REGULATORY FINANCIAL REPORTING – DRAFT DECISION (JCRA 23/41)

General comments

1. Sure (Jersey) Limited ("Sure") welcomes the opportunity to comment on the Jersey Competition and Regulatory Authority's ("the Authority's") non-statutory Draft Decision[1], regarding its proposals for the reintroduction of regulatory financial reporting (Case T-080). What the Authority is proposing is a form of separated or regulatory accounts. Within this response, we refer to them as regulatory accounts.

2. This response is provided on a non-confidential basis and we are happy for it to be published on the Authority's website.

3. We are generally supportive of the Authority's plans, but taking account of the level of financial detail that was previously required of JT (Jersey) Limited ("JT") within its regulatory accounts[2], there is a view that the current proposals would result in a dumbed down framework. However, that may be no bad thing, if the simplification leads to more timely access to the information, more confidence in the outputs and a greater understanding by stakeholders. In many instances, the regulatory accounts are not, in themselves, the result. Instead, they generally provide the pointers to the markets in which further regulatory scrutiny may be beneficial, or warranted. Further analysis can then be undertaken in those areas of interest, based on the underlying data used by the operator to create the regulatory accounts.

4. Importantly, we note that a material deviation in definition is being proposed in relation to one of the markets in which JT has been deemed to hold Significant Market Power ("SMP"). This deviation would undermine the statutory outcome of that market's definition. The Authority's most recent full review of the SMP markets was completed in April 2010[3]. The 2010 SMP-designated markets are shown below (descriptions paraphrased), along with a summarised comparison of the Authority's 2023 proposals:

[1] www.jcra.je/cases/2023/t-080-regulatory-financial-reporting/regulatory-financial-reporting-draft-decision/
[2] The last version of which related to the 2014 accounting period.
[3] www.jcra.je/media/1681/t09j-decision-findings-of-dominance-smp-telecoms-market.pdf

SMP Market (2010)	**SMP Market (2023 proposals)**
Access to the public telephone network at a fixed location for residential and non-residential customers	**<u>Market redefined to exclude retail</u>** **At wholesale, only Wholesale Line Rental ("WLR")** Note: In the absence of FNP, only JT can provide multi-line services, without the customer having to change their number. It therefore creates a barrier to market entry.
Call origination at a fixed location	Call origination at a fixed location
Call termination at a fixed location	Call termination at a fixed location
Call termination on a mobile network	Call termination on a mobile network
On-island wholesale leased lines	On-island wholesale leased lines
Wholesale broadband on a fixed line	Wholesale broadband on a fixed line (provided as bitstream)

In the case of 'Access… at a fixed location…', it appears that the Authority is seeking to rescope the statutory definition, without having undertaken a formal review of the current SMP designation.

Whilst WLR is a key wholesale market to monitor from a regulatory accounts perspective, we note that in April 2016, the Authority concluded that 'the introduction of WLR has not altered the competitive landscape to the extent that it alters a finding of significant market power (SMP) for JT in the provision of retail fixed line services in Jersey…'[4].

We therefore request that the Authority adds an additional SMP reporting requirement on JT, to cover the category of 'Retail Fixed Access'. We are amenable to it encompassing both of the following, but the Authority might wish to seek the opinions of other stakeholders as to whether they would seek for these elements to be reported separately, due to the market entry constraints:

- Retail landlines (one-off and recurring charges)
- Retail business voice services, including ISDN & SIP (one-off and recurring charges)

Were the Authority minded to exclude Retail Fixed Access as a relevant SMP market, we would be concerned that JT may interpret that its current regulatory obligations for that market would cease to apply. That could have material implications for JT's customers (particularly Other Licensed Operators). Any change in SMP designation should therefore only be applied following a statutory review of that market, i.e. as a workstream outside of this Regulatory Financial Reporting review.

5. We provide our remaining views through our answers to the Authority's three questions, which we have set out below.

[4] www.jcra.je/media/2168/t1064gj-second-initial-notice-jt-jersey-ltd-retail-price-control.pdf

Question 1: Do you agree with [the] proposed template and approach to regulatory financial reporting? If you do not agree you should provide all of your analysis and assessment.

- We support the use of a simplified reporting template (compared to that which JT was required to use in previous regulatory accounting submissions – to 2014).

- As per our comment above, in Section 3, the template needs to be amended, to include Retail Fixed Access (across all relevant tabs).

- We note from the template that revenues are intended to be separately reported, based on whether they have originated internally (as a result of self-supply from another part of JT's business) or externally (from services provided to customers outside of JT's business). That would be viewed as a basic requirement of regulatory accounts. However, it appears that no account has been taken of the separate recognition of the associated costs. For example, within the Statement of Income tab of the template, the only cost types that have been identified are 'Operating Costs' and 'Depreciation'. These inter-market receipts and payments, usually referred to as 'transfer charges' are proposed to be hidden. Sure is not happy with the proposed lack of visibility of such charges, which can be of material value to the reported market's level of profitability.

  In addition, for further appropriate visibility of the SMP markets, we believe that it is important that operating costs are split into their two main components: 'Network Costs' and 'Wholesale Operating Costs'.

  The above proposals are key to providing the required understanding of the way in which JT's markets interact with each other, and whether, based on the reported results, these interaction are regulatory compliant (e.g. they avoid any undue cross-subsidisation). In addition, they are necessary to evidence to the Authority that JT's Jersey business appropriately recognises and differentiates itself (from a regulatory compliance perspective) from any other activities that the JT Group undertakes. JT (Guernsey) Limited will be a material consumer of JT (Jersey) Limited's network and other support services. JT's regulatory accounts must allow for a clear delineation between the activities undertaken for/by its Jersey business, versus the activities undertaken for/by the rest of the JT Group.

  That leads onto the way in which JT's Jersey business' regulatory accounts will be reconcilable. Historically, JT has only published statutory financial statements for the JT Group. Were JT not able to (or chose not to) separate its Jersey statutory accounting results, how would the proposed reconciliation (on the Reconciliations tab) be achievable? We supports the Authority's view that JT's regulatory accounts should be reconciled to the 'statutory financial statements of the Jersey entity'.

- We are pleased to see that the Authority intends to compare JT's reported returns to its relevant cost of capital (WACC)[5]. There is no mention of any intention to require JT to submit a new WACC calculation, for the Authority's review, prior to the completion of its first regulatory accounts

[5] Section 3.12 of www.jcra.je/media/598774/regulatory-financial-reporting-draft-decision.pdf

submission. Sure proposes that this consideration forms part of the next stage of the Authority's review (either prior to or as part of the statutory process phase). In addition, we propose that JT be required to update its WACC calculation, for the Authority's review, at least every three years.

- We have been unable to find any mention of the accounting basis under which JT's regulatory accounts are intended to be prepared. By that, we mean whether they are to be produced on an historic cost or current cost basis (the former having previously applied). For the purposes for which the Authority is likely to want to use JT's regulatory accounts, we would be amenable to their preparation on an historic cost basis.

- We note the Authority's proposal for JT to provide an explanatory note[6], alongside each iteration of the template. We would prefer more of a formalised document, or at least a pro forma, to avoid any mismatch of expectation as to the type and level of detail required.

- In more simplistic cost models, like the one being proposed by the Authority, there is a risk of material residual costs – those costs for which there is no easily established means of appropriate allocation across the relevant markets. Sure would be concerned, were the value of this to be more than 10% of the costs relevant to JT's Jersey business. The particular reason for our concern is that, in many cases, where there is no suitable 'cost driver', a cost is apportioned across the markets on the basis of the revenue, as a proxy. We know from our own experience that in many cases, this risks creating a material distortion. For example, some parts of a telecoms business can be particularly labour intensive, but were the costs to be allocated on the basis of market revenue, the likes of data centre activities would take a disproportionally high percentage. That's because they can create high revenues, but are generally equipment-intensive, but with very little labour related costs.

  We would therefore like to propose that the Authority sets a cap for JT's residual (unattributable) costs of 10% of JT's total Jersey costs, such that the impact of the use of revenue based 'proxy drivers' is appropriately minimised. The submission of regulatory accounts with the inclusion of unattributable costs greater than 10% of total costs should be viewed as non-compliant, with a requirement placed on JT to correct and resubmit its results.

Question 2: Do you agree with the proposed approach to implementation for regulatory financial reporting? If you do not agree you should provide all of your analysis and assessment.

- Sure supports the Authority's proposed annual timeframe of May for JT to submit its regulatory accounts. Based on JT's previous experience of regulatory accounts, it should be well versed in the steps required to finalise them, post the annual publication of its statutory accounts, which occurs prior to the end of April. We consider that a total duration (from year end to submission) of five months should be adequate. Were JT's starting point to be the creation of regulatory accounts, from scratch, that would be a different matter in Year One, but we understand that it decided to maintain its costing system, after the regulatory requirement fell away, in 2016[7]. It is therefore

[6] Sections 3.17 to 3.20 of www.jcra.je/media/598774/regulatory-financial-reporting-draft-decision.pdf

[7] With 2014 having been the last submission made, as required.

well placed to enhance its costing system to report its results by market, as the Authority is now proposing.

- We understand, from footnote 13 of the Authority's Draft Decision, that 'JT's cost methodology will be reviewed by the Authority and Frontier as part of this project'. This is somewhat reassuring, but in Sure's view, falls short of what should ideally be required of JT – that being an annual external audit, by default, prior to the submission of its regulatory accounts. However, we recognise that proportionality is important, as is the timeliness of the submission of JT's regulatory accounts, which would risk being slowed by an annual audit.

  On the basis that the Authority is looking for JT to provide only summary level information (compared to the more detailed previous requirements), we feel able to support its proposal to require an audit only by exception. This regulatory provision should provide stakeholders with the confidence that the Authority would have the power to require detailed external scrutiny and validation of JT's regulatory accounts, at any time, were any material concerns to arise in relation to JT's activity based costing decisions and its methodological preferences.

Question 3: What are your views on the level of information from the template that should be published?

- Operators that are required to publish financial information as part of their regulatory obligations will often assert that their results are commercially confidential. However, that should not automatically prevent most or all of the information being published. Instead, the onus should be on the operator to prove that the release of the information could be unfair or harmful to its business.

  Sure's initial view was that JT's regulatory accounts should be published in full. Our underlying concern was that we might not be able to gain the required level of confidence in JT's results, were we (and other stakeholders) not furnished with the full results. However, after further consideration, and taking account of the Authority's proposals for its own review, we consider that the only areas of direct interest/concern would be those markets in which JT holds SMP. Our confidence in the other areas would be gained through the knowledge that the Authority would look to scrutinise anything of concern, without it needing to be flagged by an external stakeholder.

  On that basis, and to appropriately recognise the likely reduced risk of contention on JT's part[8], we would be amenable to JT limiting the contents of the published version of its regulatory accounts to those markets in which it holds SMP. Alongside its Draft Decision, the Authority helpfully provided a spreadsheet[9], which sets out its proposals for the financial reporting requirements to be placed upon JT. Based on the tabs within that spreadsheet, the table below indicates the types of data that we believe JT should be obliged to publish:

[8] Any material resistance of which could impact the Authority's proposed submission timeframe.
[9] regulatory-financial-reporting-draft-template.xlsx (live.com)

Spreadsheet tab name	Obligation to publish	No obligation to publish
Statement of Income	JT SMP markets	Unregulated markets
MCE	JT SMP markets	Unregulated markets
OPEX	JT SMP markets	Unregulated markets
Capital costs	JT SMP markets	Unregulated markets
Average Cost and Revenue	All contents (being SMP specific)	-
Reconciliations	-	Contents (no direct SMP relevance)

- It is important in any publication of financial data, which at least covers SMP markets (were our proposals deemed acceptable), that stakeholders outside of JT and the Authority are afforded some form of visibility of the methodologies used by JT for cost (and any revenue) allocations.

  We would not expect to have sight of the cost allocation key values, but we would expect access to general information that explains the basis and methodology of the allocation approach. This would enable stakeholders to gain a reasonable understanding of the way in which JT's underlying cost model operates – that being the fundamental tool that will impact the results of its regulatory accounts.

We are keen to engage with the Authority on this topic and can make ourselves available, should the Authority and/or Frontier Economics wish to discuss any of the points that we have raised.

Sure (Jersey) Limited

15 September 2023