Investigation into Dispute between Cable & Wireless Jersey Limited and Jersey Telecom Limited regarding ADSL broadband takeover charges

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Provisional Findings in Dispute and

Initial Notice of Proposed Determination

3 October 2011

Table of Contents

1. Introduction

In June 2011, Cable and Wireless Jersey Limited ('C&WJ') submitted a complaint to the Jersey Competition Regulatory Authority ('JCRA') regarding the charge applied by Jersey Telecom Limited ('JT') for the migration of Asymmetric Digital Subscriber Line ('ADSL') broadband customers from one internet service provider ('ISP') to another. JT's wholesale business ('JT Wholesale') currently charges ISPs £44 if they wish to take over a broadband customer from another ISP. This "takeover charge" is intended to cover the cost to JT Wholesale of the administration of transferring customers between ISPs.

C&WJ has alleged that the takeover charge is not cost-justified and that it is a barrier to effective competition in the market for retail broadband services provided on fixed-line networks in Jersey.

Upon receipt of the complaint, and after consideration of the issues, the JCRA began a formal investigation of the complaint. In July 2011 the JCRA provided JT with a notice of the complaint and JT provided a response setting out its justification for the charge. C&WJ was then asked for its view on JT's response and the JCRA has now considered this information along with such other information as it believes is relevant to its consideration of the matter.

This report summarises the issues involved, and sets out the provisional findings of the JCRA and the determination that the JCRA proposes to issue under Article 16(3) of the *Telecommunications (Jersey) Law 2002* (the 'Law') and Condition 33.2 of the Class III licence issued to JT by the JCRA under Article 14(1) of the Law (the 'Licence'). It constitutes the Initial Notice of the proposed determination under Article 11(1) of the Law. The JCRA is now inviting comments on its provisional findings and proposed determination.

2. Details of Complaint and JT's response

C&WJ has requested the JCRA to investigate the level of JT's takeover charge for Wholesale ADSL services. This charge is applied when a retail ADSL broadband customer transfers (or migrates) between ISPs, since JT Wholesale is required to take certain steps to facilitate this transfer. Currently JT charges the acquiring ISP £44 per migration pursuant to the Wholesale DSL Agreement between JT and the other licensed operators ('OLOs'). It is alleged by C&WJ that the charge is not cost-based as, in its view, the function should be a quick administrative one and should be capable of being done without the need for a site exchange visit. It is alleged by C&WJ that the charge acts as a barrier to competition, by making it more difficult for retail ADSL broadband customers to switch ISP, and is an abuse of JT's dominant position in the market for wholesale broadband services provided on fixed-line networks in Jersey.

The JCRA provided JT with a copy of the complaint and requested JT's views on the matter. On 8 July 2011, JT provided a response to the JCRA in which it stated that the work required to migrate a customer follows a very similar process to a new order for a broadband service. It provided a schematic diagram of the steps involved in migrating a customer and confirmed that the process and charge applied by JT Wholesale to JT's retail business is the same as that applied to OLOs. JT further provided a cost breakdown which it believes supports the £44 charge currently applied by JT Wholesale, based on an average time of 69 minutes of staff time required to complete a migration.

Upon receipt of this information from JT, the JCRA sought C&WJ's views on the justification provided. In a response dated 25 August 2011, C&WJ stated that it does not accept that the time required by JT Wholesale to complete this work is as claimed by JT. C&WJ agreed with JT that the work required to provision a takeover under JT's current system would follow a similar process to a new order for ADSL. However, C&WJ notes that such work is solely related to system-inputting requirements, and does not entail any engineering tasks.

CW&J stated that operational staff at Cable & Wireless Guernsey Limited ('C&W Guernsey'), which is the main operator of the fixed-line telecommunications network in Guernsey, estimated that the process outlined by JT in its response should take a maximum of 20 minutes (less than a third of the time estimated by JT). The process for transfer of ADSL customers in Guernsey is automated, so customer migrations can be undertaken rapidly. C&W Guernsey does not levy a charge on OLOs for transferring ADSL customers.

C&WJ argues that the application of the takeover charge by JT creates a financial barrier to customers switching between ISPs, given this charge equates to an additional £3.67 per month per customer (assuming a 12 month contract term). It further highlights that should a customer at the end of their contract with an ISP move to an alternative ISP, a further £44 charge will be levied. C&WJ argues that in such circumstances, the incentives for customers to switch between broadband providers are significantly diminished.

C&WJ also notes that while it might well be the case that JT Wholesale levies an equivalent takeover charge on JT's retail business when it acquires a new broadband customer, JT's 2009 separated accounts suggest that JT's retail broadband activities "cannot afford" this takeover charge, given that these activities alone generated a loss of £266,000. C&WJ contends that this is further evidence that the takeover charge is currently set at an inappropriate level.

C&WJ submits that, in applying this takeover charge, JT is infringing condition 34.1(b) (Fair Competition) of the Licence.

3. Legal Background

In April 2010, the JCRA determined, as part of its review of the telecoms sector in Jersey, that JT has significant market power ('SMP') in the market defined as 'Wholesale Broadband Services Provided on a Fixed Network'. As the owner and operator of the main fixed-line telecommunications network within Jersey, JT remains the sole provider of wholesale broadband services provided on a fixed-line network.

In addition, at the retail level, the JCRA estimates that JT currently supplies approximately 80% of ADSL subscriptions within Jersey.

As a result of having SMP in a number of the markets in which it operates, JT has certain additional conditions in its Licence which do not apply to non-SMP operators. Licence Condition 34.1 states:

34.1 The Licensee shall:

(a) not abuse any position of Significant Market Power and/or established position in any telecommunications market;

(b) not engage in any practice or enter into any arrangement that has the object or the likely effect of preventing, restricting or distorting competition in the establishment, operation and maintenance of Licensed Telecommunication Systems or the provision of Telecommunication Services; and

(c) comply with any direction issued by the JCRA for the purpose of preventing any market abuse or any practice or arrangement that has the object or effect of preventing, restricting or distorting competition in the establishment, operation and maintenance of Licensed Telecommunication Systems or the provision of Telecommunication Services.

Although not specifically mentioned by C&WJ in its formal complaint, Licence Condition 33 also confers on the JCRA certain powers to regulate, or make directions in respect of, the prices charged by JT for certain telecommunications services.

JT is obliged under Licence Condition 33.3 to ensure as follows:

all published prices, discount schemes and special offers of, or introduced by, the Licensee for Telecommunication Services shall be transparent and non-discriminatory; all prices and discount schemes shall be cost-justified and all special offers shall be objectively justifiable.

Licence Condition 33.4 provides that, in the event that the JCRA, after consulting JT and such other persons as it may determine, is satisfied that any published price, discount scheme or special offer of JT is in breach of the Law or the Licence, the JCRA may, by issuing a direction, require JT to bring the relevant prices, discount schemes or special offers into conformity with the Law and/or the requirements of the Licence.

Licence Condition 33.2 allows the JCRA to determine the maximum level of charges that JT may apply for Telecommunication Services within a relevant market in which JT has been found to be dominant. The determination may:

(a) "provide for the overall limit to apply to such Telecommunication Services or categories of Telecommunication Services or any combination of Telecommunication Services;

(b) *restrict increases in any such charges or to require reductions in them whether by reference to any formula or otherwise; or*

(c) *provide for different limits to apply in relation to different periods of time falling within the periods to which any determination applies*."

"*Telecommunication Services*" is defined in Licence Condition 1.1 as meaning "the provision of any telecommunications services to the public". The JCRA is satisfied that this definition encompasses the supply of ADSL takeover services to OLOs under the Wholesale DSL Agreement.

4. The JCRA's Provisional Findings

The JCRA believes the availability of an efficient process for enabling customers to switch between broadband providers is essential in promoting effective competition in the retail market for fixed-line broadband services. In order for new entrants to compete in that market - in particular, to compete with JT - it is important that OLOs are able to compete for existing broadband customers; otherwise, OLOs are left to try and compete for potential new broadband customers, and, given that the current level of broadband penetration in Jersey is approximately 80%, it is unlikely that an OLO could build a sustainable business through new custom alone.

The JCRA notes that JT has little or no commercial incentive to design, implement and operate a migration service for broadband customers that is as efficient as possible, given its existing position in the retail fixed-line broadband market in Jersey. In fact, it could be argued that JT has strong incentives to maintain a labour-intensive and, by implication, costly takeover process which would have the effect of reducing demand from retail broadband customers to switch away from JT.

In a market where average monthly retail broadband tariffs are typically in the region of £18 (for a 2 Mbps service) to £28 (for an 8 Mbps service), a price reduction even as large as 10% by an ISP (or an improvement in quality of service equivalent to a price reduction of this magnitude) would only begin to outweigh the £44 fixed charge (and thereby provide an incentive for a customer to switch) after more than 15 months (at 8 Mbps) or more than 24 months (at 2 Mbps). In the JCRA's view, such a significant barrier to switching is very likely to have the effect of reducing the competitive pressure on all retail broadband providers, but particularly JT, which currently supplies approximately 80% of retail broadband subscriptions (and held an even larger share prior to its introduction of a wholesale ADSL product). All other things being equal, the absence of competitive pressure would be expected to reduce the efficiency of provision of these services, and reduce the propensity of current providers or potential entrants to innovate.

There is no evidence currently before the JCRA which would cause the JCRA to doubt JT's claim as to the costs that it actually incurs in handling a broadband migration request. However, the JCRA considers that in performing its functions under Licence Conditions 33 and 34, it must also assess whether such costs are ones that an efficient operator would incur. In so doing, we have looked to other jurisdictions to assess what steps wholesale operators have taken to reduce the cost of this essential service and considered whether it is reasonable to expect that JT, operating efficiently, would itself take similar steps.

The information provided by C&WJ with respect to the manner in which C&W Guernsey handles broadband takeover requests is considered particularly relevant. JT and C&W Guernsey are broadly similar, both in size and in terms of the wholesale broadband service offered. As noted in section 2 above, in Guernsey, the process applied by C&W Guernsey (as the provider of wholesale ADSL services) for transferring customers between ISPs is automated. C&W Guernsey does not levy any charge on OLOs for an equivalent migration service (provided to, amongst others, JT's sister company, Wave Telecom Limited, which purchases wholesale broadband services from C&W Guernsey for its retail operations in Guernsey).

In its response of 25 August 2011, C&WJ contended that even if a takeover charge were justified, and it was reasonable to continue to use a manual process for customer migrations, the actual level of charge applied by JT does not reflect the cost that an efficient operator would incur in performing that function. As noted above, C&WJ estimates that undertaking the processes that JT states in its submission of 8 July 2011 are necessary for transfer of an ADSL customer should take *a maximum* of 20 minutes work.

The JCRA does not accept that an efficient provider of ADSL takeover services would continue to utilise the manual migration process currently adopted by JT. As stated above, the JCRA notes that in Guernsey, C&W Guernsey has adopted an automated process and applies no charge on OLOs for the same service. Even if a manual process remained appropriate, we do not believe that charge levied by JT is reflective of the costs that an efficient operator would incur in providing the takeover service. Given the incentives on JT to keep this charge at a high level, the JCRA believes it is important that, in determining the appropriate level of this charge, it is set with reference to efficiently-incurred costs rather than on the basis of the actual costs incurred by JT. The JCRA considers that the evidence of C&W Guernsey in relation to the time that the process performed by JT should take provides an appropriate benchmark for setting the maximum charge for the takeover service in Jersey.

Applying JT's current implied per hour charge of £38.25 (ie £44 for a 69 minute task) to the benchmark time estimate provided by C&W Guernsey (ie 20 minutes) results in an "efficient" charge of £12.75.

Importantly, the price generated by using C&W Guernsey time estimate does not appear to be an outlier. In the UK, BT Openreach applies a charge of £11 (excluding VAT) for the same service.

In light of the JCRA's provisional finding that the ADSL takeover charge levied by JT is higher than the charge that an efficient operator, setting a cost-based price, would impose for this service, the JCRA has considered whether such conduct could constitute a breach of Licence Condition 34.1. While the JCRA considers, for the reasons set out above, that the level of the ADSL takeover charge currently levied by JT restricts competition in the provision of retail broadband services using a fixed-line network, it is not, at this stage, satisfied that Licence Condition 34.1(b) is intended to be invoked in situations of unilateral conduct where there is no evidence that the entity in question is setting a price that exceeds the actual costs that it incurs for providing the service.

The JCRA considers that it would be open to it to issue a decision under Licence Condition 33.4 that JT was in breach of Licence Condition 33.3, on the basis that it has found that the ADSL takeover charge is not “cost-justified”, as it exceeds by a considerable margin a reasonable benchmark of efficient cost. However, in circumstances where JT holds a position of dominance in respect of a particular service, and the JCRA proposes to instruct JT to set the price of that service in accordance with the costs of an efficient operator, the JCRA considers that the more appropriate power is the ability to issue a determination under Licence Condition 33.2.

5. Proposed Determination

The JCRA has had regard to the following findings and facts:

a) JT has been found in April 2010 to hold a dominant position in the provision of wholesale broadband services provided on a fixed-line network, and the JCRA is not aware of any reason to depart from this finding;
b) The ADSL takeover charge is levied by JT as part of its provision of wholesale broadband services provided on a fixed-line network;
c) The ADSL takeover service is integral to the efficient functioning of the retail market for broadband services provided on a fixed-line network, as it facilitates customer switching between alternative suppliers;
d) JT’s position in the downstream market for retail broadband means that it faces clear incentives not to maximise the efficiency of the ADSL takeover service that it provides at a wholesale level;
e) JT contends that the current takeover charge is cost-justified, on the basis that the takeover service takes, on average, 69 minutes and the fully-allocated cost of the relevant personnel is £41 per hour;
f) C&W Guernsey estimates that the maximum time that it should take to perform the processes outlined by JT for the customer migration process is 20 minutes;
g) The JCRA is satisfied that the estimate provided by C&WJ forms a reasonable benchmark for the efficient provision of such services by JT, and its view is reinforced by the fact that the charge levied by BT Openreach for an equivalent service in the UK is £11.

In light of those findings and facts, the JCRA hereby gives an initial notice under Article 11(1) of the Law of its intention to issue a determination under condition 33.2 of the Licence that the maximum charge levied by JT for ADSL takeover services shall be £12.75 per transferred subscriber. This determination will take effect 29 days after the publication of the JCRA’s final notice with respect to this determination.

In proposing this determination, the JCRA has considered its duties set out in Article 7 of the Law and is satisfied that the determination will:

- promote competition among persons engaged in commercial activities connected with telecommunications in Jersey (Article 7(2)(a));
- promote efficiency, economy and effectiveness in commercial activities connected with telecommunications in Jersey (Article 7(2)(b));
- further the economic interests of Jersey (Article 7(2)(c));
- increase accessibility and affordability for business and domestic users (Article 7(3)(a)); and
- promote innovation in broadband services and their provision (Article 7(3)(b)),

and that the furtherance of these duties is not outweighed by any prejudice with respect to any other duties set out in Article 7.

6. Next Steps

The JCRA is now inviting comments on its provisional findings and proposed determination. Any objections or representations regarding the provisional findings or proposed determination should be sent to the following address by 5pm on Thursday, 3 November 2011:

Jersey Competition Regulatory Authority
2nd Floor, Salisbury House
1 – 9 Union Street
St Helier
Jersey
JE2 3RF

Or by email to Andrew.riseley@cicra.je

By order of the JCRA Board

3 October 2011