CABLE & WIRELESS

Consultation on the publication of Jersey Telecoms' Regulatory Separated Accounts

Response to document issued by the Jersey Competition Regulatory Authority (2009-T4) on 15 December 2009

5th February 2010

Introduction

Cable & Wireless Jersey Limited (C&WJ), also trading as 'Sure', welcomes the opportunity to respond to the JCRA's consultation on the publication of Jersey Telecom (JT) Limited's Regulatory Separated Accounts, which was published on 15 December 2009 ("Consultation").

This document sets out C&WJ's responses to the three questions raised by the JCRA, along with some additional comments in response to other information that has come to light as a result of this consultation process.

Responses to the JCRA's questions

1. Do stakeholders agree that JT should publish its regulatory separated accounts and its accounting separation methodology in full?

C&WJ considers that the publication of regulatory separated accounts and methodology in full would facilitate the provision of key regulatory information to stakeholders and has lobbied the JCRA on numerous occasions (since January 2005) for JT's separated accounts to be published.

The request was reiterated in C&WJ's submission of 9 October 2009[1], in response to Regulaid's review of JT's regulatory accounts and access provision (the "Review")[2]:

- "C&WJ has long argued that JT should be required to publish its separated accounts so that all operators can ensure that JT is not engaging in any discriminatory pricing behaviour towards its competitors. The regulatory accounts of an incumbent operator can also provide key indicators to OLOs of the potential profitability of the various telecoms services that they may choose to provide. OLOs in Jersey currently have no such information available to them. This is potentially restricting competition and therefore choice for consumers. Publication of separated accounts is a standard regulatory requirement in all other modern jurisdictions that C&WJ is aware of. C&WJ is surprised to see, therefore, that there is no specific recommendation with respect to this requirement in the subsequent sections of the Report. It believes that this is a significant omission and would request that the final version of this Review should ensure that such a specific recommendation is included."

- "The publication of JT's separated accounts would also enable OLOs to consider the extent to which any special offer or discount notified by JT in advance of launch do indeed cover its incremental costs, and would allow OLOs to make any necessary submissions to JCRA if they believed that they could have anti-competitive effects."

C&WJ is pleased to note that the preliminary view of the JCRA is that JT's separated accounts should be published, this being a standard requirement in all other jurisdictions

[1] Comments on JCRA Consultation Document 2009-T2, Fixed Line Access review, 9 October 2009

[2].The review of Jersey Telecom Ltd's regulatory accounts and access provisions, a draft report to the Jersey Competition Regulatory Authority, Regulaid BV, 17 August 2009

that C&WJ is aware of, where the provision of separated accounts is directed. C&WJ also notes that in the analysis of remedies available to European regulators and the JCRA at paragraph 3.1.7 of the Review, it states, "There are a number of important obligations missing from the list [including] the publication of JT's separated accounts".

In Guernsey, where separated accounts have been submitted annually since 2001, Cable and Wireless initially expressed major reservations about publication of its regulated results, but making use of the EU pro formas meant that the data was provided in a similar format to that of many other telcos, whilst protecting the business from the release of information considered to be highly confidential. C&WJ sees no reason why this should not also apply in JT's case.

2. Are there any parts of the JT regulatory separated accounts which should remain in commercial confidence and therefore not be published?

It appears that JT does not believe that it should publish any accounting separation data, with its reasons centring around two arguments:

- Its need to protect commercially sensitive information from its competitors,
- Its concerns that readers might misinterpret the stated returns of some of its businesses and draw inappropriate conclusions from them.

It is highly likely that commercial confidentiality is a concern of all operators that are required to publish regulatory separated accounts. If JT provides its submission in an EU Commission style format C&WJ can see no reason why it should have any legitimate concerns greater than those of other operators that already publish regulatory accounts using that format.

C&WJ considers that readers should have access to enough information to enable them to draw appropriate conclusions from JT's published separated accounts. Any discrepancies in expected results should be explained in the accompanying submission documentation. Should JT's separated accounts be published (as LECG[3], Regulaid, other operators and provisionally the JCRA believe to be appropriate) then JT's associated documentation would be of almost equal importance to the statements themselves.

It could be considered that JT is expecting to be rewarded for not being more compliant in the preparation of its separated accounts by suggesting that it should not publish the results, in case other parties misconstrue the returns. Interested parties are very likely to have already read the Review and will therefore appreciate the context of those results. It should be remembered that the JCRA's questions relate solely to the principles of publication, not to the provision of a specific set of JT's separated accounts. However, as JT points out in its response to the Review, all the remaining allocation errors will be corrected in its 2009 separated accounts. This should minimise JT's concerns over the misinterpretation of accounts, going forward.

The JCRA has previously stated that it wished to follow best practice[4] and referenced the EU Commission Recommendation of 1998 regarding accounting separation and cost accounting[5]. Recommendation 7 of that document states:

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[3] Review of the regulatory powers, resources and functions of the JCRA as a telecommunications regulator, LECG in association with Charles Russell LLP, March 2009.

[4] Accounting Separation – a consultation paper on Accounting Separation and Costing Methodologies, 2 June 2004, JCRA

> "It is recommended that NRAs make relevant accounting information from notified operators available on request to interested parties at a sufficient level of detail to ensure that there has been no undue discrimination between the provision of services internally and those provided externally, and to enable the average costs of unbundled interconnection services to be identified.
>
> In this respect, the publication by the notified operator of sufficiently detailed cost statements showing the average cost of network components will increase transparency and raise confidence on the part of competitors, that there are no anti-competitive cross-subsidies. This is considered to be particularly important for cross-border interconnection services and international activities…"

As the EU Commission notes, it is important that sufficiently detailed cost statements are published. In response to Question 3 below C&WJ proposes what it considers to be an appropriate format (and level of detail) for JT to publish its separated accounts.

3. Is the format of the separated accounts, as set out in the Annex to this consultation document an appropriate format?

The appendices to the JCRA's consultation show an example of the format, but they do not indicate whether JT would need to publish a profit and loss statement and a statement of mean capital employed for all of its separated businesses.

C&WJ agrees with the JCRA's view that publication of JT's separated accounts would "assist with the detection of (or help to verify in the absence of) anti-competitive behaviour in the relevant retail and wholesale markets." C&WJ is also concerned about the treatment of costs between JT's fixed businesses and its mobile business, but has fewer concerns regarding the recognition of revenues and costs between JT's disaggregated mobile businesses.

From the pro formas provided C&WJ can see that the data shown on JT's Statement of Costs of Network Services is different to the example provided by the JCRA to JT in 2004 (laid out in a format equivalent to EU Commission guidelines). It is unclear why JT has taken a different, more detailed, approach. C&WJ can appreciate why JT might not want to share this greater level of detail and suggests that for at least publication purposes it uses the more standard version provided by the JCRA in its guidelines[6].

Bearing in mind the above points C&WJ would expect that, as a minimum, JT should be required to publish the following:

- Regulatory Separated Accounts, covering:
    - Local Access Network – P&L & MCE
    - Core Network – P&L & MCE
    - Statement of Cost of Network Services (as per JCRA guidelines – route factors & average costs)
    - Fixed Retail – P&L & MCE
        - Exchange Line Rental & Connection – P&L & MCE
        - Local Calls – P&L & MCE
        - National Calls – P&L & MCE
        - International Calls – P&L & MCE

[5] EU Commission Recommendation of 8th April 1998 on interconnection in a liberalised telecommunications market Part 2 – Accounting Separation and cost accounting.

[6] See table 5.6 (two parts), on pages 53 and 54 of the JCRA's Accounting Separation consultation document, op cit.

        - Calls to Jersey Mobiles – P&L & MCE
        - Non-geographic calls free to calling customer – P&L & MCE
        - Non-geographic calls charged at local rate – P&L & MCE
        - Non-geographic calls charged at national rate – P&L & MCE
        - Non-geographic calls charged at premium rate – P&L & MCE
        - Internet Calls – P&L & MCE
        - Directory Enquiries – P&L & MCE
        - Public Payphones – P&L & MCE
        - Leased Lines & Data Services – P&L & MCE
        - Broadband xDSL – P&L & MCE
        - Broadband Other – P&L & MCE (where relevant)
        - Remaining Activities – P&L & MCE
    - Mobile Business – P&L & MCE
    - Other Activities – P&L & MCE
    - Outside Jersey – P&L & MCE (see Point b, below)
    - Transfer Charge Statement
    - Inter-Business Cost Summary
    - Reconciliation Statement for the Profit & Loss Account
    - Reconciliation Statement for the Balance Sheet

- Accounting Separation Methodology

- Detailed Allocation Appendices[7]

Additional comments

C&WJ is grateful to the JCRA for the provision of additional information, as part of its consultation process (such as JT's Accounting Separation Methodology document), that had not previously been available to external parties.

Using information provided from JT's Accounting Separation Methodology and taking account of its response to the Review, C&WJ would like to raise the following concerns about the methodologies employed by JT in its separated accounts:

a) Regulatory Audit:

C&WJ is astounded at the absence of an audit requirement for JT's separated accounts. Wording in the Review was ambiguous about such a requirement and Section 4.1 of C&WJ's response[8] was based on the assumption that a regulatory audit had been undertaken for some years. The provision of an independent audit is an integral requirement for separated accounts and the need for it is recognised by the EU Commission[9]. It enhances the quality, objectivity and credibility of the results, both to the regulator and to all other users. JT's separated accounts and its underlying Metify costing model provide the basis for the charging of a wide range of wholesale and retail services. It would seem that the situation that Jersey telecommunications operators find themselves in, when faced with the likes of disputed RIO rates, is primarily due to the lack of control on JT in the appropriate use of its separated accounts and costing model.

[7] The Attribution Methods document should also be published, if different to what JT refers to as its Detailed Allocation Appendices.
[8] Op cit.
[9] Section 7.4 of EU Commission Recommendation of 8th April 1998 on interconnection in a liberalised telecommunications market Part 2 – Accounting Separation and cost accounting.

Whilst the JCRA has stated that it does not require JT to have its separated accounts audited “in the interest of proportionate regulation” the current mechanism of sign-off by two of its Directors is clearly failing to meet the regulatory requirements that the JCRA has set down[10]. JT is acting as its own judge and jury, with no independent and objective input to question the credibility of the results before presentation to the JCRA. Had JT’s separated accounts been audited many of the issues highlighted in the Review (and those respondents that commented on the Review) could have been resolved prior to submission.

The lack of credibility is highlighted further by comments from JT in its Accounting Separation Methodology document (written as recently as June 2009), where it quotes:

“The allocation bases used in the preparation of the Separated Accounts were initially developed for management accounting purposes. In this context, Jersey Telecom has endeavoured to ensure that these allocation bases are the most appropriate for the purposes of accounting separation, subject to the limitations of time and data availability. Consequently, certain allocation bases may not meet the quality standard Jersey Telecom would normally require in the reporting of financial information for third party consumption.”

This statement, coupled with the numerous errors that Regulaid found, should emphasise to the JCRA the urgent need to introduce a requirement for JT’s separated accounts to be independently audited. An efficiently scoped and managed annual audit would provide it with additional assurance as to the quality of its future regulatory accounting outputs.

b) JT’s treatment and reporting of its consolidated business:

It is important to recognise that JT appears to have incorrectly interpreted the requirements for the accounting separation structure. Its separated accounts are based on the consolidated activities of the JT Group, without complying with the JCRA’s requirement to prepare a separate account (business) aggregating activities that are undertaken outside Jersey that are wholly unconnected with its Jersey businesses[11]. In the regulatory context this would mean JT Global and Wave Telecom. Their current inclusion within the Other Activities Business conflicts with the purpose of the accounts – to report on the financial impacts of the activities carried out by JT <u>in Jersey</u>. The results cannot currently reflect the true values of JT’s transfer charging prices in relation to Jersey activities, as the Other Activities Business results are being distorted by the inclusion of non-Jersey activities. This would impact on the visibility available to JT, should it need to counter any cross-subsidisation concerns. In the regulatory environment JT’s various operations should be accounted for on an arm’s length basis, so where for example Wave makes use of JT’s Core Network components these should be recognised as a revenue item in the Core Network and a transfer charge cost for an additional business (not currently recognised), such as ‘Outside Jersey’.

A cleaner methodology, which the JCRA could implement within the current reporting structure, would be for JT’s Other Activities Business to contain only non-telecoms activities that JT undertakes in Jersey, with costs and revenues associated with JT Global and Wave Telecom not forming part of JT’s regulatory accounts at all, more than being treated as costs and revenues from ‘Other Operators’. This kind of methodology has been employed elsewhere and better

[10] JCRA’s Accounting Separation paper of 2004, op cit.

[11] See paragraph 1 of Section 7 (page 23) of Accounting Separation consultation paper, op cit.

recognises that associated companies are truly at 'arm's length'. The reconciliation statements for the P&L account and for the Balance Sheet could then be made against the statutory accounts of JT's Jersey operations only, i.e. not its consolidated statements.

Regardless of which methodology would better suit the JCRA (accepting that the current methodology is incorrect), JT states in its Accounting Separation Methodology that the Liberty Cable is a Wave asset. When JT makes use of this cable, in the provision of end services for wholesale, retail or mobile customers, only JT's Core Network Business should interact with Wave (on an arm's length basis) to pay for its use. Currently JT recognises this network related transfer charge between its Other Activities Business and its Fixed Retail and Mobile Businesses, completely excluding its Core Network, the very business which is meant to provide the service. As the JCRA's accounting separation guidelines state:

"A core network business activity provides a range of interconnection services internally and externally in order to allow the customer of one Licensee to communicate with customers of the same or another Licensee, or to access services provided by another Licensee. These services include the switching and conveyance of communications traffic."

Wave is certainly "another Licensee" to JT. JT's use of capacity in a Wave submarine cable should have no direct relationship with JT's Other Activities Business and C&WJ is concerned about the naivety that JT appears to have shown in this regard.

The incorrect placement and treatment of costs and revenues within an operator's separated accounts can materially distort the results. C&WJ suggests that the JCRA should require JT to provide a listing of its reported products and services, showing for each item which regulated business it is reported within.

c) Other transfer charging issues:

JT's Accounting Separation Methodology document highlights what appear to be other errors in its treatment of transfer charges:

Page 10 states "Operating costs for the Core Network Business include transfer charges payable to the Local Access Network Business relating to the use of the local loop in the provision of wholesale leased lines and xDSL services." C&WJ is concerned that JT places any access related costs into its xDSL services. xDSL services are carried over existing exchange lines (which are access related) and there should be no specific access cost for xDSL. C&WJ would ask that the JCRA questions JT further in this regard.

Page 10 also states that "Operating costs for the Sub-Business Exchange Line Rental & Connection include transfer charges payable to the Core Network relating to the use of the Core Network in the provision of operator assistance and emergency services." The JCRA's definition of the Retail Exchange Line Rental & Connection business relates solely to "Connection charges and monthly or quarterly rental of fixed exchange lines". C&WJ can see no valid reason why operator assistance and emergency services costs should have any relationship with line rental or connection. Operator assistance costs would be expected to be found in the relevant non-geographic call type to which the call revenue relates (i.e. free, local, national or premium, depending on the cost of the call). Emergency call costs should be recognised in the business 'Retail – Non-geographic calls free to calling customer'.

d) Route factors:

JT appears to have an inadequate methodology in place to calculate route factors for its call related services. In JT's response[12] to the Review it stated that "OLOs are connected to only one switch and therefore 50% of the time must use a second switch, therefore having a route factor of 1.5 for local switches and 0.5 for the local to local link". This shows a complete lack of effort and/or understanding in JT's calculation of RIO based charges. Estimates should be used as a last resort, not as a matter of course. In addition, on page 37 of its Accounting Separation Methodology JT states that 'route factors are calculated based on a probabilistic survey combined with actual traffic volumes for a twelve week or twenty-four week period…' C&WJ cannot understand why an operator of JT's size makes use of sampling techniques for route factor purposes, when fifty two weeks of CDR (call data record) data should be readily available, to reflect the full accounting period. Regulaid more generally criticises JT's calculation of route factors in Section 4.4.2 stating that it found "major problems in the routing factors used by JT, which influence all traffic products, including termination and transit rates." C&WJ would expect JT to either improve its route factor calculation processes or seek guidance from an experienced external source as to how an operator should undertake such a requirement. Publication of route factor data, in a Statement of Cost of Network Services (as C&WJ is proposing) would provide visibility to all interested parties as to whether JT is compliant with its route factor requirements.

e) Recognition of RIO services costs:

On pages 10 and 11 of JT's Accounting Separation Methodology document, in relation to the Statement of Costs of Network Services, it states that no information has been included for RIO services, with no volume in the period and therefore also no time of day gradients. As both C&WJ and Jersey Airtel interconnected with JT throughout the 2008 accounting period it is difficult to understand how JT does not view these calls as RIO related. JT should ensure that it recognises RIO calls and time of day gradients appropriately.

To ensure that JT is not favouring its own associated businesses (e.g. Wave) through the provision of services at less than the prevailing interconnect or wholesale rates the JCRA should request a copy of the Interconnect Agreement, which JT refers to on pages 15, 19, 20 and 27 of its Accounting Separation Methodology document.

f) Treatment of telephone directory revenues and costs:

C&WJ notes that JT recognises 'the sales of directories' in its Other Activities Business. This wording is ambiguous as it could relate to the selling of telephone directories to other operators, as is often requested by UK operators and the likes of public libraries, or it could relate to revenues received from customers paying for lineage and adverts within the directory. The latter is the more likely meaning. As part of JT's universal service obligation (USO), C&WJ believes that JT should publish an annual listing of subscribers' phone numbers (i.e. the white pages) in a paper format. The revenues and costs associated with these pages should be recognised in the business 'Retail – Remaining Activities'. Revenues and costs for the yellow pages of JT's telephone directory relate to an unregulated activity and

[12] Jersey Telecom Response to the JCRA consultation: Regulatory Accounts and Access Provisions, 9 October 2009.

could legitimately be reported in the 'Other Activities Business'. C&WJ would ask that the JCRA requests JT to correct its treatment of white page directory listings.

C&WJ does not consider that any of these issues should prevent or unnecessarily delay the publication of JT's separated accounts. Any errors that cannot be corrected prior to submission should be described in the associated Accounting Separation Methodology document, so that interested parties can form an appropriate opinion, based on the most complete information available at that time.

Cable & Wireless Jersey Limited

5th February 2010