Jersey Competition Regulatory Authority

Consultation Document 2007-2

Consultation on JT Price Control

16 October 2007

Introduction

Condition 33.2 of the Licence issued to Jersey Telecom Limited ('JT') under the Telecommunications (Jersey) Law 2002 (the 'Law') allows the JCRA to determine the maximum level of charges JT may apply for telecommunication services within relevant markets in which JT has been found to be dominant. This price control power of the JCRA is intended to protect consumers from excessive prices by the dominant provider in markets where competition cannot yet act as sufficient check on the dominant provider's ability to increase prices. It is a power given to regulatory authorities in many other jurisdictions, both large and small.

In 2004, the JCRA determined that JT held a dominant position in certain markets, including:

- Fixed-line telecommunications services;
- Fixed-line telecommunications networks;
- Leased circuits and
- Fixed-line broadband services.

Thereafter, the JCRA consulted on the application of a price control mechanism for JT[1].

As a result of this consultation, the JCRA concluded that applying price controls on JT was appropriate in the following markets:

- Fixed line retail market (as defined); and
- Certain fixed line wholesale and interconnect market services (as defined);

and the JCRA thus issued a Direction to JT applying price controls in these areas[2].

Since the issuance of that Direction, limited competition has emerged in the fixed line retail market at the service level, but no significant alternative fixed network infrastructure or alternative access technology has been deployed. On the Island, other operators rely on JT's fixed network to carry their own services (although there is alternative access available for off-island backhaul).

[1] Price Control of Jersey Telecom Limited
http://www.jcra.je/pdf/040318%20Consultation%20on%20Price%20Control%20Cover%20Sheet.pdf

[2] 2004-2 Jersey Telecom Limited's Price Control Decision Paper and Direction
http://www.jcra.je/pdf/040429%20Decision%20re%20Consultation%20on%20Price%20Control%20of%20JT%20.PDF.pdf

Price Control Review

In its 2004 Direction, the JCRA used the Retail Price Index minus X (RPI-X) method of price control. Using Jersey's RPI at the time, the JCRA set the X factor at 2 in its Direction. Most respondents to the consultation supported the use of a Retail Price RPI-X method to control prices and it is a method of control that is well-established elsewhere. For example, the various UK utility and telecommunications regulators have used this method in the past, and it is used elsewhere in the EU including in small jurisdictions such as Malta. Guernsey also uses the RPI-X method.

At the time of the Direction, the JCRA also considered the issue of 'sub-price caps' for individual services within the JT portfolio and sub-price caps were defined for the following services:

- Line Connections;
- Line Rentals (including any JT bundled packages);
- Local single fee call rate;
- Retail Private Circuit Connection; and
- Retail Private Circuit Rental.

The Direction also indicated that sub-price caps may be considered within the service groups outlined above. However, the JCRA has not thus far applied any further sub-price caps.

In order to measure the overall effect of price control, a reference tariff was set as a suitable measure for comparison. This was agreed with JT and prices overall have been measured against this basket of prices. The JCRA was of the view at that time that this structure would protect consumers while at the same time allowing competition to emerge in downstream retail markets.

Since the JCRA's initial consultation paper, competition has emerged in some markets. However, as mentioned above, no significant alternative access infrastructure has been deployed since the original Direction. Prices have not changed significantly over the period in these markets, including prices for line rental sector and on-island retail services (with consequential effects in the wholesale on-island private circuit sector).

The JCRA also set prices within the JT Reference Interconnect Offer ('RIO') under its Direction. However, while the pricing was seen as appropriate at the time because JT had not as then produced a satisfactory RIO and clarity was required for new entrants, this aspect of pricing is now also captured under the JT Licence Condition 26 following the subsequent publication of its RIO.

In the view of the JCRA, the current price cap applied to JT has been successful in limiting an overly rapid tariff rebalancing, that is moving costs from competitive areas to non-competitive areas, particularly in relation to subscriber line rentals and local call rates. Reporting across the bundle of products has enabled the JCRA to monitor the overall effect of price changes for the consumer. While the JCRA notes that businesses have benefited from competition over the period, there may still be a need for some price cap mechanism if there are any areas where JT is not subject to actual or prospective competition.

Cost of Capital

In the 2004 Consultation the allowable cost of capital was discussed with reference to an economic model developed by the consultants Coleago in a report to the JCRA.[3] The Weighted Average Cost of Capital ('WACC') was set in the ensuing Direction at a rate of 11.25%.

The JCRA is aware that some of the underlying assumptions in the Coleago report may have changed since then. The JCRA therefore considers that this matter should be re-examined. The JCRA welcomes stakeholder opinion on which approach may be most appropriate to assess the WACC for any future price control method.

Appropriate Price Control

Price control, in markets characterised by an absence of competition, acts to protect consumer interests by controlling the ability of incumbent operators to extract monopoly rents from those markets. As stated above, the RPI-X method of price control method is commonly used by regulators in other jurisdictions.

Price control, if appropriately applied, can also act as a catalyst for improving efficiency. However, it is also important that price control does not adversely affect the incumbent operator's ability or willingness to make further investments in its network infrastructure.

Much will depend on the particular method adopted for price control to avoid the potentially adverse affects on efficiency in the overall provision of retail and wholesale fixed line services and on the necessary network investment.

Wholesale Products

At present, with the exception of its RIO pricing, JT sets its wholesale prices as discounted retail services, although not all of JT's current retail services are subject to the price cap regime. In relation to wholesale pricing, while some of JT's RIO prices are currently subject to price caps, its other RIO pricing is determined by JT's wholesale division and reviewed by the JCRA in accordance with JT's Licence Condition 26.

The JT Licence requires that its pricing is cost-oriented and transparent. Generally, verification of cost-orientation can reasonably be achieved only through the production of separated statutory accounts. JT has been required to produce such

[3] Coleago: Price Control of JT – Final Report
http://www.jcra.je/pdf/040318%20Coleago%20JT%20Price%20Control%20Final%20Report%20cc%20v1.2%20MDU.pdf

accounts from 2005.[4] Under JT's Licence Condition 33, cost-justified pricing is required for all its retail services. However, until now JT has not offered cost-oriented wholesale prices in all sectors.

The current price cap method ensures that services subject to it in general track below the Jersey RPI. There is some merit in retaining that method for the retail sector. However, as retail prices may not necessarily be cost-orientated (as in other jurisdictions)[5] it may be appropriate to decouple wholesale products from retail pricing and base wholesale prices on cost-plus principles.[6]

Setting wholesale prices on cost-plus principles requires an understanding of the underlying costs of provision as well as an assessment of the common costs between products. The incumbent operator also has to reinvest and to take a certain risk against the provision of existing and new technologies. If cost-plus is correctly implemented, then theoretically there may be no need for the provision of price caps on wholesale products. However, there is a risk that poor implementation could misdirect investment incentives.

Survey of Stakeholders

The JCRA is now seeking stakeholders' views on the issue of price control of JT through the following questions:

Q1. Based on JT's current market position, do stakeholders consider that there is a requirement for a price cap mechanism for the protection of Jersey consumers?

Q2. If so, do stakeholders consider that the current range of services covered by the current mechanism is appropriate?

Q3. If so, do stakeholders consider that the present mechanism, as defined in the 2004 consultation, is appropriate?

Q4. Do stakeholders consider that sub price caps should be introduced within any of the current ranges covered by the existing price cap?

Q5. Do stakeholders consider that the current value for X is still appropriate?

Q6. Do stakeholders consider that using an average basket of products from the JT portfolio an appropriate measure of the overall effect of the price cap mechanism?

---

[4] Direction to Jersey Telecom Limited Re: Separated Accounts http://www.jcra.je/pdf/050511%20Direction%20to%20JT%20re%20Seperated%20Accounts.pdf

[5] Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications http://eur-lex.europa.eu/LexUriServ/site/en/oj/2005/l_266/l_26620051011en00640069.pdf

[6] A ERG Report Regulatory Accounting in Practice 2007 Regulatory Accounting Project Team April 2007 http://erg.eu.int/doc/whatsnew/erg_07_22_regulat_account_practice_rep.pdf

Q7. The JCRA invites stakeholders to comment on the approach and the input assumptions of the WACC model used in the 2004 consultation so that the JCRA is able to make an informed approach to JT's cost of capital for the fixed telecommunications price control.

Q8. Do stakeholders consider that any price cap structure needs to continue to cover any pricing within the JT RIO or that this aspect can be managed adequately through the JT Licence and its conditions regarding the RIO?

Q9. Do stakeholders believe that wholesale and RIO prices should be set as cost plus by the JCRA separately or as part of any price cap direction?

Q10. Do stakeholders have any other comments or observations that are relevant to this consultation?

Consultation Period

Written comments on this Consultation Paper are invited, to be received no later than **5PM on 27 November 2007.** Submissions should be clearly marked "Comments on JCRA Consultation Document 2007-2" and may be supplied either in hard copy or electronically, addressed (as appropriate) to:

Graeme Marett
Telecommunications Case Officer
Jersey Competition Regulatory Authority
2nd Floor Salisbury House
Union Street
St Helier
Jersey
JE2 3RF

E-mail: enquiries@jcra.je

N.B. The JCRA reserves the right to publish on its website any submissions to this or any other consultation. Any commercially sensitive information that a stakeholder may wish to submit as part of a response should therefore be clearly marked as such.