



## **Unite Submission on the proposed structural separation of Jersey Telecom**

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**Unite represents the workforce of Jersey Telecom and is the UK's largest trade union with 2 million members across the private and public sectors. Our members work in a range of industries including manufacturing, financial services, print, media, construction and not for profit sectors, local government, education and telecoms.**

Unite welcomes the opportunity to respond to the proposal on the structural separation of Jersey Telecom Group. Unite would welcome any opportunity to provide further, and/or oral evidence on this issue to the States of Jersey Government and the Telecoms Privatisation Scrutiny Sub-Panel.

### **Executive Summary**

Unite believes that structural separation of Jersey Telecom would constitute a drastic, disruptive and damaging course of action. The union is against the proposal to pursue structural separation of Jersey Telecom on the following grounds:

- The rationale behind separating Jersey Telecom is unclear and has divided States Members.
- The risks and costs associated with structural separation are high.
- No other telecoms business has been split in this way prior to possible privatisation.
- The consequences of structural separation of an incumbent operator, prior to privatisation, are unknown.
- There is no evidence to show that structural separation would be of any benefit to Jersey Telecom or its customers.
- Structural separation would produce two less efficient business units with diminished value to potential buyers if the proposed sale of the company were to proceed.
- There is every chance that structural separation may jeopardise the island's economy and reliability of telecoms service.

### **1. The Rationale behind Sale**

- 1.1 The issue of structural separation has emerged largely from submissions made by the JCRA and Senator Ozouf, the Economic Development Minister, to the Economic Affairs Scrutiny Sub Panel.
- 1.2 Structural separation has not been collectively advocated by States Members, indeed Senator Le Sueur, the Treasury Minister, has opposed this route on the grounds that such a move would increase prices for JT customers.

- 1.3 It has been estimated that the cost of separation could amount to 35% of the annual capital expenditure budget.<sup>1</sup>
- 1.4 The management of Jersey Telecom are also in opposition to structural separation. In January 2008 Managing Director Bob Lawrence was quoted in the Jersey Evening Post saying that structural separation would lead to 'economic disaster for the island'.

## **2. The risks and costs associated with structural separation**

- 2.1 The full press release from Jersey Telecom Group on the issue of structural separation in January 2008 argues that the risks of this process are 'extraordinarily high' and potentially damaging to the island's financial industry. In particular the company has expressed fears that separation is unsuitable in such a small market.
- 2.2 Furthermore, without shared overheads and with the duplication of core functions (such as IT, human resources and accounting departments) post separation, the resulting units will face increased costs and will be vulnerable to takeovers or being squeezed out of the market.
- 2.3 The process of structural separation is also likely to be a costly exercise. Separation of wholesale/network and retail functions is a complicated process and will involve high administrative and legal costs as well as lengthy negotiations on pension funds and staffing matters.
- 2.4 A number of bodies consider structural separation to be a risky step. Ovum Consulting warns that "if the experiment fails, it is difficult to revert".<sup>2</sup>

## **3. Lack of precedent for structural separation of a publicly owned telecom**

- 3.1 No other publicly owned telecom has been separated prior to possible privatisation and there are no compelling reasons why Jersey Telecom should be an exception to this.
- 3.2 Where structural separation is being considered by telecoms authorities and regulators in Europe, there is much uncertainty about the regulatory implications. Without a body of robust evidence to demonstrate the success of structural separation in other nations, the States of Jersey would be very unwise to use a substantial island asset such as Jersey Telecom as a testing ground.
- 3.3 Ovum Consulting raises the issue that splitting telecoms companies is not analogous or as straightforward as the separation of other industries or utilities. A separation of Jersey Telecom would be complicated by the fact that telecommunications technology infrastructure is constantly changing and the lines of demarcation for any separation would be unclear<sup>3</sup>, for example as between fixed and mobile, core and access, retail and network
- 3.4 This concern is echoed by a report by the Evatt Foundation which asks the question: "Where...do 'wholesale' services end and 'retail' value added services begin?"<sup>4</sup> In particular it would be difficult to discern where to place

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<sup>1</sup> Estimated by TCNZ, quoted in Analysys report to the Treasury Minister

<sup>2</sup> See <http://www.ovum.com/go/content/c.62120.68058>

<sup>3</sup> ibid

<sup>4</sup> See <http://evatt.org.au/publications/papers/41.html>

services such as caller line identification. In addition, after separation there would be fewer incentives to develop new network capabilities in a company that is defined by being a 'pure utility operator'.

#### **4. The consequences of structural separation for an incumbent, non privately owned operator are unknown**

- 4.1 As has been previously stated, there is no comparable instance of structural separation of a telecommunications company prior to possible privatisation. Oxera's report to the States of Jersey Government in 2007 concluded that the lack of empirical evidence of the effects of structural separation suggest that requiring this structure of a future Jersey Telecom would be a "high risk strategy".
- 4.2 In Unite's view, those in favour of structural separation are in danger of compromising the economy of the island. Jersey's economy, and in particular the critically important international finance sector, is dependent on the provision of high speed and high quality, advanced and reliable communications networks and to subject these networks to an experiment would be excessively imprudent.

#### **5. Structural separation has no known benefits to consumers or to a small island economy**

- 5.1 A report by the OECD in 2003<sup>5</sup> argues that structural separation is a significant intervention in the marketplace, with substantial and, unlike behavioural separation which can be reversed, irreversible costs.
- 5.2 Ovum Consulting warns regulators that when contemplating structural separation in the name of competition and opening up telecoms markets to be aware that "more competition at all costs does not always lead to better public welfare".<sup>6</sup>
- 5.3 Ovum also finds that "an integrated operator model is the most efficient approach to serving the public (that is, generating the greatest economic welfare)"<sup>7</sup>
- 5.4 A submission by the Australian Telecommunications User Group into the Inquiry into the Structure of Telstra in 2003 raised concerns that the significant costs that "structural separation would generate is likely to be passed on to consumers resulting in price rises."<sup>8</sup>

#### **6. Structural separation would produce inefficiencies**

- 6.1 The management at Jersey Telecom have raised concerns that the businesses units resulting from the split of Jersey Telecom would be inefficient. They are particularly concerned that the network unit would not be able to generate enough profit to fund its own necessary capital expenditure and that the retail unit would face increased costs and could not compete with rival companies.

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<sup>5</sup> See [http://www.oecd.org/document/10/0,3343,en\\_2649\\_33725\\_15321034\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/10/0,3343,en_2649_33725_15321034_1_1_1_1,00.html)

<sup>6</sup> See <http://www.ovum.com/go/content/c.62120,68058>

<sup>7</sup> *ibid*

<sup>8</sup> See <http://www.atug.com.au/article.cfm?newsid=398&newstype=1>

- 6.2 In 2003 ATUG also argued that separation would threaten the various efficiencies enjoyed by an integrated company, including economies of scale and scope.<sup>9</sup> It is reasonable to expect that there would be a number of inefficiencies incurred by separating Jersey Telecom, including replication of core functions.
- 6.3 Furthermore, if the States Government continues to push for the sale of Jersey Telecom, there is little sense in separating the company before it is sold. Jersey Telecom is a small and compact business unit and a relatively small company by international standards. If a sale of the company were to be sought after separation there is a risk that the value of the asset will have been diminished by the cost of separation. The States of Jersey may also find that it needs to attract more than one buyer for the resulting business units.

## **7. A threat to Jersey's economy and reliability of telecoms services**

- 7.1 Any perceived benefits of structural separation are likely to be outweighed by significant costs. The financial costs of administering the separation of Jersey Telecom will be accompanied by the potential economic costs of disrupting the telecoms service delivered to the island's population and resident industries. A structural separation may also compromise future expenditure on the telecommunications network.
- 7.2 Ovum Consulting has also raised the prospect of Private Equity interest in the resulting business units produced by structural separation.<sup>10</sup> Private Equity funds are attracted to businesses such as Jersey Telecom which are rich in assets and infrastructure and provide reliable rates of return. Unite has serious concerns about the activities of Private Equity firms, including their focus on a relatively short time frame for return on investment and a propensity to restructure businesses, threaten existing pension provisions and cause substantial redundancies.

January 2008

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<sup>9</sup> ibid

<sup>10</sup> See <http://www.ovum.com/go/content/c.62120,68058>