



Jersey Telecom response to the JCRA consultation: Regulatory Accounts and Access Provisions

9th October 2009

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1. Executive summary

1.1 Introduction

This report comprises Jersey Telecom's ("JT's") response to Regulaid's report on regulatory accounts and wholesale access issues in the Jersey telecoms sector, which the JCRA have published for consultation. As always, JT appreciates the opportunity to comment on and potentially influence the JCRA's developing thinking on regulatory matters, but this is particularly germane to the consultation in question, given both its vast scope and its potential implications for JT, our competitors, competition and consumers. In developing our response, we have carefully considered the recommendations and underlying analysis of Regulaid's report.

As detailed in the body of our response, JT is profoundly disappointed with the overall sweep and several detailed aspects of Regulaid's report, and asks the JCRA to undertake serious contemplation before adopting many of these proposed measures.

In short, Regulaid appears not to have properly considered whether a raft of costly and intrusive regulation is sensible and justified in such a small market. Instead, it has overly relied on replicating actions from markets which are larger by orders of magnitude.

Notwithstanding these major concerns, as also outlined below and in the report, JT agrees with several of the recommendations, and considers these sensible and practical ways to enhance the regulatory framework to the ultimate benefit of competition and consumers.

1.2 Regulaid's report is not a sound basis for making policy

JT considers that Regulaid's report and the associated process is fundamentally flawed in a number of respects.

1.2.1 The degree of analysis carried out and presented by Regulaid is not proportionate to either the complexity of the issue or the significance of the proposed intervention

As detailed in the body of this response, Regulaid is proposing a raft of fundamental remedies to be imposed on JT. Despite these intrusive remedies, JT's view is that Regulaid's analysis supporting these recommendations is often cursory and not in-depth. Given both the complexity and severity of the remedies, it would be expected that the supporting analysis would be correspondingly detailed and sophisticated. This is a major shortcoming of the report.

For example, the text devoted to the analysis supporting the recommendation of duct sharing is just over 300 words. It is commonly established that duct sharing is one of the more intrusive remedies, raising a myriad of complexities of economic and engineering analysis. Thus a regulatory response to the issue would normally warrant more than a superficial treatment. This typifies our concern with the report, i.e. the supporting analysis is disproportionately light, given the issues at stake.

1.2.2 The severity of the intervention is not proportionate, given the balance of associated costs and benefits

The second failure of proportionality is that, irrespective of the standard of the analysis, the ultimate recommended remedy is invariably disproportionate to the competition issues it is attempting to address. Proportionality is a key principle of regulatory best practice, which requires regulators to carefully consider both the costs and unintended consequences of their interventions, relative to the benefits, whilst also taking into account the level of uncertainty characterising both the costs and the benefits. For many key recommended remedies, Regulaid systematically understates the magnitude of their attendant social costs, whilst at the same time overstates the apparent benefits. This leads to the recommendation of many remedies when it is the case that a balanced assessment of the costs

and benefits would lead to the conclusion that such remedies are not justified from a cost-benefit perspective.

The error of such an approach is particularly acute in the context of a small island market such as Jersey, where the costs of regulatory intervention are defrayed across a small mass of consumers, which is a key distinction to larger countries, where these costs are minor relative to the benefits and to the population.

The core problem with Regulaid’s approach is that it ignores the simple but extremely important insight that the size of the costs and benefits of regulation do not depend in the same way on the size of the telecoms market in question. Specifically, whilst the benefits of regulation and competition policy tend to be proportionate to the size of the market in which the regulated entity operates, the costs of regulatory measures tend to vary relatively little with the size of the regulated companies or their markets. It will therefore generally be the case that whereas an onerous regulatory measure may well be justified in a large market the same measure may be sub-optimal and value destroying in a small market. Hence, NRAs in small economies such as Jersey need to take care to choose regulatory measures which do not impose costs that might outweigh the benefits they are intended to bring. Regulaid’s recommendations fail to be sound on this basis.

In general, this error is manifested in the absence of an appropriately conceived and carried out Regulatory Impact Assessment (“RIA”). The consultation includes a superficial RIA, and notes that an RIA is not a legal requirement in the Jersey regulatory framework, implying that this justifies the non-inclusion of a more comprehensive RIA. JT finds such an approach unsatisfying and legalistic. As noted, an adequate RIA is especially necessary in the case of a small jurisdiction, due to the materiality of the costs arising from regulatory interventions. In terms of the analysis that was done, the costs side of the equation, which, as discussed throughout this document, is significant in a microstate such as Jersey, is instead given minimal consideration by Regulaid, who merely assert that the costs are immaterial.

1.2.3 Transposition of EU-style solutions to Jersey is not appropriate

In a similar vein, the report effectively transposes EU-style solutions to the case of a small island, which we consider to be a basic error of regulatory analysis. As is evident by, inter alia, its regulatory scorecard comparing Jersey to the EU on page 17, Regulaid has essentially observed the regulatory landscape of Jersey through the prism of the EU Regulatory Framework. This approach leads to and thus explains another fundamental error in Regulaid’s approach, namely the simple transposition of the EU framework and its associated remedies to the regulatory environment in Jersey. Such an approach is highly inappropriate in the context of Jersey, given its small size both geographically and in terms of population. The table below illustrates the size of Jersey relative to both the EU average and to the smallest EU country.

Table 1 - Relative size of Jersey

	Jersey	EU average	Smallest EU country (Malta)
Population (000s)	90	18,400	400
Area (km ²)	116	165,000	316

This highlights in stark relief the relatively small size of Jersey; the average population for an EU country is 200 times larger than that of Jersey. It should also be appreciated that, whilst Malta is (only) around 4.5 times larger than Jersey in population, and Luxembourg of a similar size, the next smallest EU country is Estonia, with a population of over 1.3 million, an order of magnitude greater

than that of Jersey.

The basic underlying reason why such a simple comparison between Jersey and the EU and resultant transposition of regulatory approach is erroneous is that the introduction of these remedies is costly relative to the potential total expected benefits in the context of a small population. Equivalently, the costs of implementation on a per customer basis of these remedies are likely to offset and outweigh any per customer benefits.

1.2.4 Capital investment has been relatively high in Jersey, contrary to Regulaid's assertions

Regulaid states that the transparency and predictability of the EU regulatory framework has created conditions favourable to investment in the sector across Europe, and conjectures that without a regulatory environment that offers similar fairness and predictability, Jersey will be less attractive than its neighbours. Regulaid concludes that the lack of effective regulation makes Jersey less attractive than its neighbours for telecommunications investment. JT submits that such a conclusion is at odds with the facts regarding investment in the telecoms sector across the Channel Islands. In this regard JT notes that the same operators are licensed in each island, with a similar level of network roll out and investment.

1.2.5 Regulaid ignores interplay between remedies

Related to the above point, in recommending the simultaneous imposition of the full suite of wholesale remedies, Regulaid's report evinces a lack of recognition of the interplay between these remedies, particularly as regards the potential substitutability of some of these remedies. For example, it is not recognised that a combination of WLR and bitstream is, under some circumstances, potentially sufficient for introducing competition, thereby obviating the need to impose more intrusive remedies such as LLU and naked DSL. Similarly, the need to provide a wholesale IP bandwidth service is questionable given the presence of the availability of wholesale leased lines and the fact that OLOs have their own off-island capacity.

To highlight this point, even were the costs of each of these remedies small, and the market in question large, regulators should still be circumspect about the application of the full range of regulatory remedies, especially in the absence of much analysis. This is because imposing remedies which achieve similar or overlapping objectives is unnecessarily burdensome, for both the regulator and the regulated operator, and can also potentially lead to unintended distortions, e.g. in operator's choice of wholesale products. This point is only magnified in the case of a small island, where regulatory parsimony is especially paramount.

Regulaid appears to under-appreciate this principle. This error of omission has thus resulted in an unnecessary proliferation of proposed remedies.

1.2.6 Report overlooks concern regarding existence of OLO demand for these products

Another fundamental flaw of Regulaid's approach is that it is implicitly assumed that demand for these products by OLOs exists. It has been JT's experience that OLOs have a tendency to overstate their demand for wholesale products, which has led to unnecessary costs incurred by JT. In particular, we note that no major operator has approached us to request any of these wholesale access products. It should be appreciated that such an outcome is predictable *a priori*, as OLOs have an incentive to raise rivals' costs.

Thus, even if the case for some or all of these remedies could be demonstrated on a conceptual level, upon which we cast significant doubt, the appropriateness and workability of these remedies would still turn on whether OLOs actually need and demand the associated wholesale products. The importance of this point is underlined below in the context of our recommendations. Thus, the issue of credibility of OLO demand for these new wholesale products is absolutely critical to the appropriateness or otherwise of these remedies.

1.2.7 Market is increasingly competitive, alleviating the need for regulatory action

It is beyond the scope of the current document to set out a full analysis of telecoms markets in Jersey. However, in imposing such a comprehensive list of remedies on JT, Regulaid has evidently failed to appreciate the increased competitive intensity experienced in key markets in recent times. This is partly driven by the competitiveness of the mobile sector, and the impact this is having in fixed line, in both voice and data markets. For example, Regulaid's observation about the offering of low broadband speeds in Jersey is already obsolete: as planned, JT has recently quadrupled its broadband speeds in offering 8 Mbit/s products.

1.2.8 The report contains a large number of significant errors of fact and interpretation and was deficient on process grounds

A key part of Regulaid's brief was to perform a review focussed on assessing the transparency and correctness of the allocations in JT's current regulatory cost model in the context of their impact on information that JT provides to the JCRA. In particular, the review looked at the numerous cost allocations in the model, and found a total of 171 errors. JT wishes to highlight two key criticisms of Regulaid's approach to this exercise. First, on substance, JT analysed the 171 errors and found that only 13 errors are material (of which 8 have already been corrected for in the 2008 Separated Accounts).

The broader point is that JT finds the approach undertaken by Regulaid to be compromised on process grounds: i.e. in the way in which the review was carried out and more importantly how the results of this review were published. Regulaid was aware that JT was changing the few material allocations at the time of writing of their report. Once Regulaid had finalised its report there was no opportunity provided to give detailed feedback to the JCRA/Regulaid in relation to clear misunderstandings/errors included within the report. Rather than being given this opportunity, JT was given a copy of the Regulaid report prior to its publication for the sole purpose of identifying any confidential information contained in it that should be redacted. However, having reviewed the report and the detailed report in Annex 1, JT highlighted to the JCRA that Regulaid's report contained a large number of significant errors of fact and interpretation which materially affected the report and the conclusions that could be drawn by readers of this report. The JCRA did not, however, take JT's views into account at that time, despite being aware of the report's errors of fact. As a result the JCRA published a report written by Regulaid which we believe contains a number of factual errors. JT finds the JCRA's actions in this matter to be disappointing and inconsistent with its regulatory responsibilities. Of most concern to JT is the JCRA's failure to incorporate JT's factual representations at the appropriate juncture (i.e. prior to the publication of the Regulaid report) has unfairly cast JT in an unfavourable light, in terms of the perception of JT's professionalism and treatment of its customers.

Regulaid has also made a range of factual errors, unrelated to the Accounting Separation exercise, most of which are contained in Annex 2 of its report, which is a comparative analysis of retail and wholesale prices in Jersey and Guernsey. These errors cast further doubt on and further impugn the basis for Regulaid's recommendations.

1.3 Areas of agreement with Regulaid

Notwithstanding these misgivings, JT does, however, see merit in several of Regulaid's observations and recommendations and considers that the considered implementation of these ideas may improve the overall efficacy of the regulatory framework. Chief amongst these suggestions are the following:

- JT publishing its retail prices for enhanced service levels for leased lines, with this service being available to OLOs at a discount of 5 -10% from the retail price
- Removal of requirement on JT to publish changes to wholesale prices in local press
- JT providing electronic notification of changes to wholesale prices to the OLOs with at least 30 days notice of their implementation

- JT providing electronic notification of new wholesale products and their prices to the OLOs with at least 60 days notice of their implementation
- JT initiating the payment of penalties, rather than the OLO
- The application of a properly implemented price cap on JT's interconnection services, for a period of 3 years
- Inclusion of router costs in JT's backhaul prices, which JT already does.
- Improvements in JT's regulatory training and process documentation

In relation to Regulaid's review of the cost allocations in JT's separated accounts, notwithstanding our serious concerns on approach to materiality discussed above, JT acknowledges the findings of Regulaid on material errors in the accounts. As discussed, these (relatively few) outstanding errors will be corrected in the 2009 statements.

Regarding Regulaid's recommendations on corporate reorganisation, broadly, JT can see benefits in engendering a more commercial and customer-centric culture in its wholesale division. JT will examine the rest of the following recommendations in this series and look for a beneficial way to implement improvements:

- Publication of total KPIs on its provisioning and fault repairs for leased lines and DSL lines, distinguishing between retail and wholesale customers
- Restriction of access to wholesale information on its provisioning and billing systems (JT is in the process of instituting mechanisms such as password protection)
- the OLOs and JT committing themselves to holding a quarterly meeting for the next 12 months
- JT and the OLOs reviewing the requirements to submit regular forecasts
- The OLOs and JT agreeing a process for resolving all disputes between them

JT also broadly agrees with most of Regulaid's recommendations regarding NGN, but wishes to highlight that JT has every intention of communicating details of its planned NGN migration to the OLOs, and it should also be recognised that our NGN plans are less developed than is perceived. JT agrees that going forward, some form of multi-operator forum, independently chaired, with the JCRA as observers, should be initiated in order to facilitate the communication of JT's plans regarding NGN migration. On migration of telephony interconnect, JT agrees that such a transition will be delayed until the necessary services and interfaces had been provided on the interconnection with BT. In relation to charging mechanisms for NGN wholesale products, JT broadly agrees that these arrangements are likely to remain as at present for the immediate future, and agrees that other jurisdictions should take the lead at this stage,

JT also broadly agrees with the recommendations regarding implementation of these proposals.

1.4 JT's key conclusions and recommendations

In addition to our broader points above, in this response, JT makes a range of recommendations to the JCRA in how to take forward Regulaid's report. The key conclusions and recommendations are as follows:

1.4.1 JT rejects Regulaid's approach to the introduction of new wholesale products

- JT rejects Regulaid's approach of simultaneously imposing the broadest superset of possible remedies.
- Instead, JT wishes to highlight the merits of creating and sustaining a multi-operator forum, chaired by the JCRA, with the specific purpose of eliciting the true need and demand (if any) for these products and associated forecasts.
- Furthermore, this forum should be conducted on a pan-island basis. JT observes that at present, there is very little inter-working between the JCRA and the OUR. We consider this sub-optimal and think it is sensible and desirable for the approach outlined above to be applied on a pan-island basis, i.e. the need or otherwise for these remedies should be considered in both Jersey and Guernsey concurrently. Our proposition is prompted by several observations:
 - The two islands have significant geographic and economic similarities and inter-dependencies
 - The same operators operate on both islands
 - The small size of the Channel Islands suggests that economies of scale in the design and implementation of regulation will be of significance
 - Fundamentally, formulation of a common approach among common geo-economic areas to key regulatory issues has wide-ranging benefits, notably the promotion of regulatory certainty and potential for competition and investment across jurisdictions. Indeed, the European Regulators Group in the EU is an example of such a facilitative body with a much more complicated and heterogeneous area. The case for harmonisation of regulatory approaches in the circumstances characterising the Channel Islands is therefore even more compelling.
 - It has worked before: Developing a consistent approach across both Jersey and Guernsey has been shown to be successful in the past (i.e. on MNP).
- Given the importance to JT, the OLOs and the functioning of the market as a whole, JT itself is willing to initiate and coordinate such a forum, in consultation with the JCRA.

1.4.2 Retail replicability and bundling

- JT acknowledges that Regulaid's recommendations represent progress over the existing set of constraints related to bundling, where JT can only bundle if there are technical reasons why it should or if it can show that it leads to economic benefits to users. However, JT remains concerned that the proposed recommendations still amount to an undue and unjustified ex ante constraint on JT's flexibility, to the ultimate detriment of consumers.
- The JCRA should confer a greater role for ex post competition law in its oversight of bundling and discounting. This would minimise the need for a complicated and costly ex ante regime to regulate bundling, which would more than likely stifle the creation of bundles which would be enjoyed by and benefit consumers. JT's pricing and bundling behaviour will be adequately constrained by the threat posed by ex post competition law.

1.4.3 Existing wholesale product and pricing issues

- JT does not accept the recommendations in relation to leased lines. JT rejects Regulaid's inference of the presence of margin squeeze made on the basis of high market share and the verbal claims of OLOs that they cannot compete on the available margin.
- More specifically, in respect of on-island leased lines, JT considers Regulaid's recommendation to move from retail minus to a cost-based price cap to be flawed, as it is at

odds with its principal concern of preventing a margin squeeze.

- Moreover, JT considers the current margin of 11% to be representative of the avoidable costs of retailing wholesale leased lines. However, JT will embark on a verification exercise to identify whether such a margin remains appropriate.
- For off-island leased lines, JT supports the retention of the current system of retail minus. However, JT does not agree with the proposed increase of the margin from 11% to 25%. As discussed above, JT considers that 11% is an accurate reflection of the relevant downstream costs.
- With respect to the proposal to move to a cost-based regime for bitstream, Regulaid's claim of growing pricing inconsistency were bitstream to be charged at retail minus and other services such as LLU based on cost does not accord with precedent.
- JT is surprised by the proposal to regulate wholesale DSL backhaul prices. This is not currently a regulated service, and hence a market power analysis is necessary before imposing regulation. In any event, the one-off and monthly rental charges for backhaul are significantly lower in Jersey than in Guernsey.

1.4.4 Principles and practice of cost allocation

- JT rejects Regulaid's recommendation to adopt CCA, as the benefits, in terms of a more accurate economic valuation, of requiring JT to prepare accounts on a separate and non-standard valuation basis are relatively small and unlikely to justify the significant costs of preparation.
- In relation to Regulaid's review of cost allocations, our finding is that only 5 errors in the allocations are legitimate errors that could impact JT's recently submitted 2008 Separated Accounts. That gives an error rate of 0.5%. These errors will be corrected in the 2009 Separated Accounts including the comparatives. All other immaterial errors that have not as yet been corrected will be corrected in the 2009 Separated Accounts. (In aggregate the immaterial items are still immaterial).
- JT refutes the suggestion that it is cross-subsidising its data hosting business. Regulaid's analysis is misconceived on this point. JT were the last to market in what is a competitive market, and prices its offering at the competitive level. JT also notes that this claim has already been the subject of investigation by the JCRA, and it does not seem to be sensible to continue doggedly to investigate an issue solely on the basis of one operator raising the same complaint, where its accusations have already been shown to be groundless.

1.4.5 Wholesale and retail functions of JT

- Regarding corporate re-organisation, on the one hand, JT can see benefits in engendering a more commercial and customer-centric culture in its wholesale division. However, it should be recognised that complaints about the wholesale division are low. Regulaid also overlooks the importance of economies of scale and scope in its thinking about organisational restructure. In any event, such restructurings are costly, an aspect which has again been overlooked by Regulaid. Fundamentally, Regulaid has failed to convince of the need to make such structural changes.
- JT also disagrees with Regulaid's views regarding the definition of a wholesale customer and its implications. Our concern is that corporate customers will exploit the regime as proposed by Regulaid by garnering a licence from the JCRA and setting up as a telecoms operator in order to obtain wholesale rates.

1.4.6 NGN issues

- In terms of JT's plans on NGN, it should be noted that JT has every intention of communicating details of its planned NGN migration to the OLOs. However, it should also be recognised that JT's NGN plans are less developed than is perceived. In addition, JT has in fact communicated its plans so far, to the extent they are developed. Hence the perception

that JT is holding back details from the OLOs is not correct.

- JT agrees that going forward, some form of multi-operator forum, independently chaired, with the JCRA as observers, should be initiated in order to facilitate the communication of JT's plans regarding NGN migration.

1.4.7 Implementation issues

- In terms of implementation of any remedies, JT understands that ultimately, the logistical step consists of amending JT's licence. The real issue should be on refining the procedure for how regulatory remedies are arrived at. The underlying model and principles provided by the EU regulatory framework is a good one. In particular, a process of market definition, followed by sound analysis of those markets, identification of operators with SMP, and characterisation of potential resultant competition problems, are necessary pre-conditions for the imposition of any remedies on operators. However, this is completely distinct from any suggestion that the remedies available or applied in the EU should simply be transposed automatically onto JT, based on a vague hint of competition issues. As stressed throughout the EU framework and associated commentary and precedent, an equally integral part of the framework is the principle that remedies must be appropriate and proportionate to the identified competition issues. Practically, this means that remedies should only be applied in cases of market failure and where these can be shown to have incremental benefits that far exceed the costs of implementation.

1.5 Structure of the rest of this document

The body of this response is organised as follows:

- **Section 2** covers JT's views on recommendations in relation to the introduction of new wholesale products
- **Section 3** looks at retail replicability and bundling
- **Section 4** discusses existing wholesale product and pricing issues
- **Section 5** is on the principles and practice of cost allocation
- **Section 6** deals with wholesale and retail functions of JT and JT's administrative and operational practices
- **Section 7** covers NGN issues and
- **Section 8** looks at Implementation issues
- **Annex A** is JT's detailed analysis of Annex 1 of Regulaid's report (review of separated accounts)
- **Annex B** is JT's comments on Annex 2 of Regulaid's report (comparative pricing analysis).

2. Introduction of new wholesale products

2.1 Regulated recommendations and supporting rationale

Regulaid recommends the concurrent introduction of a suite of new wholesale products via alteration to JT's licence, namely:

- Carrier Pre Selection (CPS)
- Wholesale Line Rental (WLR)
- Fixed Number Portability (FNP)
- The sharing of duct infrastructure
- Local Loop Unbundling (LLU)
- New bitstream products, such as naked DSL, should be discussed among JT and the OLOs, with disagreement to be referred to the JCRA for dispute resolution)
- Wholesale IP bandwidth

Ancillary to these remedies, the JCRA also recommends that JT and the OLOs should form a working group to agree service definitions, specifications, and processes for wholesale services.

Further, specifically regarding LLU, it is recommended that JT should work with the OLOs to:

- develop a wholesale backhaul product from its MSANs
- identify where they require space in MSANs
- agree a suitable co-location arrangement, and
- plan the necessary processes, plans and procedures for the implementation of LLU.

Regulaid's basic rationale for the introduction of **CPS** is its contention that OLOs are demanding this product and that Carrier Selection (CS) alone is inadequate for promoting competition, as it does not fully replicate JT's product offering to consumers. The report notes that CPS is an essential remedy in the EU, and would be appropriate for JT, given its high market share (92% of calls market), which is reflected in relatively high prices (compared with those prevailing on Guernsey.) CPS would, however, only apply to new switches, not existing ones.

Regulaid also proposes that the OLOs and JT need to **agree a service definition**, service specification, and processes for the migration of customers before CPS can be made available.

Regarding **WLR**, Regulaid points out that JT controls 100% of the fixed narrowband access market in Jersey and that the only way of introducing competition in this market is through the availability of WLR. The report contends that pricing analysis shows that current levels of margins for wholesalers in calls market are insufficient to make entry profitable and that WLR is a key way of making the calls market more attractive by providing another source of revenue. In short, the consultation report argues that with WLR, the OLOs will be able to offer packages in competition with JT; it enables replication and strengthens the relationship with customer.

On essentially the same basis, Regulaid also recommends the introduction of **FNP**, seeing this as a package with WLR and CPS, so that OLOs can offer a convincing package to potential customers.

With respect to **duct sharing**, the report notes that on the one hand, it would permit OLOs to provide

their own infrastructure without the cost of duplicating the ducting network and it would avert disruption to traffic and local communities. On the other hand, it notes that the installation of additional cables, jointing boxes and break out points in existing ducts may damage the existing cables, and maintenance operations are made more complicated by having multiple maintenance gangs. It concludes that duct sharing should take place where practical and where it promotes the roll out of alternative infrastructures, reduces costs to operators and customers. Further, duct sharing may present a business opportunity for JT. It is also recognised, however, that mandating duct sharing would require JT to collect and make available information on where it has duct space available, and the JCRA would have to set terms and conditions, including price, for duct sharing.

Regulaid recommends the imposition of **LLU** on the basis of JT's very high market share of the broadband access market¹. Whilst price is reasonable, according to Regulaid, the absence of speeds above 2 Mb/sec on Jersey is indicative of a lack of competitive pressure on JT to widen its range of services. LLU also offers the advantage of greater flexibility and service differentiation as compared with bitstream.

With respect to the **ancillary LLU** remedies, it is acknowledged that exchanges will be closed and replaced with about 30 MSANs as JT rolls out its NGN network and hence there seems little point in requiring JT to provide co-location space in the existing exchanges. However, regarding backhaul, as the MSANs are distributed across the Island, the report suggests that it will be necessary for additional backhaul to be provided for OLOs which have co-located equipment in the MSANs.

The final wholesale product recommended to be introduced is a wholesale **IP bandwidth** product. IP bandwidth is required by OLOs who provide data warehousing services in order to provide connectivity to the rest of their customers' networks. Presently, JT provides this service on a retail basis. Regulaid states that OLOs have requested this on a wholesale basis but that JT has refused on the basis that it is not a regulated service. In order to offer such a service, a network of leased lines and IP routers is required. Whilst OLOs are able to self-provide routers, they cannot replicate JT's access network of leased lines. In the light of the principle of replicability, Regulaid proposes that JT should be mandated to offer a wholesale IP bandwidth service.

2.2 JT's views

JT has a number of serious and fundamental reservations with several aspects of Regulaid's approach. The key points we wish to highlight to this end are as follows:

- Regulaid's set of recommendations do not respect the principle of proportionality
- Regulaid's Regulatory Impact Assessment is inadequate
- Regulaid ignores Interplay between remedies
- Report overlooks our concern regarding the existence of OLO demand for these products
- Market is increasingly competitive, alleviating the need for regulatory action.

These points are discussed in turn below.

¹ Regulaid states (page 44) that "at the end of 2008, JT had 1559 retail DSL lines and had provided 164 wholesale DSL lines, giving it 90% of the wholesale broadband access market." This is factually incorrect, on two counts. One is that Regulaid has reported the number of *business* DSL lines sold, not total DSL lines. JT has in fact sold 23,205 retail DSL lines and 6,116 wholesale DSL lines. In any event, this still means that JT has 100% of *wholesale* DSL lines, and 73% of retail DSL lines.

2.2.1 Regulaid's set of recommendations do not respect the principle of proportionality

As discussed in the opening section, JT disagrees with the overall thrust of the Regulaid report, especially with respect to its blanket application of EU remedies requiring the introduction and development by JT of the full suite of wholesale remedy products because they may exist in other jurisdictions. Indeed, Regulaid have picked not only remedies often applied in larger markets but have picked the largest set of remedies that are possibly available in the EU framework. The essential flaw in this approach is that there is a distinct lack of regard to the principle of proportionality. The report has paid insufficient attention to the high and certain costs of implementation of these remedies relative to the limited and uncertain benefits that may arise from their imposition.

The underlying failure of the report is that it fails to appreciate that regulation is not an end in itself. Regulation is, or should be, designed to correct market failure or address a public policy objective which would be neglected by the market. In the context of economic regulation of telecoms markets, the primary market failure is that of significant market power. However, as discussed, regulation gives rise to benefits and costs. It is a straightforward principle of good regulation that it be applied where the benefits are greater than the costs, taking into account risk and uncertainty. For any given type of market failure there are likely to be a range of regulatory remedies that could be imposed with a view to correcting the market failure in question. The performance of Cost-Benefit-Analysis, typically carried out in the context of a Regulatory Impact Assessment ("RIA") (discussed below) is thus necessary to choose between these remedies. Cost-Benefit Analysis rightly focuses on both the potential benefits to be had and the likely costs to be incurred. Hence the choice of the particular measure to be imposed should not be a function of the benefits alone but must take into account the costs incurred as a result of this measure if the outcome is to be efficient and socially desirable. Otherwise, a regulatory authority might choose a remedy which results in slightly higher benefits than the other remedies available but, at the same time, result in disproportionately higher costs and hence in lower net benefits than alternative, less heavy-handed, regulatory measures.

On the benefits side, where market power is ameliorated by regulation, there can be potential benefits in the form of increased consumer welfare. This welfare increase tends to be a result of price reductions, output increases, quality increases (including product choice and innovation) or a combination of these.

On the costs side, the most tangible costs of regulation can be categorised as follows:

- Costs associated with the operation of required regulatory processes. These may include, for example, the costs of maintaining wholesale product offerings and wholesale channels in prescribed forms, the costs of number portability, etc.
- Costs arising as a result of information requirements prompted by the regulatory measure such as, for instance, information on asset values, service costs, service profitability etc. As discussed, the provision of such information in Jersey has required the implementation of a complex cost accounting and cost allocation systems as well as a considerable amount of resources related to the updating of such systems and information sources (e.g. with regard to changes in asset values etc.).

Equally importantly, the indirect costs of regulation should also not be overlooked, such as disincentives to invest and innovate, unintended consequences etc.

The core problem with Regulaid's approach is that it ignores the simple but extremely important insight that the size of the costs of regulation varies in relation to the size of the market in a different way than do the size of the benefits...Specifically:

- As benefits typically result from consumer surplus increases prompted by price reductions and or consumption they are likely to be more or less proportionate to the size of the market.
- The costs of regulation, on the other hand, largely depend on both the certain types of analyses that need to be carried out as well as the costs of implementation and product development and management; these costs are not directly linked to the size of the market and are largely fixed. For example, the revaluation of a telecom operator's asset base: this

process will be slightly more complicated for a large operator than for a small one due to more types of equipment used etc. However, the cost of obtaining equipment prices is the same irrespective of whether one piece of equipment of a given type is used by the operator or ten, or hundreds. The same applies to the implementation of service costing systems and a whole range of other regulatory measures.

As a result, the general rule will be the following: whereas an onerous regulatory measure may well be justified in a large market the same measure may be sub-optimal and value destroying in a small market.

Thus the main conclusion is that the benefits of regulation and competition policy tend to be proportionate to the size of the market in which the regulated entity operates. The costs of regulatory measures, on the other hand, tend to vary relatively little with the size of the regulated companies or their markets. Hence, NRAs in small economies such as Jersey need to take care to choose regulatory measures which do not impose costs that might outweigh the benefits they are intended to bring. Regulaid's recommendations fail to be sound on this basis.

JT would therefore like to emphasise that the JCRA should follow a number of analytical and procedural steps in addressing regulatory and/or competition issues:

- Market definition and analysis
- Identification of problem to be addressed
- Cost benefit analysis of alternative remedies
- Imposition of least onerous remedy which achieves the policy aims
- Clear and transparent argumentation in respect of remedy imposed.

In general, such an approach will lead to regulatory authorities avoiding high cost regulatory measures in microstates, e.g.

- Excessive accounting separation requirements
- CCA
- LRIC (incremental costing concept)
- LLU
- Duct sharing

Instead, less costly measures should be used, and only where essential:

- Less detailed accounting separation
- Negotiation and arbitration
- Ex post mechanisms
- Intervention only on the basis of evidence

The JCRA might wish to focus its efforts within the market review process on developing proportionate remedies, imposing simpler, lower cost remedies, use a simpler approach to setting access prices (e.g. based on the incumbent's actual costs) whilst checking its cost efficiency in other ways. It might also want to screen complaints from OLOs by requiring a minimum standard of supporting evidence before any investigation starts, and put more emphasis on negotiation and arbitration to resolve disputes between operators.

2.2.2 Regulaid's Regulatory Impact Assessment is totally inadequate

Judged in the above light, we consider that Regulaid's report has overlooked these fundamental considerations, as can be seen in the nature and content of its Regulatory Impact Assessment ("RIA"). This should be the place where a Cost-Benefit Analysis ("CBA") is either carried out or is at least summarised. The costs side of the equation, which, as discussed above and throughout this document, is significant in a microstate such as Jersey, is instead given minimal consideration by Regulaid, who merely assert that the costs are immaterial:

We are not in a position to put a cost on these proposals, but we do not think that they will in total be substantial. We see these proposals as a package necessary to ensure that competition becomes effective in Jersey's telecommunications market...

Overall we believe that the costs of our proposals are easily outweighed by the benefits.²

By a crude method, Regulaid calculate the benefits to be approximately £3m per year. JT notes that these benefits *per se* are not particularly substantial, working out at a mere £33 per head per year, but more importantly are in any case likely to be offset significantly or wholly outweighed by the associated costs of the proposed regulatory measures.

2.2.3 Regulaid ignores Interplay between remedies

Related to the above point, in recommending the simultaneous imposition of the full suite of wholesale remedies, Regulaid's report evinces a lack of recognition of the interplay between these remedies, particularly as regards the potential substitutability of some of these remedies. For example, it is not recognised that a combination of WLR and bitstream is, under some circumstances, potentially sufficient for introducing competition, thereby obviating the need to impose more intrusive remedies such as LLU and naked DSL. Similarly, the need to provide a wholesale IP bandwidth service is questionable given the presence of the availability of wholesale leased lines, which would enable OLOs to replicate this service.

To highlight this point, even were the costs of each of these remedies small, and the market in question large, regulators should still be circumspect about the application of the full range of regulatory remedies, especially in the absence of much analysis. This is because imposing remedies which achieve similar or overlapping objectives is unnecessarily burdensome, for both the regulator and the regulated operator, and can also potentially lead to unintended distortions, e.g. in operator's choice of wholesale products. This point is only magnified in the case of a small island, where regulatory parsimony is especially paramount.

Regulaid appears to have under-appreciated this principle in producing its report. This error of omission has thus resulted in an unnecessary proliferation of proposed remedies.

Regulaid reasons that the provision of the full range of wholesale broadband products is desirable in light of the "ladder of investment" principle, espoused by many NRAs in the EU. This principle recommends that new entrants are able to move from one wholesale broadband product (or 'rung') to another as they improve their knowledge of the market and wish to increase their investment in the market, and hence these rungs need to be available simultaneously in order to facilitate this movement. JT submits that such a rationale is groundless in the context of a small island. Regulaid has again not appreciated the vastly different cost-benefit considerations applying in EU states.

² Page 81 of Regulaid report.

2.2.4 Report overlooks concern regarding existence of OLO demand for these products

Another fundamental flaw of Regulaid's approach is that it is implicitly assumed that demand for these products by OLOs exists. It has been JT's experience that OLOs have a tendency to overstate their demand for wholesale products, which has led to unnecessary costs incurred by JT. In particular, we note that no major operator has approached us to request any of these wholesale access products. It should be appreciated that such an outcome is predictable *a priori*, as OLOs have an incentive to raise rivals' costs.

Thus, even if the case for some or all of these remedies could be demonstrated on a conceptual level, upon which we cast some doubt, the appropriateness and workability of these remedies would still turn on whether OLOs actually need and demand these remedies. The importance of this point is underlined below in the context of our recommendations.

2.2.5 Market is increasingly competitive, alleviating the need for regulatory action

It is beyond the scope of the current document to set out a full analysis of telecoms markets in Jersey. However, in imposing such a comprehensive list of remedies on JT, Regulaid has evidently failed to appreciate the increased competitive intensity experienced in key markets in recent times. This is partly driven by the competitiveness of the mobile sector, and the impact this is having in fixed line, in both voice and data markets. For example, Regulaid's observation about the offering of low broadband speeds in Jersey is already obsolete: as planned, JT has recently quadrupled its broadband speeds in offering 8 Mbit/s products.

2.3 JT's recommendations

These concerns have thus driven JT's view that, to take forward this issue, JT submits that the decision on which wholesale remedies to impose should be deferred. In order to address these concerns, the key next steps, should be as follows:

- the set up of a multi-operator forum, potentially chaired by the JCRA, with the specific and express purpose of eliciting the true need and demand (if any) for these products by OLOs and associated forecasts
- Furthermore, this forum and any subsequent imposition of wholesale access provisions should be conducted on a pan-Island basis.

2.3.1 Multi-operator forum to elicit need and demand (if any) for new wholesale products

As discussed, JT's principal concern above all is that OLOs have the incentive and ability to make non-binding requests for wholesale products that they will actually ultimately never use. Thus we recommend the creation of a forum where the true need and demand (if it exists at all) for these products can be revealed. The driver of such a forum is that JT is unwilling to incur the significant costs of remedies such as CPS, WLR, FNP and LLU in the absence of a serious and credible demonstration by the OLOs of their need and demand for such products. Absent such an approach, our major concern would be that the OLOs simply request such services, at JT's great expense, but ultimately do not seek these services to any material extent or at all, once they come on stream. From the perspective of competition and consumers, such a situation would fundamentally undermine any basis for these remedies, since no consumer benefits would flow. Indeed, the unnecessary costs incurred by JT would need to be passed on to wholesale and retail customers where possible, resulting in higher prices for consumers.

Thus, we envisage that at this forum, JT and the OLOs would work together to understand the likely demand for the availability of these products, as well as the associated level of demand for each of these products, if it exists at all. This would require the OLOs to present credible and binding forecasts of their demand for each of these products. In effect, under this model, the OLOs would be

co-investors with JT in the future shape of the market and regulatory structure in Jersey.

Our suggested solution can thus be linked to Recommendations 5.8, 5.19, 5.20, 7.2, and 8.2.

Given the importance to JT, the OLOs and the functioning of the market as a whole, JT itself is willing to initiate and coordinate such a forum, in consultation with the JCRA.

Needless to say, and as discussed, a necessary pre-condition for the imposition of any remedies is that the JCRA has carried out a thorough market analysis and RIA, which justifies in principle the application of these remedies.

2.3.2 Need for pan-Island approach

JT observes that at present, there is very little inter-working between the JCRA and the OUR. In this context, we think it is sensible and desirable for the approach outlined above to be applied on a pan-island basis, i.e. the need or otherwise for these remedies should be considered in both Jersey and Guernsey concurrently. Our proposition is prompted by several observations:

- The two islands have significant geographic and economic similarities and inter-dependencies
- The same operators operate on both islands
- The small size of the Channel Islands suggests that economies of scale in the design and implementation of regulation will be of significance
- Fundamentally, formulation of a common approach among common geo-economic areas to key regulatory issues has wide-ranging benefits, notably the promotion of regulatory certainty and potential for competition and investment across jurisdictions. Indeed, the European Regulators Group in the EU is an example of such a facilitative body with a much more complicated and heterogeneous area. The case for harmonisation of regulatory approaches in the circumstances characterising the Channel Islands is therefore even more compelling.
- It has worked before: Developing a consistent approach across both Jersey and Guernsey has been shown to be successful in the past (i.e. on MNP).

Such pan-island consistency between the regulatory frameworks and their implementation is critical to providing a climate of regulatory and investment certainty for the region. We consider it is the most sensible approach going forward on wholesale access issues. JT thus looks forward to greater inter-working and coordination of the JCRA with the OUR.

JT contends that our approach as outlined above would better and more sensibly meet the needs of JT, OLOs, and ultimately consumers, in both the short and long term.

3. Retail replicability and bundling

3.1 Regulated recommendations and supporting rationale

Regulaid makes a series of recommendations in relation to the circumstances and conditions under which JT can engage in product bundling. Specifically, it is recommended that JT should be permitted to bundle subject to the JCRA requiring JT to:

- make available wholesale services that enable OLOs to replicate its retail services, provided that they are demanded by an OLO
- demonstrate to the JCRA that equivalent wholesale products are available, that the price of the bundle exceeds the incremental cost of each element, and that the retail price does not constitute a price squeeze, and, in addition, that the individual elements of the bundle should be available on an individual basis to retail customers
- demonstrates to the JCRA that the reduced price covers the incremental cost of the service and that it is not undertaking a margin squeeze if JT wishes to be able to make special offers or discounts.

The rationale invoked for this set of recommendations is essentially that it ensures that the incumbent operator is not discriminating in favour of its own retail arm and/or acting anti-competitively in offering retail bundles. Regulaid recognises that this may deter investment by the incumbent operator in innovative retail services. However, whilst this is a concern, according to Regulaid it is outweighed by the need to ensure a more level playing field in Jersey, especially as JT appears not to be planning any new retail services over its NGN in the foreseeable future. Regulaid also proposes that where there is disagreement between the OLO and JT over whether the service should be provided, the JCRA should step in to resolve the dispute.

Regulaid proposes 4 tests for replicability of retail offerings:

- does the service have the same functionality from the end-user's viewpoint?
- does the OLO face a similar cost base to the incumbent operator?
- can the OLO provide the same quality of service?
- is the wholesale service available at the same time as the retail service (that is, when a retail customer is able to make a buying decision about the retail service)?

The basic driver of these recommendations is that the freedom of a dominant incumbent operator to bundle should only be permitted if OLOs can replicate these bundles, not only in terms of wholesale services, but also in terms of having similar conditions, prices and processes.

3.2 JT's views

In essence, this series of recommendations provides that JT can engage in bundling where the JCRA is satisfied that OLOs are able to replicate and viably offer these bundles, which in turn will depend on whether the associated wholesale products exist and JT's pricing at the retail and wholesale level is not anti-competitive.

JT acknowledges that these recommendations represent progress over the existing set of constraints related to bundling, where JT can only bundle if it can show that it leads to economic benefits to users. This enhanced flexibility is a positive step for Jersey consumers, as they will benefit from greater service and pricing innovation facilitated by the increased ability to offer bundles valued by consumers. However, JT remains concerned that the proposed recommendations still amount to an undue and unjustified *ex ante* constraint on JT's flexibility, to the ultimate detriment of consumers.

Regulaid appears to be concerned with the risk of three distinct types of anticompetitive behaviour arising in relation to bundling:

- Anti-competitive bundling/tying
- Anti-competitive discounting,
- Margin squeeze in the presence of bundling

The major flaw in the Regulaid approach is that it overlooks the effective constraint against these types of conduct played by *ex post* competition law. Implicit in the approach is that bundling should be presumed anti-competitive, and hence a complicated *ex ante* regulatory architecture should be imposed on JT as a safeguard against the possibility that bundling may have anti-competitive effects. An undue heavy reliance on *ex ante* regulation is not justified by either precedent or economic theory, both of which show that bundling and discounting invariably increase consumer welfare in the short and long term. Burdensome *ex ante* regulation should not be allowed to chill the scope for offering bundles or discounts, which in most cases are to the short and long term benefit of consumers. This is doubly true in the case of small markets.

This context also raises the issue of OLO demand for wholesale products enabling replications, and the extent to which these demands are credible. As discussed in the previous section, OLOs need to demonstrate credibility of their business case before requesting replicable wholesale products. Otherwise, JT will incur great cost to develop wholesale bundling products where these may ultimately not be demanded by OLOs.

3.3 JT's recommendations

Thus, JT's view is that the JCRA should confer a greater role for *ex post* competition law in its oversight of bundling and discounting. This would minimise the need for a complicated and costly *ex ante* regime to regulate bundling, which would more than likely stifle the creation of bundles which would be enjoyed by and benefit consumers. JT's pricing and bundling behaviour will be adequately constrained by the threat posed by *ex post* competition law.

In the specific instances where it is still considered that *ex ante* rules are appropriate, JT submits that a sensible and proportionate approach must be taken. Practically, this means that the JCRA should resist the application of these provisions to every single instance of bundling or discounting practised by JT. The JCRA should consider developing an approach which filters out the vast majority of instances of bundling/discounting, since these are likely to pose little risk of margin squeeze. Such a sensible approach will guard against the possibility arising under an overly interventionist approach of dampening the incentives of JT to offer pro-competitive bundles and discounts.

4. Existing wholesale product and pricing issues

4.1 Regulated recommendations and supporting rationale

Regulaid makes a range of recommendations in relation to JT's existing wholesale portfolio, in terms of both the products supplied and their pricing. The 5 key recommendations are essentially as follows:

On interconnection:

- Price cap on interconnection, set on the basis of separate baskets of RIO services; cap should be set for a period of three years, with the target prices being set by the use of benchmarks and the setting of an efficiency target

Regarding leased lines:

- Price cap on-island leased lines, moving from retail minus
- Retain retail minus for off-island leased lines, but increase minus from 11% to 25%.
- Cost based price cap on bitstream pricing, moving from retail minus

In respect of DSL backhaul:

- Price cap on JT's DSL backhaul services

In relation to **interconnection**, Regulaid notes that JT's costs are higher than they could be, and that there is insufficient competitive pressure to make JT more efficient. In particular, Regulaid makes the following points:

- The JCRA should use a more intrusive process to force down interconnection prices to those which would be incurred by an efficient operator, which should result in more pressure being put on JT to become more efficient, and lead to lower retail prices
- Given the presence of disputes, a more formal approval process is necessary
- Retail minus approach is not appropriate for all interconnection prices as there are no direct retail equivalents for call termination, call origination or call transit
- A price cap is appropriate, as it promotes:
 - Correct build/buy signals
 - Certainty over time
 - Lower compliance costs

Regulaid proposes a period of 3 years, which in its view will allow a review after most of the NGN roll out has been completed. The X factor for each basket should be set by the use of benchmarks.

In respect of leased lines, Regulaid contrasts the case of on-island and off-island leased lines in proposing a price cap and retail minus, respectively. Retail minus has been retained for **off-island leased lines**, recognising the greater level of competition in this market, and hence price is likely to be closer to cost. However, there is greater concern with competition in **on-island leased lines**, hence a price cap is recommended to be imposed.

Regulaid states that OLOs told it that the margin of 11% is insufficient for them to recover their costs of sales, and that they do not sell on-island leased lines unless they are part of a wider sale. Based on the number of retail and wholesale leased lines provided by JT, it retains about 80% of the leased line market. On this basis, Regulaid infers that margin is insufficient for effective competition and that a margin squeeze is likely to be present. Cost based prices enable OLOs to make an economically rational decision between investing in their own network and buying leased lines from JT.

In terms of the level of the margin (minus), the current 11% margin is lower than benchmark discounts of over 20%; e.g. on Guernsey the price differential between retail and wholesale on-island circuits is between 21% and 24%.

In regard to **bitstream**, the minus is currently 40%, which is in line with benchmarks. However, the problem with retail-minus according to Regulaid is that as retail prices for DSL services fall, the value of the margin also falls, and if, as is proposed, other prices for wholesale access products are cost based, there is a danger that the prices for wholesale DSL will become inconsistent with cost based prices.

Regulaid notes that **backhaul** is a critical element for the provision of competing DSL and bitstream services. Therefore it recommends that prices for backhaul should be controlled in the same way as wholesale on-island leased lines.

Other recommendations in this category are less significant and seem sensible hence are those on which JT makes no comment, which include recommendations in relation to:

- JT should publish its retail prices for enhanced service levels for leased lines and that these should be available to OLOs at a discount of 5 -10% from the retail prices
- Removal of requirement on JT to publish changes to wholesale prices in local press
- JT to provide electronic notification of changes to wholesale prices to the OLOs with at least 30 days notice of their implementation
- JT to provide electronic notification of new wholesale products and their prices to the OLOs with at least 60 days notice of their implementation
- JT should initiate the payment of penalties, not the OLO

4.2 JT's views

JT supports the application of a properly implemented price cap on its **interconnection** services, and considers that 3 years is a reasonable period length.

JT does not, however, accept the recommendations in relation to **leased lines**. In particular, JT rejects Regulaid's inference of the presence of margin squeeze made on the basis of high market share and the verbal claims of OLOs that they cannot compete on the available margin. JT considers that a claim of margin squeeze requires much more detailed substantiation, and cannot be asserted merely on the basis of high market shares and the claims of OLOs. Whilst JT has a high market shares of leased lines, increasing competition has seen a recent steady decline.

This suggests that OLOs are increasingly able to compete on the basis of the current margin between retail and wholesale prices.

More specifically, in respect of **on-island leased lines**, Regulaid's recommendation to move from retail minus to a cost-based price cap is flawed. First, despite recognising this in the report, it understates the difficulty of estimating costs for these services. More fundamentally, Regulaid's recommendation to depart from a retail minus and impose a price cap is at odds with its principal concern of preventing a margin squeeze. As is well established, a retail minus pricing approach is primarily aimed at ensuring the maintenance of a given margin which enables equally efficient competitors to compete with the vertically integrated incumbent. The move to a cost-based price cap

is not adequately justified.

Moreover, JT considers the current margin of 11% to be representative of the avoidable costs of retailing wholesale leased lines. However, JT will embark on a verification exercise to identify whether such a margin remains appropriate. Therefore, JT submits that the JCRA should first investigate the true size of the avoidable downstream costs before presuming that the current margin is insufficient and leads to margin squeeze.

For **off-island leased lines**, JT supports the retention of the current system of retail minus. However, JT does not agree with the proposed increase of the margin from 11% to 25%. As discussed above, JT considers that 11% is an accurate reflection of the relevant downstream costs. JT would expect that a margin of 25% as proposed by Regulaid to be a gross over-estimate of the likely magnitude of these costs. As above, JT will embark on a verification exercise to identify whether such a margin remains appropriate. We would suggest, however, that JT should not be held responsible if its competitors are not equally efficient.

With respect to the proposal to move to a cost-based regime for **bitstream**, JT is similarly not convinced of the rationale for this. Regulaid's claim of growing pricing inconsistency were bitstream to be charged at retail minus and other services such as LLU based on cost does not accord with precedent. For example, Ofcom regulates in such a way in the UK.

In relation to DSL backhaul, this product is the on-island connectivity between the OLO and the JT network, which JT was providing on a wholesale basis. However, this product has now changed and the router is now included with the circuit. In terms of price, it is now based on cost-plus for the router and retail-minus for the bearer circuit (which is now an ethernet bearer (100MBit/s or 1GBit/s)).

On the issue of the **renaming of the 300 metre leased line** category, JT first wishes to highlight the relative banality of this issue in the context of this exercise and considers that Regulaid has strayed into micro-management with this suggestion. Notwithstanding that, JT believes the product in question is clearly named.

5. Principles and practice of cost allocation

5.1 Regulaid recommendations and supporting rationale

Regulaid make four recommendations related to the principles and practice of cost allocation:

- JT should implement current cost accounting as the basis for its regulatory accounts as from the start of 2011. According to Regulaid:
 - This will bring JT's cost calculations closer into line with the standards used for the calculation of long run incremental costs
 - JT should introduce CCA as it implements its NGN, when many network assets will be replaced by modern equivalent assets, so the revaluation will be then easier.
- JT to confirm that the recommended cost allocation changes have been implemented
- The average Fixed Termination Rate should be 0.736ppm
- The JCRA should require JT to demonstrate that it is not cross-subsidising its data hosting business, which would be contrary to its Licence Condition 30.1.

5.2 JT's views

5.2.1 Proposal to implement CCA

The proposal to implement CCA in Jersey's Regulatory Accounts is in our view a prime example and manifestation of Regulaid's excessively benign view of regulation. We would like to re-iterate the proportionality principle in regulation which espouses 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 that "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."³ The recommendation to implement CCA pays insufficient attention to this principle of proportionality.

Whilst conceptually, JT 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. In essence, the production of CCA separated accounts would entail a significant effort and cost to JT and provide very little gain as demonstrated by international practice and an illustration of what an indexed valuation applied to JT's assets would be compared to their Historic Cost Accounting (HCA) value.

The preparation of CCA valuations requires that the regulated firm prepare a new revaluation of its assets each year (and two valuations in the first year for opening and closing balances). This would involve a significant amount of effort and cost.

JT would be required to maintain two separate books of accounts (CCA and HCA) which would

³ Consultation Document on a Draft joint ERG/EC approach on appropriate remedies in the new regulatory framework as of 21/11/2003

create a significant management overhead and could lead to potential confusion between statutory and regulatory numbers. It is likely that JT would need to recruit one additional staff with total internal costs of the order of £50,000 annually. In addition to JT's own resource requirements, the company would also incur annual consultancy costs in the region of £200,000 (100 man days) together with other external costs such as any external real estate valuations which would be required.

In total, the annual cost for performing CCA is unlikely to be less than £400,000. It is unlikely that the benefits of performing the valuations will outweigh this substantial cost.

While JT acknowledges that the use of current cost valuations has the conceptual advantage that it more closely represents the economic value of investments, JT does not believe that it is justifiable to incur costs of the size mentioned above to bring limited improvements in accuracy as demonstrated below.

International benchmarks indicate that differences between CCA and HCA capital employed values are not significant. 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 e.g. BT's CCA capital employed value for the year ended 31 March 2009 was £17,147m, only 9% lower than the HCA valuation of £15,679m; Romtelecom's HCA Fixed Asset value for 30 June 2008 was €1,618m compared to a CCA valuation of €1,612m, a decrease of 0.4%.; for C&W Guernsey the CCA adjustment (£1,436,756) to the HCA assets value (£61,097,381) was only 3.4% of the HCA value.

Furthermore, HCA and CCA will in Jersey tend to be relatively closely aligned due to the revaluation of the asset base in 2000. In preparation for its incorporation, JT undertook a full asset revaluation that it adopted for its statutory books in the financial year ended 31 December 2000. Given this, it is likely that the difference between CCA and HCA would be even smaller than at companies like BT. JT 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. These points are especially relevant given the move to an NGN, where we would expect the difference in the asset base calculated under HCA and CCA to differ by an even smaller amount.

A further issue with CCA is that it 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 JT maintain two separate books of account.

In conclusion the benefits, in terms of a more accurate economic valuation, of requiring JT to prepare accounts on a separate and non-standard valuation basis are relatively small and unlikely to justify the significant costs of preparation.

For these reasons, JT contends that there is little justification for requiring future Separated Accounts to be prepared according to current cost accounting.

We request that the JCRA rejects the recommendation to produce Separated Accounts using Current Cost Accounting ("CCA") and replace it with an obligation to produce Separated Accounts on an HCA basis.

5.2.2 JT to confirm that the recommended cost allocation changes have been implemented

The JCRA hired Regulaid in order to perform a review focussed on assessing the transparency and correctness of the allocations in JT's current regulatory cost model in the context of their impact on information that JT provides to the JCRA. In particular, the review looked at the numerous cost allocations in the model.

We first highlight below a number of high level issues relating to process and approach adopted by the JCRA/Regulaid before considering each of the recommendations made by Regulaid.

Process

JT finds the approach undertaken by Regulaid to be compromised on process grounds: i.e. in the way in which the review was carried out and more importantly how the results of this review were published. Regulaid was aware that JT was changing the few material allocations at the time of writing of their report. Once Regulaid had finalised its report there was no opportunity provided to give detailed feedback to the JCRA/Regulaid in relation to clear misunderstandings/errors that exist within the report. Rather than being given this opportunity, JT was given a copy of the Regulaid report prior to its publication for the sole purpose of identifying any confidential information contained in it that should be redacted. However, having reviewed the report and the detailed report in Annex 1, JT highlighted to the JCRA that the report contained a large number of significant errors of fact and interpretation which materially affected the report and the conclusions that could be drawn by readers of the report. The JCRA did not, however, take JT's views into account at that time, despite being aware of the report's errors of fact. As a result the JCRA published a report written by Regulaid which we believe contains a number of factual errors. JT finds the JCRA's actions in this matter to be disappointing and inconsistent with its regulatory responsibilities. Of most concern to JT is that the JCRA's failure to incorporate JT's factual representations at the appropriate juncture (i.e. prior to the publication of the Regulaid report) has unfairly cast JT in an unfavourable light, in terms of the perception of JT's professionalism and treatment of its customers.

Approach

We understand that Regulaid's brief in respect of the Separated Accounts was to review all the allocations in the underlying cost model and report back their findings. Regulaid were specifically instructed to take no account of materiality in their review but to highlight all findings. JT is extremely surprised at the narrowness of Regulaid's brief as typically, a review of a set financial accounts would be carried out with regard to the impact of the allocations on the accounts.

Any serious and properly planned review of a set of accounts must take into account the level of materiality appropriate for those accounts. The JCRA appears to have decided on an absolute level of materiality; i.e. every error is material.. Each indentified "error", irrespective of the value has been given the same weight in their report. This is a fundamental flaw both in the design of the work carried out by Regulaid (under the JCRA's direction) and in the findings of the report. No other regulator in the world, to our knowledge, takes such a view, indeed no set of financial statements for any company is produced under such a standard. The previous review carried out by Robson Rhodes in 2004 on behalf of the JCRA was carried out bearing in mind materiality and as a result produced a sensible report with sensible recommendations. Unfortunately the same approach has not been taken as part of this review and as a consequence the report as it is written currently is seriously flawed.

Regulaid make the following statement about materiality:

"We were not required to evaluate whether these errors have a material effect on JT's separated accounts. In order to assess this, a rerun of the accounts with the recommended changes would be necessary, and then we could see what impact the changes have on the results. While some errors may not be material, in total they may have a significant effect – alternatively they may cancel each other out."

As discussed, whilst no account was taken of the factual representations in relation to the misunderstandings/errors, of the detail of the report identified by JT, this statement was a late addition to the report and only included after JT pointed out the significant flaw in the approach to the issue of materiality taken by Regulaid (as directed by the JCRA). The statement recognises that they do not distinguish the significant from the insignificant but incorrectly asserts that materiality could not

be assessed without rerunning the accounts. For the majority of issues identified by Regulaid it is comparatively simple to calculate the impact of the required changes on the results as the impacts are very well defined. There are a small number of potential changes where a rerun of the model might be required in order to determine the impact.

The JCRA/Regulaid also reported “errors” in relation to Wave only accounts. These costs are incurred by and relate to Wave Telecom (“Wave”) services which by definition all sit in the Other Business in the Separated Accounts. Firstly, the JCRA should not be reviewing these costs as they are incurred in relation to unregulated services and secondly, there will be no impact on the Separated Accounts as all the costs appear in the same Business.

High level comments on Regulaid’s findings

Regulaid asserted that of a total of 956 allocations, 168 were deemed erroneous. At a closer inspection of the report JT has counted 171 errors identified by Regulaid. In many instances Regulaid has made an assumption about an allocation and based on this assumption drawn a false conclusion about the “correctness” of the allocation. JT has attached a detailed response to every issue raised by Regulaid as Annex A to this response. Given the detailed and confidential nature of this part of the response this is made available only to the JCRA. However, in order to convey the problems with the report we include below a summary of our findings.

Summary of our findings

JT analysed the 171 errors and found that only 13 errors are material, of which 8 have already been corrected for in the 2008 Separated Accounts. Regulaid was aware that JT was changing these allocations at the time of writing of their report.

Out of the remaining:

- 16 are Regulaid’s errors of fact or interpretation,
- 8 refer to items being allocated which have zero balances in 2007,
- 30 are relating to Wave, and
- 104 are immaterial.

In conclusion, only 5 errors in allocations are legitimate errors that could impact JT’s recently submitted 2008 Separated Accounts. That gives an error rate of 0.5%. These errors will be corrected in the 2009 Separated Accounts including the comparatives. All other immaterial errors that have not as yet been made will be corrected in the 2009 Separated Accounts. (In aggregate the immaterial items are still immaterial).

A detailed breakdown of the errors in cost allocation by area is shown in the table below. More broadly, we feel that the numerous errors in Regulaid’s assessment of JT’s separated accounts have unfairly painted JT in a bad light.

Table 2 - Summary of findings of errors in cost allocation by area

	Errors reported by Regulaid	JT's findings (number of errors)				
	No. of errors	Material error	Immaterial errors	Errors of interpretation	Zero balance	Wave-related
Allocation of direct costs	12	6 (already corrected in 2008 accts)	1	2	2	1
Allocation of departments	9	0	8 (already corrected in 2008 accts)		2	
Allocation of capital employed	2	1			1	
Reallocations to departments and assets	3	0	2		1	
Allocation of support activities	3	0	2		1	
Allocation of assets	51	1 (already corrected in 2008 accts)	31 (20 already corrected in 2008 accts)	2	2	15
Allocations of network activities	11	1	4	4		2
Allocations of customer facing activities	35	4 (1 already corrected in 2008 accts)	15	6		10
Allocations of network elements	45	0	43	1		1

5.2.3 The appropriate level of the average Fixed Termination Rate

Regulaid states the following in relation to product FI202 Fixed Line – Incoming (National)

“includes all types of calls from OLOs to JT fixed lines, including special numbers like premium rate numbers, freephone, local call fee access, JustConnect etc. To calculate the cost of fixed termination from product FI202 we have excluded the unit cost of network elements used for these special calls.”

Regulaid has misunderstood the nature of calls included in product FI202. As the title suggests these calls are inbound call from operators on the mainland and by definition include no calls from OLOs. Regulaid should instead have used the product PSTN Termination which is exactly the product that should be used to calculate the fixed termination rate. JT advised the JCRA of the error made by Regulaid in their calculation of the average Fixed Termination Rate prior to the publication of the Regulaid report.

There is a fundamental difference between the two products, in relation to Incoming (National), BT has a link to both switches in JT and so can always correctly route a call to the right switch and as a consequence has a route factor of 1 for local switch, whereas all the OLOs are connected to only one switch and therefore 50% of the time must use a second local switch, therefore having a route factor of 1.5 for local switches and 0.5 for the local to local link. Regulaid states that JT have used the network costs for PSTN termination which are similar to network costs for Incoming National. As described above, this is not true and materially understates the costs of fixed termination. In light of this, the JCRA should re-perform its analysis and, given the passing of time and the availability now of 2008 data, this data should be used to calculate the fixed termination rate.

5.2.4 JT is not cross-subsidising its data hosting business

JT refutes the suggestion that it is cross-subsidising its data hosting business. Regulaid’s analysis is misconceived on this point. First, Regulaid has overlooked the fact that JT were the last to market in what is a competitive market. Second, there is no evidence that JT prices its offering at anything other than the competitive level. JT can demonstrate that indeed, its prices for data hosting are competitive.

Third and more fundamentally, Regulaid’s analysis fails to understand the nature of costs and revenues in such a business. In particular, data hosting is an immature market, and as such, an assessment of whether anti-competitive exclusionary pricing is occurring must go beyond a simple snapshot comparison of allocated costs and revenues, as Regulaid has done. Rather, costs and revenues need to be looked at over a longer period, typically a customer lifetime period, in order to take account of the fact that large costs will be incurred up-front, with the expectation of achieving profitability with ever-increasing and resultant revenues.

Furthermore, we plainly note that this issue has already been the subject of investigation by the JCRA, and no findings of wrong-doings have been made. It does not seem to be sensible to continue doggedly to investigate an issue solely on the basis of one operator raising the same complaint, where its accusations have already been shown to be groundless.

6. Wholesale and retail functions in JT

6.1 Regulaid recommendations and supporting rationale

Regulaid makes a range of recommendations in relation to the structure and operation of JT's retail and wholesale functions. The essence of these recommendations is that JT is asked to consider how best to structure its organisation in order to promote a commercial and competitive mindset within JT, particularly as regards its wholesale division.

Regulaid notes the current **structure of JT** as follows:

- the wholesale department reports to Director (Corporate Affairs), along with the regulatory affairs team (and the fraud and revenue assurance team)
- Retail account managers now report to the Managing Director (Channel Islands) - responsible for all business on Guernsey as well as on Jersey.
- Operations department is separate, reporting to the CEO
- Technology and planning department is separate, also reporting to the CEO

Regulaid makes the observation that JT Wholesale's culture is a "legalistic" (as opposed to "antagonistic" or "commercial") one, in that it does not actively champion the interests of its wholesale customers within JT. According to Regulaid, OLOs consistently report a lack of responsiveness, and responses are based on what is (or is not) permitted by regulation. Regulaid contends that this culture is reinforced by its reporting structure to the Director (Corporate Affairs), who is also responsible for Regulatory Affairs.

Regulaid comes up with alternative suggestions for the restructuring of JT in order to address these concerns.

- Wholesale department report to a commercial director, e.g. the Managing Director (Channel Islands). This will:
 - Lead to more commercial discipline
 - reduce the separation between retail and wholesale because retail departments also report to the same Director, but,
 - in any conflict between wholesale and retail, the Managing Director is more likely to side with the retail side because this is the bigger earner of revenues
- Wholesale department would become part of the Operations Department, which reports to the CEO. This would:
 - break the link with the legalistic culture of Corporate Affairs, however,
 - it would place the unit in a department with a service rather than a commercial culture
- Wholesale reports to a commercially minded Director who is not responsible for retail functions
 - avoids some of the disadvantages of the Managing Director (Channel Islands)
 - solution has been introduced in C&W Guernsey

Regulaid suggests that to encourage a **commercial culture**, JT should consider developing a commission scheme for its wholesale staff.

Regulaid recommends that JT should **publish total KPIs on its provisioning and fault repairs** for leased lines and DSL lines, distinguishing between retail and wholesale customers. Regulaid noted that while it did not come across any allegations from OLOs that JT discriminates in favour of its own retail arm in provisioning orders or carrying out fault repairs, it thinks that it would be valuable if JT published total figures showing its performance for leased lines and DSL lines.

Regulaid also proposes that JT should **restrict access to wholesale information on its provisioning and billing systems**, and not show information about wholesale services on its customer records (with the possible short term exception of residential customers). The JCRA should invite JT to indicate how it will comply with this recommendation. JT uses the same systems and processes for product development, ordering, provisioning, billing and fault repair for wholesale customers as for retail customers. While this provides “equivalence of input”, it allows the sharing of information between retail and wholesale staff. Regulaid then outlines 3 areas of concern: customer records; ordering systems; and billing records.

Another recommendation in this series was that any operator with a Class 1, 2 or 3 licence issued by the JCRA should be **eligible for wholesale services at wholesale rates** from JT. Regulaid is concerned that OLOs are being required to use retail account managers, because this makes the control of sensitive wholesale information much more difficult. The underlying problem according to Regulaid is the definition of a wholesale customer: Regulaid perceives that JT defines it as a purchaser of regulated services.

Regulaid also proposes that JT should consider **moving the Installation and Maintenance Unit to the Operations Division**. Regulaid notes that the staff that carry out the reprogramming of CPE equipment have to service both retail and wholesale customers, and that at present this unit is part of the Channel Islands Engineering Department, which reports to the Managing Director (Channel Islands). The benefits of this set-up are that engineers are able to spot opportunities for retail sales when on customer premises installing or maintaining equipment. However Regulaid states that this role becomes difficult when they are carrying out work for an OLO, and information on OLO customers may leak informally to retail account managers. Regulaid therefore thinks that the closeness of the Installation and Maintenance Unit to the retail business could create the suspicion of collusion, and its role of spotting opportunities for retail sales could cause conflicts when working for OLOs. It proposes 3 possible solutions:

- Channel Islands Engineering department becomes part of the Operations Division, providing support to both retail and wholesale customers at arms' length
- Channel Islands department becomes responsible for both retail and wholesale operations, and so has an interest in both retail and wholesale customers
- it remains in its present reporting structure, but moves to separate offices (but in the same building if necessary) from the retail account managers.

Regulaid states a preference for the first option, as it represents a cleaner break.

A further recommendation is that the OLOs and JT should commit themselves to holding a **quarterly meeting** for the next 12 months with an agenda and written action points. Thereafter meetings should be cancelled only by agreement of both parties. Regulaid believes that regular liaison meetings between JT and the OLOs are essential: some of the breakdown of trust between the organisations would be avoided if these meetings continued, although these meetings have to provide value to both parties.

Recommendation 6.8 is that JT and the OLOs should review the requirements to **submit regular forecasts** in Schedule 4 of the RIO, the Legal Framework of the wholesale DSL Agreement (Clause

2) and in the Legal Framework of the Wholesale Private Circuit Agreement (Clause 2), and agree on suitable replacements. OLOs are required by the RIO (Schedule 4, section 3) to produce regular forecasts. Forecasts are, however, of limited value to individual operators because of the errors inherent in any forecasts, and to an incumbent operator because it cannot estimate how much double counting is taking place between the operators. Regulaid considers the process in JT's RIO to be onerous; however, forecasts do enable the incumbent operator to plan its allocation of resources and ordering of equipment. A useful compromise according to Regulaid is that used by Belgacom, which allows OLOs to opt in to a forecasting system, and in return Belgacom will guarantee that it will make resources available to fulfil their orders.

Another recommendation in this series is that the OLOs and JT should agree a process for **resolving all disputes** between them. Under this process, disputes should be brought to the JCRA only after the dispute process between the operators has been exhausted. The overall process should be sanctioned by the JCRA. This was recommended as there is no clear process for resolving disputes between JT and the OLOs, and a lack of a clear procedure for disputes that are not related to technical or penalty payment matters contributes to the poor relationships between JT and the OLOs. Regulaid suggests that some matters, such as resolution of issues related to wholesale prices and products, would be referred to the JCRA, not to an independent arbitrator or mediator, so that a consistent policy can be applied by the regulatory authority.

Two final recommendations in this series relate to improvements in JT's **regulatory training and process documentation**.

6.2 JT's views

Regarding corporate re-organisation, on the one hand, JT can see benefits in engendering a more **commercial and customer-centric culture in its wholesale division**. However, it should be recognised that complaints about wholesale division are low. Regulaid also overlook the importance of economies of scale and scope in its thinking about organisational restructure. In any event, such restructurings are costly, an aspect which has again been overlooked by Regulaid. In addition, Regulaid is factually incorrect about the location of JT's Engineering team in recommending that it should move reporting lines. The CPE equipment maintenance staff are not located next to or even in the same building as the sales teams and never have been. The CPE equipment maintenance team are issued their work on works orders which are completed in order of receipt, irrespective of whether they are a wholesale or retail customer. Behaviourally, it is therefore the case that this team operates neutrally, just receiving and carrying out orders with no view of the whether the customer is retail or wholesale. Fundamentally, Regulaid has failed to convince of the need to make such structural changes.

We do agree with Regulaid of the most importance for internal reporting of keeping Retail and Wholesale in separate reporting lines, but this has already been instituted within JT, as recognised in the report.

JT also disagrees with Regulaid's views regarding the **definition of a wholesale customer** and its implications. Our concern is that corporate customers will exploit the regime as proposed by Regulaid by garnering a licence from the JCRA and setting up as a telecoms operator. This would avail them of wholesale rather than retail rates, even though in substance they are a retail customer. The basic distinction between retail and wholesale customers should be that wholesale customers should be using our services for resale (or as inputs to) telecoms services which are then onsold as telecoms services to customers, and not for their own use. More broadly, it is a basic principle of regulation that JT's prices should only be regulated where it is deemed to have significant market power following a thorough market analysis. JT therefore believes that Regulaid has incorrectly

couched the debate about whether or not wholesale rates are available as merely one depending on licence status.

JT will examine the rest of the following recommendations in this series and look for a beneficial way to implement improvements:

- JT should **publish total KPIs on its provisioning and fault repairs** for leased lines and DSL lines, distinguishing between retail and wholesale customers
- JT should restrict **access to wholesale information on its provisioning and billing systems**
 - JT is already in the process of instituting mechanisms such as password protection
- the OLOs and JT should commit themselves to holding a **quarterly meeting** for the next 12 months
 - We support this idea and see this is as an opportunity for inter-island interaction.
 - We note that trust is not as bad as portrayed by Regulaid.
 - It should also be recognised that JT supports and upholds the principle of equivalence. Issues identified in the past have generally not reflected JT's wholesale division's treatment of wholesale customers, but rather upstream network issues that affect wholesale customers and JT alike.
 - scope for rationalization with other proposed forums
- JT and the OLOs should **review the requirements to submit regular forecasts**
 - Indeed, as discussed throughout this document, JT fully supports efforts to implement schemes which better induce credible and reliable forecasts by OLOs.
 - We see this currently as a particular problem regarding bitstream
- The OLOs and JT should agree a process for **resolving all disputes** between them
 - Although the JCRA should ensure that it adopts a sensibly streamlined process.
- JT to make improvements in its regulatory training and process documentation.

7. NGN issues

7.1 Regulaid recommendations and supporting rationale

Regulaid makes 7 recommendations in relation to NGN.

Recommendation 7.1 is that JT should **communicate more details of its planned NGN migration** to the OLOs. Regulaid states that JT has given some information on its NGN plans to OLOs, but this is widely considered by them to be inadequate. JT is, however, stressing that in the short term, no changes to wholesale products will occur. The key issue according to Regulaid is how future wholesale demands would be handled. JT sees this in a simplistic way: OLOs just approach them and they consider whether they wish to provide it; that is, whether it is in their interest to do so. Regulaid considers that it would be prudent to initiate some form of multi-operator forum as soon as possible, as this would assist in the communication of JT's plans and allay fears which exist due to the paucity of hard dates and facts surrounding the NGN migration.

The second and third recommendations are that the JCRA should set-up a **multi-operator forum** to discuss the issues and opportunities flowing from the NGN deployment. In order that the JCRA does not become fettered by decisions taken by this forum, it should ideally be independently chaired, but in any event, the JCRA should be an observer to avoid any suggestion of cartel style discussions. In particular, there needs to be more multi-lateral discussion about the need and demands for new wholesale services. Some of these may need to be subject to regulatory imposition. However, the first step would be for the OLOs to provide outline Statements of Requirements for each new wholesale service.

Regulaid notes that bilateral negotiation with the first-requesting OLO is unlikely to produce an optimum outcome and lead to excessive demands for variants from those who engage in the process later. On the other hand, discussing product development in a group with all operators is likely to be seen by Competition Authority as a form of cartel behaviour.

Recommendation 7.4 is that there also needs to be an agreed longer-term view on the **migration of telephony interconnect**, e.g. agreement on SIP-I. Regulaid notes that one of the drivers for future wholesale products on the NGN is an IP-based replacement for the TDM telephony interconnect. Most operators see the transition to IP based interconnection for telephony as some way off. However, it is agreed that long term it cannot be sensible to interpose a TDM interconnection between IP-based NGNs and indeed it will add cost and quality challenges from the extra group-delay caused by transcoding.

Regulaid acknowledges that JT would not want to make such a transition until the necessary services and interfaces had been provided on the interconnection with BT. They see this using the SIP-I interface; that is, SIP encapsulating UK-ISUP. Pure SIP is unlikely to support all UK requirements, notably CLI and many current variants of 'pure SIP' are proprietary. Nevertheless, Newtel would like to have a SIP interface with JT, but Regulaid notes they may be somewhat naive in believing that JT would provide such an interface just for them or that it is reasonable in expecting JT to face the cost of converting to their particular interface.

The fifth recommendation is in relation to **charging mechanisms for NGN** wholesale products. Regulaid notes these are likely to remain as at present for the immediate future, though there might be a need for a capacity based interconnect charge for services which are bundled at the retail level with the line rental.

Regulaid notes that wholesale charging has mimicked retail structures and that recovering costs on ppm basis do not reflect the fact that the marginal costs of a single extra call have always been very low and most of this volume based charge is actually used to recover fixed costs deeper in the network. These ppm costs are de-averaged by a time of day gradient copied from the relevant retail market, on the basis that this minimises the possibility of margin squeeze. However, Regulaid notes that increasingly, retail calls to geographic lines are not charged ppm but included in rental. Therefore, if the retail market has lump sum charges, margin squeeze could arise if wholesale outpayments continue to be charged on a ppm basis.

Regulaid asks then whether interconnection should mirror the charging arrangements governing internet peering. It notes that on one level, it not a good comparison: there is no QoS on public internet.

Regulaid states that Sender Keeps All may, however, be appropriate for termination: in a future converged network, it may be the case that networks terminate calls on a fixed or mobile line according to the current requirements of the called party. Where such calls are charged at mobile rates, the networks may over-recover costs where a fixed termination is selected. Regulaid then notes a number of issues with this regime, e.g. its impact on retail price structures, consistency with cost causation principles, and tendency for 'hot potato' routing.

Regulaid concludes that it is not appropriate for the JCRA to implement such a radical approach unless and until it has been shown to be effective in other administrations.

The sixth NGN recommendation is that the JCRA and JT will need to agree the **specific NGN network elements** that will be subject to detailed cost accounting and the drivers for allocating joint and common costs to NGN era products. Regulaid considers that JT should continue to collect costs in its separate accounts so that costs in the NGN era can continue to demonstrate the build up of costs and transparency with respect to wholesale charges.

In terms of specific cost allocation issues, Regulaid notes that in an NGN, MSAN is a joint cost with telephony and broadband, and the core IP network is common to all services, the costs of which could sensibly be allocated according to share of total bandwidth. Regulaid notes, however, that cost allocation could lead to a discontinuity in total costs allocated to telephony and/or increase the costs allocated to some high bandwidth data services. Therefore, there may some need for intervention to ensure a less disruptive impact on both the wholesale and retail markets. In this sense, the JCRA might need to approve proposals for these difficult cost allocations, either to allow a non-cost reflective allocation or to provide for a glide-path from today's charges to the future. Regulaid also raise the possibility of Ramsey pricing, with its advantages and drawbacks.

The final recommendation is that since JT does not seem to be deploying a risky **Next Generation Access** network, there is no need for a particular lenient regulatory approach to bitstream access, noting that the key commercial risk with next generation networks lies in the access not the core network. Indeed, NGN core networks are likely to bring significant reductions in operational costs. However, Regulaid considers it important that a fit-for-purpose NGN era bitstream service is provided. Regulaid notes that an NGN era bitstream service would include several features not found today such as the :

- a. ability for OLO to control more of the service parameters, e.g. contention
- b. ability to provide different QoS according to the type of service being carried, e.g. real-time voice/video, broadcast, generic data
- c. faster implementation, as MSANs have integrated DSLAM capability and do not require manual jumpering in order to provide broadband

7.2 JT's views

JT broadly agrees with most of Regulaid's recommendations regarding NGN, but wishes to highlight some points. In terms of JT's plans on NGN, it should be noted that JT has every intention of **communicating details of its planned NGN migration to the OLOs**. However, it should also be recognised that JT's NGN plans are less developed than is perceived. In addition, JT has in fact communicated its plans so far, to the extent they are developed. Hence the perception that JT is holding back details from the OLOs is not correct. JT agrees that going forward, some form of **multi-operator forum**, independently chaired, with the JCRA as observers, should be initiated in order to facilitate the communication of JT's plans regarding NGN migration. Indeed, whilst JT's NGN plans are a key part of these discussion, by the same token, as stressed throughout this document, JT sees these forums as very much placing the burden on OLOs to come forward with their needs and demands for new wholesale services. Thus, JT very much agrees with Regulaid that the first step should be the OLOs providing outline Statements of Requirements for each new wholesale service. JT emphasises however, that there must be a credible binding nature to these requests, in order to thwart the emergence of empty demands resulting in JT incurring unnecessary costs.

On the specific issue of **migration of telephony interconnect**, JT submits this discussion can be rolled into the multi-operator forum discussed above. JT agrees that such a transition will be delayed until the necessary services and interfaces had been provided on the interconnection with BT, and that the SIP interface encapsulating UK-ISUP will be adopted. JT also agrees with Regulaid that Newtel should not expect we would provide an interface specifically for them.

In relation to the recommendation on **charging mechanisms for NGN wholesale products**, JT broadly agrees that these arrangements are likely to remain as at present for the immediate future. JT would be opposed to the JCRA being a first mover on this issue, and agrees that other jurisdictions should take the lead at this stage, with the JCRA only adopting unless and until these mechanisms have been shown to be effective. JT notes in this regard Ofcom's current consultation on future charging regimes for mobile termination.

JT agrees with the suggestion to agree with the JCRA on the **specific NGN network elements** to be subject to cost accounting and cost allocation drivers. JT notes, however, that this will require a lot of work and resources, and hence again stresses the importance of proportionality shaping these discussions.

As regards **risk** and next generation networks, it is correct that JT does not currently have plans to rollout of an NGA. However, it reserves the right to engage thoroughly on the issue of risk were JT to embark on such a path. As recognised by Regulaid, NGAs are highly risky ventures, and it is absolutely vital for innovation and ultimately consumers that regulation does not unduly impinge on the incentives to invest in such networks. In relation to NGN-era bitstream, it is certainly JT's intention to develop a fit-for-purpose product.

8. Implementation

8.1 Regulaid recommendations and supporting rationale

Regulaid concludes its report by making suggestions on how to take forward its recommendations.

The first recommendation is that the **JCRA should update 2002 - 04 market analysis work**, and include suitable remedies in order to stimulate a competitive market. This work should be initiated as soon as possible. In coming to this recommendation, Regulaid considers three possible ways to implement proposals:

- rely on cases being brought by the OLOs - this has resulted in the present unsatisfactory position
- require changes in JT's licence that implement our recommendations, or
- update the market analysis process and impose suitable remedies on dominant Operators

Regulaid dismisses the first option, on the grounds that it has resulted in the present unsatisfactory position. The last option follows the process used in the European Union, where it provides a firm foundation for future regulation as the telecommunications market changes. However Regulaid notes that this process, including the necessary consultation phase, takes time and resources. Whilst the JCRA can only impose regulatory remedies through changes in licence conditions (the second option) it would be preferable for these remedies to be formulated as a result from market reviews. The framework and approach adopted by the European Union – market analysis, SMP, remedies, a focus on wholesale markets – would form a good model for the powers required by the JCRA, according to Regulaid.

The second recommendation relates specifically to **new wholesale products**: the JCRA should request the operators to form two working groups, one to plan for the introduction of new wholesale products, and one to co-ordinate the introduction of JT's NGN and associated wholesale products. Regulaid notes that all these areas require close working between JT and the OLOs in order to agree specifications, supporting processes and associated commercial arrangements. All operators have limited staff resources with the appropriate levels of expertise.

The third and fourth recommendations are that the JCRA should undertake a **public consultation** based on the findings of this report. The JCRA should put the draft report out to public consultation, and invite comments from the operators and other interested groups in Jersey on our analysis and proposals. In addition, the JCRA should draw up proposals for the **future of controls on JT's wholesale prices**, and these proposals should be subject to public consultation.

8.2 JT's views

Whilst JT does not agree with the process and substance of many of the recommendations, as discussed in this response, JT broadly agrees with the recommendations regarding implementation of these proposals. However, we wish to emphasise some points.

In terms of **implementation of any remedies**, JT understands that ultimately, the logistical step consists of amending JT's licence. The real issue should be on refining the procedure for how regulatory remedies are arrived at. As discussed in our response, the underlying model and principles provided by the EU regulatory framework is a good one. In particular, a process of market definition, followed by sound analysis of those markets, identification of operators with SMP, and characterisation of potential resultant competition problems, are necessary pre-conditions for the imposition of any remedies on operators. However, as we emphasise, this is completely distinct from

any suggestion that the remedies available or applied in the EU should simply be transposed automatically onto JT, based on a vague hint of competition issues. As stressed throughout the EU framework and associated commentary and precedent, an equally integral part of the framework is the principle that remedies must be appropriate and proportionate to the identified competition issues. Practically, this means that remedies should only be applied in cases of market failure and where these can be shown to have incremental benefits that far exceed the costs of implementation.

In terms of the substance of market definition and market power analysis, JT reserves the right to comment on this analysis at the appropriate juncture. One preliminary comment, however, is that we would expect the growing competitive intensity of the mobile sector to have a particular impact on the analysis of both voice and data markets, either in terms of market definition or market analysis.

In respect of the second recommendation, JT agrees with Regulaid on the importance of **working groups and forums** in order to agree all aspects of new wholesale products. Indeed, as discussed, it is one of JT's principal recommendations in this response that these forums are critical in determining the true need and demand by OLOs for these new wholesale products.

JT agrees with the **final two** recommendations.

Annex B: JT's comments on Annex 2 of Regulaid's report

Introduction

Annex 2 of Regulaid's report contains a detailed comparison of retail and wholesale prices in Jersey and Guernsey. The rationale for this Annex is as Regulaid states:

"In order to understand where the competitive market in Jersey may be ineffective or inefficient (and hence in need of regulatory remedies such as new wholesale products), we have carried out a comparison of retail and wholesale prices of the two incumbent operators in Jersey and Guernsey⁴."

Thus, Annex 2 of Regulaid's report forms much of the basis for Regulaid's analysis, conclusions and recommendations. Clearly, to the extent that the data used for this analysis is incorrect, some doubt would be cast on the resultant conclusions.

JT's identification of errors in Regulaid's Annex 2

JT has reviewed the data used to represent JT's prices for the comparative analysis in Annex 2 and has identified several factual errors. These errors and JT's subsequent response are shown in the following table. Note that these corrections are for prices that prevailed as at April 2009, which is period used by Regulaid in its analysis.

Table 3 - JT's identification of errors in Regulaid Annex 2

Regulaid error	JT correction
Page 86 - Table A2.6 - The price of local calls in Jersey	The price of these calls is generally lower than assumed by Regulaid. Local call tariffs are: 0.23 ppm, day, evening and weekend. Calls to Jersey mobiles from Jersey are 10.8ppm (day), 10ppm (evening), and 9ppm (weekend). Calls to UK mobiles: the weekend charge is 13.5 ppm.
Page 87 - Table A2.7: price of business line rental	<p>The line rental in Jersey should be £15.88 instead of £17.89. In the business SME basket, Regulaid has multiplied £17.89 x 30 lines. However, we do not regard this as realistic. JT assumes that Regulaid's rationale for the use of 30 lines is that most SMEs would have an ISDN 30 service. However, the internal inconsistency is that the price used in the example is not the ISDN 30 price, which is lower at £14.45⁵ x 30 = £433.50 per month. We understand that the Guernsey price for same service (ISDN 30 service) (within exchange area) yields a figure of £480 per month.</p> <p>In addition, this table states a price of £17.89 for a SOHO Jersey customer line rental, when JT did/does not offer a tariff at this price. Regulaid states in Table A2.5 that the Encompass tariff is £15.88. We consider that this is the figure that should be used in place of £17.89.</p>

⁴ Page 83 of Regulaid report

⁵ April 2009 price

Page 89 - Table A2.11: number of 2Mbit/s links assumed	<p>The example used by Regulaid uses 2 x 2Mbit/s links which in the case of Jersey and Guernsey are included in the CTU price. However by using only 2 x 2Mbit/s links in the example Regulaid has actually skewed the result in favour of Guernsey. In reality an OLO would require more than 2 x 2Mbit/s links (Wave has 13 into C&W Guernsey to interconnect for fixed and mobile) and the cost of the additional 2Mbit/s links from C&W Guernsey are much higher than those of JT. If the figures were re-run with a realistic number of 2Mbit/s, the result would be somewhat different. The price difference is as follows:-</p> <p>Guernsey - Install Price per 2Mbit/s - £2,044.59</p> <p>Monthly Rental Price - £829.96</p> <p>Jersey - Install Price per 2Mbit/s - £57</p> <p>Monthly Rental Price - £0</p>
Page 90 - Table A2.14:	<p>The Jersey Retail Broadband Price is £17.99 not £18.82, and the corresponding wholesale rate is £10.80 not £11.53 as stated.</p>
Page 92 - Table A2.20 - Retail and wholesale business DSL services	<p>Retail and Wholesale prices are wrong for Jersey. They should be slightly lower: Up to 40 GB £35.99, up to 80 GB £49.99 and unlimited £74.99. The wholesale version should be £21.60</p>
Page 95 - Table A2.24 - Price and cost of discounted calls	<p>This comparison table overlooks the fact that all calls from a JT fixed line are subject to a 7p minimum charge and consequently the price of all calls listed should be 7p (as a minimum), not the much lower prices listed in this table. When JT prepares any cost justification for price changes the minimum call charge is always included and in addition, we also look at the average call duration.</p>

JT has therefore found several errors, which potentially have a material impact on the conclusions arising from the comparative analysis, and in turn, the competition and regulatory analysis upon which Regulaid's conclusions are based.

JT's conclusion

JT considers, therefore, that these errors in the comparative analysis undermine confidence in the veracity of the comparative analysis, and hence cast further doubt on the soundness of Regulaid's broader conclusions and policy recommendations.