Jersey Telecom's Response

to the JCRA's Second Initial Notice on the

Publication of Jersey Telecom Limited's Regulatory Separated Accounts

9th September 2010

Introduction

Jersey Telecom Limited ("JT") welcomes this opportunity to respond to the JCRA's Second Initial Notice "Proposed Modification to the Class III Licence granted to Jersey Telecom Limited on 1 July 2003 concerning the publication of Separated Accounts" which incorporates the draft decision on the Publication of JT's Regulatory Separated Accounts.

JT provided a response to the first Initial Notice on the 16 July 2010 and stands by the positions taken in that response. However, based on the Final Notice issued on 10 August 2010 in relation to the First Initial Notice and based on the subsequently issued Second Initial Notice JT believes that there are a number of issues raised that require clarification. In addition there are issues where JT has substantially opposing views to the JCRA and would like to take this opportunity to reiterate these views.

As stated in our original response dated 5 February 2010 to the JCRA's Consultation document[1] 2009-T4 and reiterated in our response to the First Initial Notice, a summary of our position in relation to publication is as follows:

"JT's essential position is as follows: Whilst we accept the broad rationale for the production, as well as the publication, of Separated Accounts in respect of relevant services/markets, JT contends that preparation and publication of certain elements of the Separated Accounts – in particular, competitively supplied services/markets – would be inappropriate. The reasons for this are as follows:

1. The consultation insufficiently appreciates that accounting separation is not merely an arbitrary regulatory tool at a regulator's disposal, but is specifically a remedy in response to an operator's SMP in a particular defined relevant market;

2. In this light, JT can accept that there is both policy rationale and precedent for the publication of regulated accounts in relation to services/markets in which an operator has SMP;

3. However, in light of policy objectives and in the interests of proportionality, the production of Separated Accounts should not extend to the inclusion of non-SMP services/markets, and, in any event, the publication of Separated Accounts of non-SMP services would serve no meaningful regulatory policy objective;

4. Indeed, publication of such accounts would be damaging: The accounts for non-SMP services contain commercially sensitive information, hence it would unduly damage JT and the competitive process were they to be publicly disseminated;

5. Moreover, publication of accounts for non-SMP services can potentially facilitate un-competitive behaviour through its creating of conditions conducive to tacit collusion between operators;

6. Finally, publication of accounts for non-SMP services would be contrary to international best practice, as exemplified by the EU, ERG, Ofcom, ComReg, and the OUR."

There has been no discussion between JT and the JCRA on the cost or the impact on JT of the proposed implementation of CCA and an audit. Prior to any decision being made by the JCRA there should be discussion between JT and the JCRA on the JCRA's proposed decision in terms of:- clarification of the ambiguities in the Second Initial Notice detailed below; the impact in terms of cost and resource of the implementation of CCA

[1] Consultation Document 2009 – T4 - JCRA Consultation on the Publication of Jersey Telecom Limited's Regulatory Separated Accounts – 15 December 2009

and an audit of the Separated Accounts; and the Pan CI position. It is JT's opinion that the discussion between the JCRA and JT should be undertaken with John Curran as the party who will be responsible for implementing any JCRA direction going forward.

The remainder of this document will focus on areas where JT believes the Second Initial Notice is insufficiently clear in its requirements or where JT does not agree with the position taken.

Publication

Timing of publication

On page 4 of Annex Three to the Second Initial Notice (Decision on the Publication of Jersey Telecom Limited's Regulatory Separated Accounts") in the first paragraph of the section entitled "Decision and Direction pursuant to Condition 29.1", the JCRA states that the first set of SA published shall be for the year 2009. On page 5 the implication is that the first set of accounts to be published is the accounts for the year 2010. JT believes the JCRA's intention is that the first set of accounts to be published should be those for 2010 but the JCRA needs to clarify this. JT has already submitted its Separated Accounts for 2009 and continues to believe that it would be inappropriate for this set of accounts to be published.

Scope of publication

As discussed above, JT believes that the only information that should be published in the Separated Accounts is in relation to Services/Markets in which JT has SMP. The JCRA appears to accept this position. In the same Annex referenced above they state the following: "The first set of SA published shall be that for year 2009 and shall include data for all markets in which JT currently has SMP, pursuant to the recent JCRA Decision on SMP".

However, there appears to be a number of significant ambiguities in the current draft of the Decision which seem to require JT to publish information in relation to services and markets in which JT does not have SMP.

As JT stated in its response of 16 July 2010 there should be no requirement for JT to disclose Mobile or Other Business in the Separated Accounts, as by definition these are markets in which JT does not have SMP. Despite this, Annex 5 of the draft Decision shows a P&L and Mean Capital Employed Statement for both Mobile and Other. This does not seem to be consistent with the above statement. JT would of course include an entry in the reconciliation between the Separated Accounts and the Statutory Accounts to account for the costs of these non-SMP Businesses.

Again on page 4 of Annex 3 of the Second Initial Notice the JCRA when discussing the format of the accounts states "the format should reflect the relevant network components identified in the original Direction (which for convenience is reproduced in ANNEX 4 to the Initial Notice)". This original Direction does not refer to network components but to the framework of Businesses and sub-Businesses that should be included in the Separated Accounts. This old framework is no longer relevant as it is not aligned to the markets in which JT has SMP. Indeed this framework still contains a Mobile Business broken down into sub-Businesses which are no longer required. It also contains a detailed set of Calls sub-Businesses which should no longer be required as the SMP market is Call Origination. JT did state in its previous response that if the JCRA required the disaggregated Call information for other purposes JT would be happy to provide this information separately under confidential cover outside of the Separated Accounts. The JCRA made no comment on this issue in its Final Notice or the new Second Initial Notice.

In addition, in the Second Initial Notice the JCRA states that JT shall group its non-SMP telecommunications business activities separately from its other unlicensed business activities. It is not clear whether the JCRA intends JT to publish these two groupings of activities, these groupings are certainly not referred to in the framework set out in the original decision in Annex 4 to the second Initial Notice. If the JCRA does intend for JT to publish separate P&L's and Mean Capital Employed Statements for these two groupings this would contravene the principle of only publishing markets/services that have SMP. JT does not believe that it should be publishing any information in relation to either of these groups of activities. They would of course appear in the reconciliation to the Statutory Accounts.

In summary, JT does not believe the Second Initial Notice is specific enough in terms of what Businesses and sub-Businesses should be included in the Separated Accounts and believes that what has been defined by the JCRA steps beyond their own definition of only including data for markets in which JT has SMP. JT believes it is critical that there is clarity over the Businesses and sub-Businesses that are to be disclosed and is adamant that none of the disclosure required can relate to non-SMP markets or services. This must be reflected in the final Decision.

Requirement for Current Cost Accounting

In the JCRA's Final Notice they state in relation to the inclusion of Current Cost Accounting (CCA): "The JCRA further notes that it has already delayed the CCA requirement from 2006 to date, based on a request by JT that the changes JT said it was making to its network would be overburdonsome during this process. This revised Direction merely reaffirms this requirement and now sets a date for implementation as 2011 (for the SA to be published in 2012). The JCRA is of the view that given the current activity within JT's network and infrastructure this is reasonable."

The JCRA imposed the requirement for CCA in its Decision issued on 12 May 2005 JT wrote a letter to the JCRA on 31 May 2006 further expanding on the reasoning behind why CCA should not be required. The fact that JT was making changes to its network and this would be overburdonsome and hence would make CCA difficult to implement during the period was not one of the arguments that JT raised, so to state that the current activity within JT's network means that it is now a reasonable request is completely without merit.

The arguments that JT did put forward were as follows:

- The proportionality principle – regulatory interventions and obligations should be the least costly required to address any legitimate regulatory concerns and that the cost of intervention must be less than the benefits flowing from intervention. The European Regulators Group (ERG) states, "When there is a choice between different appropriate measures, the least onerous must be chosen. Finally the costs associated with the measure must not be disproportionate relative to the aims to be pursued."[2]

- JT is undertaking a significant investment in replacing its legacy circuit switched networks with a Next Generation Network ("NGN"). Given that a large proportion of the network is being replaced, the CCA cost will become the purchase price (HCA) of the new assets (the NGN components). The JCRA obligation therefore requires Jersey Telecom to go through a process of revaluing assets only to revert to using the HCA values of the new assets in 2007 and 2008.

[2] Consultation Document on a Draft joint ERG/EC approach on appropriate remedies in the new regulatory framework as of 21/11/2003

- JT stated that there would be considerable additional cost incurred in implementing and maintaining the CCA valuations on an annual basis which would run to a significant six figure sum. It is hard to see how these significant set up costs and ongoing costs can be justified by the benefits given the small size of the market.

- As part of the preparation for incorporation JT undertook a full revaluation of all its assets in its statutory books. It is therefore likely that the difference between CCA and HCA would be even smaller than at companies such as BT. JT performed some high level analysis that showed the difference would only be of the order of 5%.

JT stands by the above reasoning and continues to believe that the benefits to be achieved by the inclusion of the requirement for CCA do not outweigh the costs involved in producing and maintaining the valuations. The NGN upgrade to the network is still ongoing and is not due to be completed until quarter 4 2012.

Requirement for audit

In the Final Notice the JCRA stated that they did not agree with JT's assertion that the requirement for audit is disproportionate for a market the size of Jersey. This is in direct contravention to their stated position in the consultation document[3] in which the JCRA said: "In the interest of proportionate regulation, the JCRA does not require JT to have its Separated Accounts independently audited but it does require that the accounts are verified and signed-off by two of its Directors."

The JCRA has not clarified what has changed in regards to the nature of the telecoms market in Jersey between 15 December 2009 and 10 August 2010 that should cause the JCRA to change its position in relation to the disproportionality of the requirement for audit. There has been no attempt to understand the cost benefit dynamic and indeed the JCRA's sole line of argument in the Final Notice is that C&W Guernsey is required to have its accounts audited and Guernsey is a smaller market. JT's contention would be that an audit of the Separated Accounts should not be required in either jurisdiction, as the benefit of the additional assurance over the accuracy of the accounts does not outweigh the significant costs involved.

The JCRA also states in the Final Notice that JT has its Statutory Accounts audited in order to meet GAAP requirements and the JCRA sees no reason why the additional SA audit would be disproportionate. Firstly, the requirement for JT to have its accounts audited is a Companies (Jersey) Law 1991 requirement. GAAP merely lays out the accounting principles that should be followed in preparation of a set of Financial Accounts. The JCRA shows a complete lack of understanding of the costs involved in the audit of a set of Separated Accounts. The Separated Accounts themselves are much more complex than the Statutory Accounts and consequently the audit work required for sign off of an audit opinion is significantly more than is required for the Statutory Accounts. The audit cost is likely to be in excess of 2-3 times the cost of the Statutory Accounts audit. This is a substantial cost which ultimately will be borne by JT's customers and seems to JT to be disproportionate in comparison to the benefits.

It was agreed with the JCRA after the issues raised by JT on the lack of any cost benefit analysis in the Mobile Number Portability ("MNP") case that before implementing any burdensome regulation, the JCRA would consider the costs surrounding the new regulatory requirement. There has been no discussion between JT and the JCRA on the cost or the impact on JT of the proposed implementation of CCA and an audit. Prior to

[3] Consultation Document 2009 – T4 - JCRA Consultation on the Publication of Jersey Telecom Limited's Regulatory Separated Accounts – 15 December 2009

any decision being made by the JCRA there should be discussion between JT and the JCRA on the JCRA's proposed decision in terms of:- the ambiguities of the Initial Notice raised above; the impact in terms of cost and resource of the implementation of CCA and an audit of the Separated Accounts; and the Pan CI position. It is JT's opinion that the discussion between the JCRA and JT should be undertaken with John Curran as the party who will be responsible for implementing any JCRA direction going forward.

Parity with Guernsey

JT has long been of the opinion that the regulatory regimes in Jersey and Guernsey should be aligned and has consistently argued this in its various responses to JCRA and OUR consultations. In this particular case the JCRA appears to be following this approach in adopting the same regulations that are in place in Guernsey. In JT's view an opportunity is being missed here. The JCRA is aligning itself with the regulatory regime in Guernsey which in JT's view has taken a completely disproportionate approach to Separated Accounts requiring CCA and Auditing. In JT's view the regulatory regimes in Jersey and Guernsey should be aligned based on a more proportionate approach, namely not requiring CCA or Audit.

Wave Telecom commented on 18th September 2003 on the OUR Consultation Document 03/23 "Publication of Cable & Wireless Guernsey's Regulatory Accounts" as follows:-

"Wave Telecom agrees with the Director General's proposal to require C&WG to publish Regulatory Accounts and the supporting document in their entirety. However, a concern of Wave Telecom relates to the matter of audit requirements, which although not referred to directly in this consultation, is contained in the "Regulatory Accounting Guidelines to Guernsey Telecoms" issued in March 2002.

Wave Telecom believes that such a requirement, although based on good practice elsewhere, may not necessarily be appropriate to the Guernsey market. The value of an external audit is reduced if the OUR is in a position to review the suitability of the Separated Accounts methodology and the detail behind their production. Given that this is the case in Guernsey, Wave Telecom believes that the additional cost of an audit may not be warranted."