

TELECOMMUNICATIONS (JERSEY) LAW 2002

PROPOSED DIRECTION TO JERSEY TELECOM LIMITED CONCERNING THE PUBLICATION, FORMAT AND AUDIT REQUIREMENTS OF ITS REGULATORY SEPARATED ACCOUNTS

INITIAL NOTICE

1. The Jersey Competition Regulatory Authority (“JCRA”) issues this Initial Notice (“IN”) under Article 11 of the Telecommunications (Jersey) Law 2002 (“the Law”) concerning a proposed Direction which it intends to make (subject to any views and representations expressed during the consultation period) to Jersey Telecom Limited (“JT”) regarding the format, audit and publication of its regulatory separated accounts (“SA”).

Background

2. On 15th December 2009 the JCRA published a Consultation Document ¹ on the question of whether, and if so, in what format JT should have to publish SA for its regulated activities.
3. Based on the responses to this consultation and the recommendations in the Regulaid² and LECG³ reports the JCRA issued an IN to JT on 21 June 2010 proposing the publication and format of its SA which was based on the format proposed in an earlier Direction to JT issued on 1 July 2005.
4. Representations were received to that IN from JT; Cable & Wireless Jersey Limited; Clear Mobitel Jersey Limited; Jersey Airtel Limited; Newtel Limited and Nitel Limited which together resulted in the Board of the JCRA amending its original proposals.
5. Consequently on 10 August 2010 the JCRA published a new IN proposing to Direct JT on the format, publication and, in addition, the audit requirements of its SA. The JCRA’s view at that time was that requiring JT to audit its SA will ensure that the market has confidence in the integrity and accuracy of the published accounts.

¹ Consultation Document 2009 – T4 entitled Consultation on the Publication of Jersey Telecom Limited’s Regulatory Separated Accounts.

² Regulaid Review of the Jersey Telecom Limited Separated Accounts and Wholesale Access Provisions

³ LECG Review of the regulatory powers resources and functions of the JCRA as a telecommunications regulator
<http://www.gov.je/SiteCollectionDocuments/Industry%20and%20finance/R%20JCRA%20Review%20Report%2020090331%20LEGC.pdf>

6. In response to this IN the JCRA received representations from Cable & Wireless Jersey Limited and Jersey Airtel Limited. Resulting from these responses the JCRA decided to re-examine the structure of the JT SA and subsequently appointed telecommunications consultants KPMG to undertake a review of the format, audit and publications requirements that may be required for regulatory purposes.
7. Consequent to this review, the JCRA has published a Final Notice terminating the proposed 10 August 2010 IN and has published a fresh IN which proposes the necessary changes to the JT Telecommunications Licence that are required to ensure that any future proposal can be enacted.
8. This IN will now outline the steps proposed by the JCRA as a consequence of the current review of the JT SA being undertaken by KPMG.

The Specified Regulatory Function which the JCRA proposes to exercise

9. The IN published 14 April 2011 proposes changes to the JT Licence Condition 29 which shall oblige JT to prepare SA, in such a form as the JCRA may from time to time require, which may include auditing and publication of those SA. The JCRA notes that JT has already published its 2009 SA and believes the principle of publication of these accounts is no longer at issue.
10. This IN under Article 19 of the Law is to Direct JT to comply with its Licence Condition 29 to provide the SA in the format determined from time to time by the JCRA. It also enables the JCRA to Direct JT in the requirements of an audit of its SA.
11. The proposed Direction to JT regarding its SA is set out in Annex A to this IN.

Reasons for the Proposed Direction to Publish the JT SA

12. As stated in the 2009 Consultation:

“The reason for creating separated accounts for an incumbent operator is to demonstrate that it is not discriminating between its own downstream operations and those of competing providers. It is the view of the JCRA that making these accounts publicly available will assist in the detection of (or help to verify in the absence of) anticompetitive behaviour in the relevant retail and wholesale markets. This will assist in the development of competitive markets that will ultimately benefit the consumer.

Publication of the dominant operator’s accounts is in line with best international practice in both large and small jurisdictions. The Office of Utility Regulation in Guernsey requires publication the Regulatory Separated Accounts of Cable & Wireless Guernsey Limited⁴ as does UK regulator Ofcom with regard to British

Telecom plc⁴. Therefore the JCRA is of the preliminary view that JT's separated accounts should be published".

13. SA are important for regulated entities such as JT because they enable not only the JCRA to monitor the operator's performance in its role as regulator but also enable the operator to understand its own business in relation to the markets in which it is regulated. In disaggregating the various parts of its business JT is better able to use the accounting information to set prices at wholesale and retail levels such that it is compliant with its Licence obligations. This in turn creates a more transparent view of its business for the telecommunications market as a whole and enables competitive and innovative telecommunications services to be developed by other operators that rely on JT's wholesale products.
14. It should be noted that publication of JT's SA (in an appropriate format) was one of the recommendations contained in the Regulaid Report concerning JT's regulatory accounts and wholesale access provision⁵. The LECG report commissioned by the Economic Development Department also supported the need for these accounts to be published.
15. The published accounts should contain sufficient information for them to be interpreted by other operators but without revealing proprietary information about the JT business.
16. It is generally accepted that the published information should include:
 - an introduction describing key regulatory background information;
 - a copy of the audit opinion prepared by the independent auditor;
 - a statement setting out the basis on which the accounts were prepared and a description of any significant changes to the accounting methodologies; and
 - the Regulatory Financial Statements completed in accordance with the format set out in Annex B.
17. In addition to the published data set out in Annex B, JT shall also publish its Accounting Separation Methodology document which should include:
 - A description of the regulatory accounting principles used to prepare the Regulatory Separated Accounts;
 - A description of attribution methodologies used to allocate costs;

⁴ British Telecommunications plc Regulatory Statements – available at [http://www.btplc.com/Thegroup/Regulatory information/Financial Statements/index.htm](http://www.btplc.com/Thegroup/Regulatory%20information/Financial%20Statements/index.htm)

⁵ Regulaid Report Recommendation 4.5

- A description of the processes used to implement the attribution methodology;
- A description of network components, activities, and usage by service;
- The transfer charge methodology on a basis of attribution of transfer charges; and
- Tables showing the allocation of general ledger costs to activities and activities to products.

Reason for the Proposed Direction on the Format of JT's SA

18. In its Direction of 12 May 2005⁶ to JT the JCRA set the format of the JT SA against a proforma used by the EU. This format was again referred to in the 2009 Consultation. This format, which has been used in a number of jurisdictions, was however developed prior to the fundamental changes to telecommunications network topology that have occurred in recent times. As the technologies and structures of telecommunications networks have changed then the methodologies utilised in this proforma may no longer be relevant to modern networks.

19. KPMG's report⁷ on the review of the JT SA states:

“In our view the current format of JT's separated accounts does not provide sufficient transparency to enable users to identify the relevant costs of wholesale services or ensure that wholesale customers and JT's retail arm are treated equivalently.

The separation of the regulatory accounts business into Core and Access businesses creates particular confusion in respect of services which use network elements in both the Core and Access businesses.”

20. Consequent to this observation, KPMG recommends a change in the structure of the SA such that the SA separately show the Wholesale and Retail elements of JT's business and thus there will be more transparency with relation to the treatment of its own retail business and the equivalent services sold to other operators.

21. It is the JCRA's view that it is important for a regulated operator that has dominance in key wholesale markets to understand its own cost base in order to provide services efficiently and without discrimination. With JT's SA set out as

⁶ Direction to Jersey Telecom Limited – Separated Accounts

<http://www.jcra.je/pdf/050511%20Direction%20to%20JT%20re%20Separated%20Accounts.pdf>

⁷ KPMG Review of Jersey Telecom Limited's Regulatory Separated Accounts

separate wholesale and retail markets, it will be easier for JT's own retail arm to assess costs in relation to provision of its products and services. It will also assist other operators that rely on JT's wholesale products.

22. The JCRA is also of the view that this change is at a high level and will not impact on JT's existing activity based cost allocation methodologies and thus can be incorporated readily into its submissions to the JCRA under its Licence obligations and in its published accounts format.
23. In addition JT shall provide additional accounting information (AAI), as set out in Annex C of this IN, to the JCRA that shall not be subject to an audit or publication and will be provided to JCRA on a confidential basis. This AAI information will be used by the JCRA in its duties in setting regulated prices and in determining JT's compliance with its Licence Conditions.
24. In order to ensure that the SA are prepared in accordance with this format it is recommended that JT work together with the JCRA's consultants KPMG during the preparation of the 2010 SA.
25. The JCRA understands that as a result of the changes proposed to the JT SA in this IN that the preparation of the accounts for 2010 shall be delayed and consequently will derogate the presentation to the JCRA and the publication date until 30 September 2011.

Reason for the Proposed Direction to Audit JT's SA

26. Consequent to the comments received for the 10 August IN, the JCRA undertook to review the JT SA structure. To ensure that the market has confidence in any published SA the JCRA's consultants advised that an audit would underpin their preparation and presentation. This in turn would enable the JCRA to more confidently carry out its functions in regulation of the markets in which JT retains Significant Market Power⁸.
27. It is generally accepted good practice for SA to be audited. For example, the EC has stated that

“For consistency and data integrity, it is recommended that the financial reports of the regulatory accounts be consolidated into a profit and loss statement and a statement of capital employed for the undertaking as a whole. A reconciliation of the separate regulatory accounts to the statutory accounts of the operator is also required. **These statements should be subject to an independent audit opinion**

⁸ Decision on the Holding of Significant Market Power in Various Telecommunications Markets
<http://www.jcra.ie/pdf/100420%20market%20review%20decision.pdf>

or a national regulatory authority (“NRA”) compliance audit (subject to the availability of suitably qualified staff).⁹

Similarly, the Independent Regulator’s Group (IRG) commented that:

“The audit opinion and accompanying report has potentially high value in enhancing the quality, objectivity and credibility of the information presented. Users confidence and understanding of the financial statements is significantly enhanced by the presence of an independent audit.”

“NRA's shall ensure regulatory accounts are subject to an independent audit opinion to a high standard. Where the NRA does not carry out this audit then the NRA should also ensure that he has access to the auditor so that additional information can be sought in respect of the auditor's report. Where the operator appoints the auditor, the NRA may also ensure that they are consulted and agree the appointment”¹⁰.

The provision of a ‘clean’ audit opinion on the regulatory accounts will provide assurance to the regulator and other users of the accounts that they have been prepared in a reliable manner, and depending on the type of opinion, that the methodologies used to allocate costs are reasonable.

28. The standard to which the SA are audited is also of importance as the more rigorous the level applied the more confidence can be placed on the accuracy of the presented accounts. The JCRA notes that in similar sized jurisdictions¹¹ such as Malta the Generally Accepted Auditing Standards “fairly presents in accordance with” opinion is required by the regulatory authority, Ofcom requires Kingston Communications to achieve a “fairly presents in accordance with” audit opinion while in Guernsey a less rigorous standard of “properly presented in accordance with” is specified, although this is after a period in which the accounts were subjected to a “fairly presents” opinion enabling robust systems to be developed over time and which are now subject to a rigorous ‘change control’ process. The KPMG report¹² recommends that for JT the “fairly presents” standard should be applied. The key reason for requiring the higher opinion is that it adds reassurance that the underlying cost allocation methodologies being applied are themselves reasonable, rather than restricting the opinion to whether or not the cost allocations are computationally correct. Also KPMG has recommended that the audit opinion is provided over two market groupings – wholesale and retail – and not to individual markets. This will significantly reduce

⁹ Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.

¹⁰ Independent Regulators Principles of implementation and best practice regarding accounting separation and cost accounting Group November 2002 <http://www.irg.eu/template20.jsp?categoryId=260350&contentId=544695>

¹¹ Turnover of Kingston Communications was £128m (2009), Cable and Wireless Guernsey £70m (2009) and JT £91m (2008).

¹² KPMG Review of Jersey Telecom Limited's Regulatory Separated Accounts

the audit work and costs whilst still providing assurance over the underlying cost allocation methodologies.

29. SA, while assisting in the regulation of telecommunications services, also provide information to JT on the base costs of providing those regulated services and other services, and assist in the efficient management of its network. While the performance of an audit is a cost to JT, these costs should be considered against the gross turnover of its business and the potential for the audit to reveal inaccuracies or inefficient allocations that can benefit the business.
30. The JCRA accepts that in the first instance the cost of an audit will be high, but experience in other jurisdictions indicates that these costs fall significantly over time. The JCRA is therefore of the view that an audit will be of overall benefit to both JT and to the Jersey telecommunications market.

The JCRA's duties under Article 7 of the Law

31. The JCRA's primary duty under Article 7(1) of the Law is to perform its functions in such a way as it considers best calculated to ensure (as far as is reasonably practicable) that 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.
32. In this regard, and as stated in the 2009 Consultation:

“Separated accounts can assist the regulator in many ways, particularly with potential abuses by the regulated entity of its dominant status in some relevant markets, for example, the access market. Some of the potential uses for such accounts are:

- Monitoring of the operator's performance for purposes of regulated product price control;
- Informing on costs for the purpose of setting wholesale access charges;
- Setting interconnection pricing;
- Aiding the NRA in detecting anti-competitive behaviour such as unfair cross subsidisation and undue discrimination at levels of disaggregation appropriate to the relevant market; and
- Assisting in comparative competition (the process of benchmarking a company's performance in relation to other companies' performance).

If they are published, such information may also inform other stakeholders with regard to market behaviour”.

33. The publication by JT of its SA in such format as directed by the JCRA will assist the JCRA in fulfilling its primary duty that telecommunications services are provided and are provided in a way and at a price that does not entail JT breaching any of its relevant Licence Conditions.
34. The JCRA’s secondary duties are set out in Article 7(2) (a) to (f) of the Law and again, the JCRA is of the view that the greater transparency provided by the publication of JT’s SA will assist it in performing those duties.
35. Thus for example Article 7(2)(a) requires the JCRA to perform its functions in such a manner as it considers is best calculated to protect and further the short and long term interests of users within Jersey of telecommunications services and to do so, where appropriate, by promoting competition among persons engaged in commercial activities connected with telecommunications in Jersey.
36. The publication of SA (which, unlike statutory accounts concentrate on the costs and revenues from individual business activities with greater granularity than normal financial account reporting), will enable competitors of JT to raise accounting issues with the JCRA if it appears that potential Licence Condition breaches or abuses of dominance are taking place. This in turn will enable the JCRA to carry out an open and transparent investigation in order that the ultimate outcome will protect the short and long term interests of users of telecommunications services in Jersey.
37. The greater transparency provided by the publication of JT’s SA (subject only to the excision of genuinely confidential information) will likewise assist the JCRA in performing its duties under Article 7(2)(b) and (c) which relate, respectively, to the JCRA promoting efficiency, economy and effectiveness in commercial activities connected with telecommunications and to furthering the economic interests of Jersey. If the proposed requirement to publish the SA is adopted, this will assist in preventing the dominant player JT from abusing its dominant position by adopting anti-competitive practices such as predatory pricing and unfair cross subsidisation.
38. The requirement to publish SA will be neutral in terms of the JCRA’s duties under Article 7(2)(d) to (f) inclusive (which relate to restrictions placed upon persons engaged in telecoms activities, the financial and other resources necessary to conduct telecommunications activities, and the special needs of persons who are disabled or have limited financial resources). All of these duties of the JCRA will benefit at a general level from the publication of the SA.
39. In compliance with the procedures set out in the Guideline on Procedures under the Telecommunications (Jersey) Law 2002, the JCRA intends to publish full

non-confidential texts of any representations or objections received in response to this Initial Notice. Thus, respondents to this consultation should clearly identify all confidential information contained in their responses.

Any objections or representations regarding this IN must be received no later than Midnight **24th June 2011** and may be supplied either in hard copy or electronically, addressed (as appropriate) to:

Graeme Marett
Telecommunications Case Officer
Jersey Competition Regulatory Authority
2nd Floor Salisbury House
1 – 9 Union Street
St Helier
Jersey
JE2 3RF

E-mail: enquiries@jcra.je

25th May 2011

ANNEX A

Direction to Jersey Telecom Limited

Under the terms of their Licence issued on 1 July 2003 by Order of the Board Pertaining to Jersey Telecom Limited Class III Licence Condition 29.

WHEREAS

The Board of the JCRA has determined the requirements for Jersey Telecom Limited in the matter of compliance with its Licence Condition 29 – Separation of Accounts.

THE BOARD OF THE JCRA NOW DIRECTS

1. that it shall provide to the JCRA its Regulatory Separated Accounts in a format as determined from time to time by the JCRA and for the year 2010 and until otherwise Directed by the JCRA in the format as set out in Annex B of the Initial Notice enacting this Direction;
2. that it shall obtain an audit opinion on its Regulatory Separated Accounts from an independent auditor in the format as determined from time to time by the JCRA;
3. that for its Regulatory Separated Accounts for the year 2010 and until otherwise determined by the JCRA the required audit opinion which shall be prepared in accordance with Generally Accepted Auditing Standards, shall state whether or not the Regulatory Separated Accounts “Fairly Present” the results, mean capital employed and costs of JT;
4. that it shall publish its Regulatory Separated Accounts which shall comprise:

Regulatory Financial Statements which shall include:

- a statement of responsibility
- an introduction describing key regulatory background information;
- a copy of the audit opinion prepared by the independent auditor;
- a statement setting out the basis on which the accounts were prepared and a description of any significant changes to the accounting methodologies;
- Financial Statements to include the schedules completed in accordance with the format set out in Annex B;

An Accounting Separation Methodology document which shall include:

- a description of the regulatory accounting principles used to prepare the Regulatory Separated Accounts;

- a description of attribution methodologies used to allocate costs;
 - a description of the processes used to implement the attribution methodology;
 - a description of network components, activities, and usage by service;
 - the transfer charge methodology on a basis of attribution of transfer charges; and
 - tables showing the allocation of general ledger costs to activities and activities to products.
5. that it shall publish its Regulatory Separated Accounts concurrently with its presentation of those accounts to the JCRA which shall be 30 June of each year;
 6. that for the Regulatory Separated Accounts for the year 2010 the JCRA shall grant a deferment of that presentation and publication to the 30 September 2011;
 7. that it is no longer required to show markets in its Regulatory Separated Accounts in which it no longer holds Significant Market Power (“SMP”). It shall nevertheless group its licensed non-SMP telecommunications business activities separately from its other unlicensed business activities;
 8. that in addition to the published Regulatory Separated Accounts, JT shall provide additional accounting information (“AAI”) to the JCRA as determined from time to time by the JCRA. Such AAI shall not be subject to an audit and will be provided to JCRA on a confidential basis and is not required to be published; and
 9. that it shall provide the AAI in the format as set out in Annex C of the Initial Notice enacting this Direction to the JCRA on the same date as that of the Regulatory Separated Accounts which shall be 30 June of each year.

This Direction shall become effective on <date>.

<date>

By Order of the Board of the JCRA

ANNEX B

ANNEX C