Jersey Telecom's Response

to the JCRA's Initial Notice on the Publication of Jersey Telecom Limited's Regulatory Separated Accounts

16th July 2010

Introduction

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

In the original Consultation Document 2009-T4 "Consultation on the Publication of Jersey Telecom Limited's Regulatory Separated Accounts" dated 15 December 2009 the JCRA consulted on three questions in relation to the publication of the JT Separated Accounts:

1. Do stakeholders agree that JT should publish its regulatory Separated Accounts and its accounting separation methodology in full?
2. Are there any parts of the JT regulatory Separated Accounts which should remain in commercial confidence and therefore not published?
3. Is the format of the Separated Accounts, as set out in the Annex to this consultation document an appropriate format?

JT provided a response to this consultation in its document dated 5 February 2010 and does not intend to repeat the arguments made there but stands by its position laid out in that response. A summary of JT's position 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 separate 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."

JT will limit its comments in this document to those aspects of the draft decision that do not appear to have fully taken account of JT's stated position and particularly those aspects that have been included without any proper consultation.

Publication

JT set out a detailed response dated 5 February 2010 in which JT made it clear that it is not opposed to the idea of the preparation of Separated Accounts in relation to services/markets in which it has Significant Market Power (SMP) and the subsequent provision of those accounts to the JCRA. JT also accepts that there are reasonable grounds and precedent for the publication of those accounts, specifically in relation to those services/markets where JT is found to have SMP. The JCRA appears to have accepted this point and has removed the requirement for the disaggregation of the Mobile business.

JT believes that, if the Separated Accounts are to be produced, then they should be aligned with the markets in which they have been designated as having SMP, as is the case in the UK and Ireland. This does not appear to be the case, even under the proposed regime, as there still appears to be a requirement to separately disclose all of the calls sub-businesses despite the fact that the market in which JT has dominance is the call origination market. JT believes that there should be no disaggregated Retail Calls sub-businesses in the published accounts. If the JCRA still requires information on these products to meet its regulatory objectives JT is happy to supply this information as part of an Additional Financial Information document. The fact that C&W Guernsey, mistakenly in our view, is still required to disclose all of these Calls sub-businesses is no reason to impose the same set of requirements on JT.

JT's view is that for those areas where JT does not have SMP there should be no disclosure. JT therefore believes that going forward there should be no Mobile or Other Business disclosed in the Separated Accounts. The revenue, costs, assets and liabilities allocated to these Businesses would appear in the reconciliation to the Statutory Accounts as a reconciling item labelled Non-SMP businesses and products. JT cannot accept any disclosure in relation to Non-SMP markets or products in a published set of Separated Accounts.

Statutory Accounts

The JCRA has included a requirement in the draft decision to require JT to disclose its UK GAAP Statutory Accounts for 2009 and onwards. JT does not currently publish its Statutory Accounts which is consistent with its requirements under the Companies (Jersey) Law 1991. The JCRA could only require JT to publicly disclose its Statutory Accounts if it had a legitimate regulatory rationale for doing so. Given the JCRA is requiring the publication of JT's Separated Accounts which include a reconciliation to the audited Statutory Accounts, JT cannot understand the basis or rationale for publication of JT's Statutory Accounts.

Indeed, C&W Guernsey does not publish its Statutory Accounts and has not been compelled by the OUR to do so, clearly recognising the limit of its powers.

Should the JCRA leave this requirement in the Final Notice JT will be left with no alternative but to challenge this requirement.

Audit

In the consultation document the JCRA had the following comment to make in relation to the audit of the Separated Accounts:

"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."

JT agrees with the JCRA that in a market the size of Jersey it is vital that regulation is proportionate and the JCRA's stated position in the consultation paper is the correct position to take. JT does not understand what has changed since 15 December for the proportionate approach to be swept aside in favour of an extremely expensive alternative which will provide little or no benefit to the customer.

The JCRA has not consulted on the question of whether the audit of JT's Separated Accounts should be required and does not appear to have made any assessment of the costs and benefits of having an audit. JT believes that this due process must be followed before the JCRA imposes a requirement on JT that would cause it to incur substantial costs. The imposition of an audit requirement is a significant one which certainly should not be taken lightly and must be properly considered and consulted on. The requirements in relation to audit as they stand are extremely vague and require significantly more thought and detail in order for the implications for JT to be fully understood.

The JCRA must then consult on the inclusion of the audit, the nature of the audit required etc, and the timescales for the audit. Currently the draft decision is silent on the starting year for which the audit requirement would commence and it is also unclear what the required timeframe would be for production of an audited set of statements. A possible reading of the draft decision is that an audit requirement would be in place for the 2009 accounts. Clearly given the fact that the current deadline is 31 August 2010, if an audit was required this deadline would need to be delayed by many months.

Current Cost Accounting

The consultation document issued on 15 December 2009 did not discuss CCA and did not enquire of respondents what their views were in relation to its possible inclusion as the cost base for AS. JT is of the view that the inclusion of CCA in the Accounting Separation framework is so material in terms of the cost of implementation versus the benefit that can be gained that it should be the subject of a separate consultation process. Relying on a consultation process carried out 6 years ago does not seem to demonstrate an appropriate approach to identifying the pros and cons of this approach in 2010.

The JCRA first consulted on Current Cost Accounting (CCA) and its use as a cost base for Accounting Separation in the 2 June 2004 consultation paper on Accounting Separation and Costing Methodologies. At the time JT stated the following:

"While Jersey Telecom acknowledges that the use of current cost valuations has the advantage that it more closely represents the economic value of investments it does not believe the potential improvements in accuracy justify the additional costs

associated with CCA for the following reasons:

- the preparation of current cost accounting valuations requires that the regulated firm prepare a new revaluation of its assets each year (and two valuations in the first year). This involves a significant amount of effort and cost;

- it also creates a reconciliation problem since regulatory accounts based on current cost valuations can no longer be compared directly to the Statutory Accounts of the regulated firm and requires that Jersey Telecom maintain two separate books of account.

- the aggregate differences between asset values stated according to historic cost accounting and current cost accounting may not be very significant for a telecoms company. For example, BT's CCA capital employed value for the year ended 31 March 2003 was £21,513m, only 7% higher than the HCA valuation of £20,083m.

- in preparation for its incorporation, Jersey Telecom undertook a full asset revaluation that it adopted for its statutory books in the financial year ended 31 December 2000. Therefore, the difference between current and historic cost valuations for Jersey Telecom must be expected to be less significant than for other operators which have not recently restated their accounts to reflect current values. It follows that the benefits, in terms of more accurate economic valuation, of requiring Jersey Telecom to prepare accounts on a separate and non-standard valuation basis is also relatively small and unlikely to justify the costs of preparation and the confusion created by maintaining two separate accounting methodologies."

Following this consultation the JCRA directed JT to begin producing Accounting Separation statements on a CCA basis but only from 2006 onwards. In response to this direction JT wrote a further letter on the subject dated 31 May 2006, which set out the following points:

"The proportionality principle that Jersey Telecom would like to rehearse states that regulatory interventions and obligations should be the least intrusive and 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."[1]

Given that JT carried out a full asset revaluation in preparation for its incorporation, JT made the following point:

"In preparation for its incorporation, Jersey Telecom undertook a full asset revaluation that it adopted for its statutory books. Given this, it is likely that the difference between CCA and HCA would be even smaller than at companies like BT. Jersey Telecom has performed some high level analysis of its asset base using plausible inflation/deflation indices which suggests that the CCA asset value is likely to be less than 5% higher than the HCA asset values."

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

Based on the information supplied to the JCRA a derogation was given.

Since then the JCRA has made no mention of CCA and has failed to consult the industry on its applicability and appropriateness in the current circumstances. JT believes that CCA is even less appropriate now than it was in 2004 when originally consulted upon or in 2006 when the derogation was given. JT has made substantial investment and is continuing to invest in upgrading its network particularly in relation to moving to an NGN network. This investment considerably reduces any gap between an HCA and CCA valuation of its assets and greatly diminishes any benefit that could be derived from such a valuation.

JT continues to be of the view that CCA is neither appropriate nor proportionate for inclusion in the regulatory framework of a small market such as Jersey and specifically for JT. The fact that CCA is required in Guernsey does not strike JT as compelling enough a reason for it to be implemented in Jersey particularly as unlike Guernsey, JT had a revaluation of its entire asset base in 2000 and has heavily invested in an NGN network in the recent past. JT believes that with the continuing harmonisation of the regulatory regimes of Jersey and Guernsey, this requirement should be removed from both jurisdictions.

JT is adamant that before a requirement is placed on JT which would place a significant burden in terms of both internal and external resource, due process should be followed and a proper consultation process held in respect of CCA. There is currently a complete lack of detail in terms of a framework for the calculation of Current Cost and importantly, the timetable needed to achieve it. The draft decision states that "From 2011 JT shall be required to submit its SA in CCA format". Does this mean that the 2010 accounts produced in 2011 should be in CCA format or does it mean that the 2011 accounts produced in 2012 should be in CCA format ? There is also a complete lack of discussion of the deadline for production of the accounts. Production of a set of CCA AS statements requires considerably more time, particularly in the first year given that two valuations would required. C&W Guernsey currently takes 7 months to produce audited CCA AS statements and they have been producing them for some time. It is likely that JT would need more time than this in the first year of production, but none of this has even been considered due to the lack of a consultation process.

The current draft decision is unacceptable. The JCRA must consult on the inclusion of CCA and make an assessment of the costs and benefits of its inclusion to prevent an incorrect and hasty decision being taken for no benefit whatsoever.

Timetable

As discussed above, in relation to the timeframes for compliance, the draft decision is either wholly unrealistic or ambiguous in its requirements. JT will not be in position to publish the 2009 Separated Accounts unless given a substantial delay given the current date for delivery is 31 August 2010.

The requirements in relation to the timing of a potential audit and the inclusion of CCA is ambiguous. As explained above JT believes that a consultation process for audit and CCA must be held and the timeframes for production must be considered as part of this consultation.