

## **DETERMINATION REGARDING THE SPARE CAPACITY FOR MEA VALUATION OF C&WJ'S SWITCHES**

### **Overview**

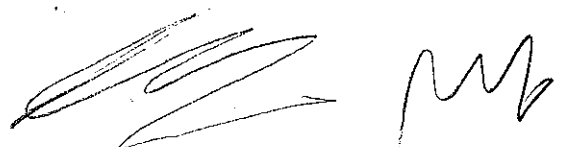
This Notice contains a specific determination by the Office on the level of spare switching equipment to be employed by C&WJ in computing the value of switches for the purpose of Modern Equivalent Asset (MEA) valuations. The Office has determined after a number of discussions with C&WJ on the matter, that the methodology adopted by the Company in arriving at the values previously submitted is flawed and consequently the results are not credible, accurate nor reliable. In this regard, the Office is resorting to the use (as is provided for at Section 33 (2) of the Telecommunications Act 2000) of international benchmark.

The Office has previously indicated to C&WJ that the level of spare switching equipment capacity that will be allowed for the determination of the applicable MEA valuation of its switches is 15 percent. C&WJ was, therefore, asked to recalculate the asset values of switching equipment on this basis. On June 28, 2002, C&WJ provided calculations of asset values that purported to include this recalculation, as well as others.

By letter of July 11, 2002, the Office asked C&WJ for details of the cost reductions associated with the spare capacity of switching equipment. On July 20, 2002, C&WJ submitted detailed results as well as an explanation and an example of the methodology used to determine the effect of reducing the spare capacity. C&WJ's analysis purports, *inter alia*, to show that only 21% of switch investment is directly related to the number of lines which means that the Company is claiming that 79% of such investment is fixed.

The Office has examined this analysis and has concluded that it is completely inconsistent with its understanding of switching technology. It is also contrary to the results of both top-down and bottom-up cost models developed in other countries, as discussed below.

Furthermore, the example given by C&WJ for host switches, in which various equipment modules were determined to be either fixed or variable, does not appear to make the assignments properly. The experience in the global telecommunications industry is that traffic is approximately proportional to the number of lines – not independent of it. Furthermore, the Northern Telecom study from which your computations are derived presumably calculated the investment needed to accommodate the traffic generated by

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the lines, as well as the lines themselves. Nevertheless, these investments were identified as independent of the number of lines in C&WJ's computations. It is difficult to determine what some of the other modules are, but if there are large quantities of a particular module, they are likely to be engineered to meet the traffic load, and hence are (indirectly) a function of the number of lines. If, in this example, the fixed cost is assumed to be made up of equipment that requires only one module per switch, and all else is assumed to be traffic (and hence line) dependent, then the variable cost proportion comes to 65%, which, as shown below, is in full conformance with international benchmarks.

### **Determination 1**

**Given C&WJ's flawed methodology in the adjustment of the value of switching assets, the Office has determined that your submissions on the adjustment of the value of switching assets are not accurate and reliable. The Office will therefore rely upon international benchmarks for adjusting switching asset values so that they include only 15 percent spare capacity.**

### **INTERNATIONAL BENCHMARKS**

International bottom-up benchmark models, when applied to the C&WJ network, show line-related costs ranging from 53% of the total (Hatfield) to 78% (FCC HCPM).<sup>1</sup> Intermediate results include the Benchmark Cost-Proxy Model (BCPM) and OfTel and NTT's bottom-up cost models. Furthermore, a bottom-up cost model conducted by SPR for Peru yields an estimate of 68 percent, while a statistical top-down cost model, conducted by SPR of large independent (non-Bell) telephone companies in the U.S., shows a ratio of 80%. C&WJ's methodology yields results far outside this range.

### **BENCHMARK COST PROXY MODEL**

The international benchmark that is most applicable to C&WJ's network is the BCPM, whose development was sponsored by incumbent local exchange carriers in the U.S. The overall network cost of C&WJ's network based on this model is \$288 per line,<sup>2</sup>

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<sup>1</sup> The methodology underlying these calculations is described in the Office's consultative document titled, *Assessment of Cable & Wireless Jamaica Reference Interconnection Offer (RIO-4)*, December 2001.

<sup>2</sup> See the Office's Consultative Document of December 2001 *ibid.* for a discussion of the BCPM, and other cost models.

close to C&WJ's revised figures, and the model specifically relates to DMS switches. The proportion of cost associated with lines in the BCPM model as applied to C&WJ's network is 63.6%.

#### **Determination 2**

The Office now directs that C&WJ recalculate the C.O. Switching MEA by reducing the number of lines included in the valuation from 694,184 (as equipped) to 585,359 (working plus 15%). This represents a reduction of 15.68% which when multiplied by 63.6% yields a total cost reduction for C.O. Switching of 9.97%.

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