Sure's response to the JCRA's Wholesale Broadband Access price review

Sure (Jersey) Limited ("Sure") is pleased to submit this response to the Jersey Competition and Regulatory Authority's ("JCRA's") Non-Statutory Draft Decision in relation to its Wholesale broadband access services: price review ("WBA pricing Draft Decision"), issued on 27th January 2021, as document JCRA 21/01[1].

This document is the non-confidential version of Sure's response with redactions shown by [✄].

Executive Summary

The JCRA's approach

Sure welcomes the WBA pricing Draft Decision and believes the analysis presented by the JCRA (including within the accompanying Frontier Economics Report) is thorough and provides a solid underpinning for the forthcoming JCRA decision.

Sure agrees with the majority of the JCRA's proposals and analysis, including that price regulation should only be applied to the bitstream services (as Sure and, we understand, other OLOs have already stopped using the old broadband resale products), that cost orientation is a more appropriate pricing approach than would be, for example, an ex-ante margin squeeze remedy, and that a top-down costing approach is the most appropriate as well as being proportionate in a market the size of Jersey.

Sure also agrees with the JCRA's proposal for the scope of the costing model, but we do have some queries in relation to the proposed methodology:

- non-replicable assets – Sure agrees with the JCRA that a RAB approach is appropriate. We also believe that the JCRA should examine the network design choices made by JT for the FTTP network and review whether the investment can be considered efficient by modern network standards. Sure believes that, due to the unique circumstances in Jersey, the costs of fibres should be included in the non-replicable assets category.
- replicable assets – Sure does not understand why the JCRA has chosen a tilted annuity approach for the recovery of replicable assets used in the provision of bitstream services. To the best of our understanding there are very few traffic-sensitive components in those assets and as JT applied a forced migration from copper to fibre-based access services, there is likely to be little or no change to the level of penetration over the period of this charge control.
    - Sure further believes the JCRA may have made an error in its tilted annuity formula.

Sure agrees in general with the JCRA's proposed approach to setting the WACC for JT, but believes it may be appropriate to introduce separate WACCs for non-replicable assets (that is, in the RAB model). Sure believes this may result in prices that better reflect the risks faced by JT in the infrastructure market, where no further competition is expected at all.

Sure also wishes to alert the JCRA to the risk of relying on JT's internal costing model which, to the best of our knowledge, has not been validated or audited.

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[1] https://www.jcra.je/media/598303/t-011-wholesale-broadband-access-services-price-review-frontier-economics-report.pdf and https://www.jcra.je/media/598302/t-011-wholesale-broadband-access-services-price-review-draft-decision.pdf.

Pricing structure for bitstream services

The JCRA has presented two options for how bitstream services could be priced in Jersey: one option being a single fixed charge per connection and the other being a two-part price with a fixed element and a variable element to represent busy hour usage.

Overall, Sure believes that the single fixed price is the most truly cost-orientated pricing structure. This is because the actual cost components that make up the bitstream service include very few elements that vary by usage level. The bitstream costs are effectively fixed per connection. Creating a pricing structure that varies significantly depending on the level of traffic in busy hour would therefore risk distorting the market.

The rationale presented by the JCRA for offering the two-part pricing option is that the Government's telecoms policy requires the JCRA to:

"*As appropriate, direct JT to offer fibre wholesale products to allow for differentiated retail services*."

It would seem that the JCRA is concerned that a single charge per connection could reduce the incentives and ability for OLOs to develop a portfolio of services at different speeds and price levels.

Sure, however, believes that OLOs have strong incentives to offer differentiated retail broadband services, regardless of whether the bitstream pricing varies by the level of consumption of its users. This is because backhaul costs are directly related to traffic levels and, as backhaul constitutes a significant proportion of the total costs in providing retail broadband services, it is in operators' interests to design products and pricing to reduce backhaul costs, while maximising revenues.

This, combined with the greater complexity of using a two-part pricing approach that could also increase the scope for disputes and delays, means that, on balance, Sure favours the single fixed price approach.

Sure's response

Question 1: Do you agree with the proposed approach to only include the wholesale bitstream service in scope of the price review and to exclude wholesale access products? If you do not agree you should provide all of your analysis and assessment.

Sure agrees that it is appropriate and proportionate to only include the wholesale bitstream service in the scope of the price review. Sure has already migrated from wholesale access products and has no plans to use those products again. Indeed, we understand that other Jersey ISPs have also migrated their broadband services to bitstream. If there is no likely future demand for the existing wholesale access products we would anticipate that JT (Wholesale) would remove that legacy product set from the market.

Question 2: Do you agree with the proposed approach to adopt cost orientated wholesale prices for the price review, rather than use an ex-ante margin squeeze test? If you do not agree you should provide all of your analysis and assessment.

Sure agrees with the JCRA's proposed approach.

Given the unique situation in Jersey, where the Government has significantly funded the deployment of ubiquitous fibre coverage and has developed a policy that focuses on competition in the market based on access to that fibre infrastructure, it would be inappropriate to apply an ex-ante margin squeeze test.

We agree with the JCRA's reasons for that, namely:

- the network is already deployed, so JT needs no pricing flexibility to encourage investment in new fibre
- policy is to develop competition based on network access rather than competing network infrastructure, and
- there is no price regulated anchor copper product to constrain how JT sets its retail fibre prices and there is also no competing fibre-based product that is not based on access to the JT fibre infrastructure.

In these unique circumstances, Sure considers that setting regulated wholesale pricing based on cost-orientation is the most appropriate approach.

Question 3: Do you agree with the proposed approach to modelling cost orientated prices using a top-down approach? If you do not agree you should provide all of your analysis and assessment.

Sure agrees with the JCRA's proposed approach.

Sure believes that a bottom-up costing approach would be unduly complex and disproportionate for a market the size of Jersey and, in any case, the conditions in which a bottom-up approach would typically be applied do not exist in Jersey. As mentioned by the JCRA and set out above, the policy in Jersey is not to encourage competitive deployment and JT has already completed its island-wide fibre deployment, so there is also no need to design the pricing in a manner that would encourage investment by JT. Further, as JT operates the only fibre broadband network in Jersey, there is little uncertainty related to the level of network utilisation to assume (only those choosing to have mobile-wireless broadband-only would not have a JT fibre connection to their premises).

Sure believes it is important that the top-down model includes adjustments to reflect reasonable efficiency improvements over time and any changes in asset values[2].

Question 4: Do you agree with the proposed specification of the cost model, including in particular:

- model scope;
- model methodological choices; and
- approach to JT's WACC

If not, what alternative would you propose and why?

Overall, Sure agrees with the JCRA's proposals, but we set out below some queries we believe the JCRA should consider before making its final decisions.

Model Scope

Service scope – Sure believes it is important that the model is comprehensive and covers all services that use the relevant network elements. As the JCRA is also currently working on its Business Connectivity Market Review decision, which includes proposals for regulated cost-orientated dark fibre access, Sure would like to gain a better understanding of how the JCRA is planning to allocate common and shared costs between the bitstream and the leased lines dark fibre access services. Sure encourages the JCRA to consult separately on this matter.

Network scope - Sure agrees that the level of incremental network build to serve additional new-build premises is limited and can be excluded without causing material inaccuracy in the outcomes of the model.

Costs considered - Sure agrees with the costs the JCRA proposes to consider in the model. We also agree that the potential costs associated with High Risk Vendors (HRV) and how they should be recovered are uncertain and should not be included in the model at this stage.

Time period - Sure agrees that a 5-year period is appropriate but considers that perhaps it would be more appropriate to model the costs for 2022 – 2026, given that at least part of 2021 will have passed when the new pricing is introduced.

Model methodological choices

Price base - Sure agrees that the model should use nominal prices.

Model type and cost standard - Sure agrees that a FAC model is appropriate.

Asset valuation method – Sure agrees in principle with the use of the CCA valuation but is not certain whether this is perhaps unduly complex for non-replicable costs such as trenches, ducts, poles. We recognise though that the use of CCA is in line with the JCRA's previous regulatory requirements in relation to the production of separated accounts.

[2] In line with the proposals set out by Frontier in Section 3.2 of its associated report: www.jcra.je/media/598303/t-011-wholesale-broadband-access-services-price-review-frontier-economics-report.pdf

Capital cost annualisation approach

Non-replicable assets – Sure believes that the regulatory asset base (RAB) approach including holding gains and losses is the appropriate approach for the non-replicable assets. Sure would be keen to gain a better understanding of the key assumptions in that model and to what extent adjustments are considered in case the assets deployed by JT are not considered efficient. This could for example relate to the number of fibres used, the use of a point-to-point network architecture rather than a PON based architecture[3], and other such assessments. Whilst Sure agrees that it would be inappropriate to create a bottom-up model that may reflect a different network architecture than that deployed by JT, we are keen that any relevant adjustments are made to the top-down model to ensure that costs recovered are those of an efficiently provisioned modern fibre network.

Replicable assets – Given that the JT fibre network is fully deployed, and that demand (in terms of number of connections) is unlikely to change substantially over time, Sure is not certain why a tilted annuity approach is appropriate in this situation. An increase in busy hour consumption could have an impact on costs of traffic-sensitive electronics, but this is unlikely to have a material impact on the overall cost levels.

Prices of replicable assets are expected to reduce over time, which has been the trend for many years, so we do not see the need to introduce a tilted annuity approach to the recovery of those assets.

Sure would be grateful for further clarification of the underlying rationale for the use of the tilted annuity as well as a sensitivity assessment of resulting prices from the use of a tilted annuity and a flat rate depreciation approach.

In the formula set out in the Frontier Report, for the tilted annuity approach, we have noted what we believe may be a typographical error. Below is the formula as presented in the Frontier Report:[4]

Figure 21 Calculation of annual capital costs – "replicable" assets

$$Annual\ charge\ (2019) = GRC(2019)\ x\ \frac{WACC - p - d}{1 - \left(\frac{1+p-d}{1+WACC}\right)^{asset\ lifetime}}$$

$$Annual\ charge\ (2019+t) = Annual\ charge\ (2019)\ x\ (1+p+d)^t$$

Where:

- *p = annual % trend in asset price for the particular asset*
- *d = annual % trend in fixed broadband subscribers on the JT network*

Source: Frontier

In the denominator, where it says (1+p-d) we believe it should read (1+p+d). If this is just an error, then there is no problem as this can be corrected in the Final Decision. If, however, the proposal is to apply the formula as set out the impact would be material. Below we have produced an illustrative example of the impact of the two different versions of the formula:

[3] GPON or XGS-PON.

[4] Figure 21 on page 49 of the Frontier Report.

Assumptions	
WACC	10%
Gross Replacement Cost	100,000
asset life (yrs)	5
asset price trend	-8%
demand trend	4%

	2019	**2020**	**2021**	**2022**	**2023**	**npv**
Annuity as stated	20,823	19,990	19,191	18,423	17,686	73,435
Corrected annuity	28,356	27,222	26,133	25,088	24,084	100,000

As can be seen in the illustration above, the formula in the Frontier Report would not allow JT to recover its full costs. It would be helpful if the JCRA could clarify which formula it plans to apply.

Approach to JT's WACC

Sure believes that the proposed approach to setting JT's WACC is, in principle, reasonable. We are, however, curious as to why the JCRA has not proposed to apply a differentiated WACC to the replicable and non-replicable assets, or at least considered doing so and explained why it has chosen to not do so.

With the increase in the use of the RAB approach to recovering costs of non-replicable assets, there is an increasing awareness that the risk profile of non-replicable assets differs (potentially substantially) from the risks associated with assets used for contestable services, where competition could reduce the active life of some assets, due to customers choosing to take services from another provider.

This approach has been adopted by Ofcom in the UK, where it has set a separate WACC for BT's passive assets (such as ducts and poles) and for the rest of BT, which faces significantly more competition.

In the UK, some operators are investing in competitive passive infrastructure, so the risk level to BT is arguably higher than is the case in Jersey, where there is an explicit policy to not encourage competitive infrastructure development. The difference between the WACCs for replicable and non-replicable assets in Jersey should therefore be higher than that which is applied by Ofcom in the UK.

JT's cost model

Sure understands that the model developed takes as inputs the outputs from JT's current costing model. Sure is concerned that that model may not have been subject to scrutiny or audit and as such may not be a reliable data source for the model to calculate regulated access prices. Sure would be interested in understanding what efforts have been made to validate or benchmark the JT model outputs before relying on them for the regulatory costing model.

Question 5: Do you agree with the proposed fixed fee approach set out in this Consultation and Frontier report? If not, what alternative would you propose and why?

Sure generally agrees with the proposed approach for setting the fixed fee.

Sure notes that, whilst the total cost of bitstream and WLR is set using the cost model, the WLR price was not set originally using costing analysis. This therefore results in a bitstream price that, by definition, cannot be cost-based either. Given, however, that the two products must be purchased together the actual distribution of the costs between the two is likely to be immaterial and Sure finds it acceptable. It is relevant to note here though that any blended rate for bitstream and WLR may lead JT to believe that it can flex the pricing of its individual components for commercial gain. As JT has more landlines than broadband users it may be tempted to tilt its prices up for WLR and down for bitstream, such that the fixed fee total remains the same, but its total return is increased. It would be helpful for the JCRA to provide clarity on this matter within its Non-statutory Final Decision, such that potential loopholes of this nature are closed.

Question 6: What are your views on the relative merits of a two-part tariff approach over a fixed fee approach? If your view is that a two-part tariff approach is appropriate, do you agree with the proposed approach set out in this Consultation and Frontier report? If not, what alternative would you propose and why?

Before expressing a preference between the fixed versus the two-part pricing approach, we first comment on the proposed approach for setting the two-part price.

The JCRA proposes that 70% of the fixed fee bitstream price would remain fixed and that the remaining 30% would be distributed in accordance with the average monthly busy-hour usage of each operator (including JT). We note that Footnote 37 in the Frontier Report states as follows:

"The 30% value was informed by the "gradient" in the wholesale FTTH access prices across product speeds in Ireland. More details on this and on the calculation of busy hour usage is provided in Annex A of this report."

We are not certain that the Irish FTTH access prices represent a relevant precedent or benchmark if the pricing is to remain cost-based. It is our view that, if a two-part pricing approach were to be adopted, then it should be more closely based on demonstrable cost causality.

Sure is not certain that any of the costs recovered through the bitstream price vary materially between the different levels of busy-hour consumption of the different bitstream users in Jersey. If there are no significant demonstrable cost differences, then Sure is not certain that it is meaningful to offer the option of the two-part tariff where 30% of the total costs are distributed in accordance with the busy hour spread between the bitstream users. It would seem to be a significant departure from cost-orientation and one which would seem relatively arbitrary.

Evaluation of fixed versus two-part bitstream pricing

Sure plans to offer a number of different speeds in Jersey, regardless of which pricing approach is applied at the wholesale level. This is because we believe that a portfolio of speeds will better meet customer requirements and perception of value for money.

In Guernsey, Sure operates its own broadband network where, like in the JT fibre network in Jersey, only a relatively small part of the total costs are variable by busy hour consumption, but we still offer a rich portfolio of speeds, in order that our customers can chose the product they consider most suitable for their individual needs.

Sure, therefore, does not agree that, without a variable wholesale bitstream access price, operators would naturally migrate to a single 1Gbps product. There is clear evidence of this not being the case across the world, with fixed network operators designing tariff gradients to optimise value to consumers as well as maximise the utilisation of network assets.

It would therefore seem unnecessary for the JCRA to design a bitstream pricing structure that distinguishes artificially between connections that are used at different speeds.

Sure would also expect that there would be considerable debate about how to apply the two-part pricing (for example, whether 30% of total costs is the appropriate portion of costs to include in the variable element).

Also, as recognised by the JCRA, the two-part pricing approach would require complex data collection and agreement between JT and each OLO every month before invoices could be produced. We believe this could lead to disputes.

Finally, there is also an increased risk that JT would not be able to recover all its efficiently incurred costs.

On balance, Sure finds that the two-part pricing approach is unnecessary and would likely cause significant complexity for no added benefits.

Preference for single fixed wholesale bitstream price

Enabling competition through product and service differentiation

As set out above in this response, Sure does not believe that the proposed two-part pricing approach would accurately reflect the difference in the cost of providing bitstream at different speeds. The network elements included in the bitstream service are largely not traffic volume sensitive.

The traffic volume sensitive elements of the retail service provided to customers are part of what the operators purchasing the bitstream service have to provide themselves, such as backhaul to internet exchange points.

As also explained above, operators that own and operate the physical infrastructure and network elements still tend to offer different retail packages that reflect the needs and demands of different retail customers segments, despite their underlying cost structure at the customer connection level being largely fixed and not variable with speed or data consumption by individual customers. The traffic sensitive backhaul costs make the price differentiation an attractive option for operators and it results in a retail portfolio offering choice for consumers.

Sure therefore does not believe that a two-part bitstream price, that significantly overstates the level of cost difference between different access speed, would be appropriate. In fact, Sure believes that the introduction of two-part pricing would be a departure from cost-based pricing. If a two-part pricing approach were to be introduced, Sure believes that the price gradient should reflect the actual variance in the costs of providing bitstream at different speeds. It is our estimate that this would likely result in less than 10% of the total costs being variable, resulting in an almost flat price gradient.

Sure is confident that retail competition with differentiated pricing for different speed internet access products will develop regardless of the bitstream pricing not reflecting the (very limited) difference in costs of providing bitstream at different speeds. It is Sure's intention to offer a set of different retail products [✂] and our motivation for that is two-fold:

- There is a clear demand from consumers for differentiated speeds and pricing, and
- The cost elements that are traffic sensitive (for each operator, not for JT at the wholesale level) are sufficiently material to incentivise Sure to offer different speeds at different price levels.

A significant portion of total costs to provide broadband services are the costs of backhaul. Those costs are directly linked to busy-hour traffic volumes and they provide operators with a strong incentive to design products and pricing structures to even out the utilisation levels over the day and also across days of the week. Products with lower speed limits will contribute less to the busy hour peak traffic volumes (than higher speed variants of the product) and will therefore have a lower impact on the variable backhaul cost levels. It is Sure's view that this traffic/cost relationship constitutes a strong incentive to operators to offer a portfolio of different broadband speed products.

Commercial freedom arising from upstream access products

By introducing the bitstream access product and cost-orientated pricing, the JCRA has increased the commercial freedom of JT's competitors, as they are no longer tied to JT's retail product portfolio and pricing structure. That is one of the benefits of moving to remedies further upstream from simple resale. In Sure's view, the creation of an artificial wholesale tariff gradient would counteract that move and, as set out above, would not represent true cost-orientation.

There is also a real risk that the introduction of the wholesale tariff gradient could distort competition in the market, penalising high users by over-allocating costs to the operators whose busy hour usage is highest despite this not, in reality, reflecting the cost causality.

Question 7: Do you agree with the proposed approach to other charges? If you do not agree you should provide all of your analysis and assessment.

The JCRA proposes that "*as safeguard to protect OLOs from potential price increases in the transition period, it is proposed to set safeguard caps for these charges, with the caps set at the current level of prices.*"

Sure is concerned that the current set of CP broadband interconnection services is already inappropriate for broadband backhaul purposes. JT's existing portfolio does not provide for capacity requirements (or pricing) above 40Gbps, even though both JT Retail and Sure's usage is significantly greater than that. JT has recognised this deficiency and has spoken about introducing a 100Gbps variant, which would replace the current need for X times 10Gbps separately-fibred services. [✂]

[✂]

Sure requests that JT is specifically required to provide such new active wholesale leased lines (within the CP broadband interconnection portfolio) as may be reasonably required by OLOs to support the optimisation of broadband efficient backhaul facilities.

Question 8[5]: What are your views on the impact of the proposals set out in this Consultation? Are there any other impacts the Authority should take into account? You should provide all of your analysis and assessment.

Subject to the comments and concerns set out in this response, Sure believes that the proposals in this consultation could have a very positive impact on the level and nature of competition in the Jersey broadband market, to the ultimate benefit of consumers and customers of broadband services in Jersey.

[5] The consultation document has 2 questions labelled as Question 7. We have changed the 2nd of those to Question 8.

In combination with the proposed introduction of a dark fibre access remedy in the leased lines market, Sure believes that a move to cost based bitstream wholesale access pricing will enable operators to offer a rich portfolio of broadband services and leased lines/connectivity services to individuals and businesses in Jersey and we therefore very much welcome the JCRA's focus in these two key areas.

Sure (Jersey) Limited
24th March 2021