not come to the informal meeting. Just to ask, you say that this alternative has been completely overlooked and you were saying the phone is there; you are at the end of a telephone. Who have you contacted to ask? You have obviously contacted the Treasury and they know of this

alternative?

Mr. J. Davey:
Yes.

Deputy J.A. Martin:
My second question is if this alternative - which sounds fine to me, but I mean, I would have to take expert advice - was put on as a fourth alternative, would it just be your company? Then would it open up to other companies like you to do a tendering sort of thing?

Mr. J. Davey:
Well, we did the first one and we trademarked it but other people have -- in financial services everybody copies everybody else in the blink of an eye so there are other people who have done AIPOs and there are other people who are quite capable of doing AIPOs. What they probably lack is local share knowledge. We do most of the trade in all of the local companies and we always have done. We are the only people who write research that we know of in local companies so I suspect a third party would come to us and say could we play second fiddle to them and we would have to swallow our pride. We would play second fiddle but it would choke us to do that, in truth. There are other people who could do this. What is frustrating is before it is -- the idea needs to at least be -- if people disagree with us fundamentally then absolutely no problem. We have paddled -- we have put it in the sunlight; people did not like it. You do not have to follow it but at least it had a fair hearing. That is our sense of frustration that we do not think we are necessarily getting a fair hearing here.

Deputy G.P. Southern:
You fixed on, say, 25 per cent retention of shareholding by the Government would not put off investors necessarily. What is the grounds for objecting to a majority, the Government retaining a majority shareholding? Is that experience or is that just practicalities, or…?

Mr. J. Davey:
There are experiences of that and situations like that. It has been used in particular I think with companies where the Government has floated a monopoly and left it with a fixed period of non-competition. A period in which to adjust and the Government would sell it over time. Those situations are usually dealt with by what is called an orderly market arrangement where the Government can only sell under certain circumstances. Generally investors are distrustful of government and looking at this particular situation, would you want your dominant shareholder to be the people who have put you in this situation? Would we put £5 million of our money, or me put a year’s salary, advise other clients to put money in alongside this situation? Probably not. You would want a very silent majority.

Deputy G.P. Southern:

So, it is a practical question: the price that you would get is reduced, effectively?

Mr. J. Davey:
It affects the price. You can do it. It affects the price because it will turn certain investors off at certain classes of share. It would not turn anyone off a preference share. It would have no impact on your pricing of preference shares. It would probably turn certain equity investors off but it is not impossible. You would want, though, some very strict parameters in place where your dominant shareholder could not dictate the direction of the company, otherwise public market investors would not want to sit alongside the government.

The Deputy of St. Ouen:
One final point: obviously certain individuals have raised the issue that we could, if we follow the trade sale type route, replace a public monopoly with a private one. With your suggestion or proposal, would that still be the case?

Mr. J. Davey:
Yes. Depends, you tie a monopoly -- it is not monopoly anymore because you have allowed a very big aggressive competitor to enter the marketplace so, you know, if you are not careful here, Jersey Telecom could reach a tipping. If you left this too long, unless the management and staff respond right away, you might find you have tied their hands behind their back and their lunch is completely eaten while they are busy fighting this fight, that fight and this fight, and their competitors have come in and cleaned up their customers. They will be left with the customers nobody really wants, or the low margin customers, the high cost customers to service essentially. You would be left with what is perceived to be the dominant player and I do not think is really the dominant player because in a very short order of time this market will equalise, but that is my ideological view versus somebody else's ideological view that you have got a dominant monopoly. I think you have got a fragile monopoly which will soon be equalised.

The Deputy of St. Ouen:
It would be slightly different to a global telecoms operator currently having a licence on the Island bidding. That would create more of a situation, would it not?

Mr. J. Davey:
I think the fundamental difference is a global company will take action at the centre of the global company for the benefit of the global company. If the global company gets into trouble and wants to rein back investment in Jersey or wants to sell out from his Island businesses or there is a change of management taken over, it is a decision made at the centre of a global company for global benefit, not local benefit. Our situation is we have got nowhere to go. We are a local company serving local people. If we behave badly in the local market we will be upsetting our only customers. We cannot cut back investment and go because there is nowhere else for us to go under that scenario, so I think it

would regulate behaviour because it is a local company.

Deputy G.P. Southern:
Anything else you would like to add?

Mr. J. Davey:
No. All I say is if there is no interest in our idea, let us know early on and we will stop wasting our time on it because we have got other commercial things we could be doing with our time. I do not mean that in a facetious way. We are currently outsiders propagating an idea which appears has limited interest. If that is the case, let us formally say: "It is off the agenda" by Citibank or by Treasury or whoever. We will pack our tents and get on with something else. Otherwise we are still sitting here waiting for a call, broadly speaking.

Deputy G.P. Southern:
Sure. Well, thank you very much for that.

Deputy J.A. Martin:
Thank you.