Jersey Telecom Price Control

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Final Notice of Determination: T817J

23 December 2011

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

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1. Introduction

On 31st December 2011, Jersey Telecom Limited's (***JT***) existing three year price control[1] will end. Since January 2010, the Jersey Competition Regulatory Authority (***JCRA***) and Guernsey's Office of Utility Regulation (***OUR***), together with the telecoms industry in the Channel Islands, have been working on a project to facilitate the development of new wholesale access products, aimed at increasing choice for fixed-line telecoms services. A consultation paper on the Wholesale Access Project was issued jointly by the JCRA and OUR on 24 November 2011[2].

Creating fairly-priced wholesale access products is considered key to the development of fixed-line competition. If successful, competitive access to JT's network may stimulate further competition in the fixed-line services, providing consumers with greater choice and better pricing and helping to drive innovation in the services provided to telecoms users. In the event that competition is increased in fixed-line services, the need for price controls in the longer term would be less and there may be scope to reduce significantly, or remove entirely, price controls on JT's products.

The regulators and industry together have identified a range of new wholesale services that may be introduced to promote further fixed-line competition, and the next steps in this project are being considered as part of the current consultation mentioned above. At this time, the products to be introduced and their timing remains to be determined; however, it is expected that during 2012 the first products should be launched. Therefore, the JCRA believes it is necessary to retain a price control on certain JT services, and that the services to be price controlled should remain those covered by Decision T2008-1.

However, the time period in which sufficient competition might develop in fixed-line services, given this workstream, is such that the JCRA has decided to refrain from setting an entirely new price control for an extended period of time (i.e. the normal three year price control) given the resources involved and the possibility that the period of such a control may need to be revisited if effective competition develops over a shorter time period. Instead, the JCRA has decided to set a price control to run until the end of 2012 (as is also being proposed in Guernsey for Cable & Wireless Guernsey Limited (***C&W Guernsey***) for similar reasons). The detail of the price control is set out later in this Final Notice.

[1] *Decision Paper and Determination T2008-1*, 15 September 2008
[2] *http://www.cicra.gg/_files/CICRA%201101.pdf*

2. Structure of the Final Notice

This Final Notice is structured as follows:

Section 3: Sets out the legal basis for the imposition of price controls on JT by the JCRA;

Section 4: Discusses the background to the current price control and subsequent developments;

Section 5: Sets out the representations made in response to the Initial Notice, as well as the JCRA's views on the matters raised in those representations; and

Section 6: Explains the JCRA's price control determination and its rationale.

3. Legal Background

The legal basis for the JCRA to subject JT services to price control is the licence issued to JT by the JCRA under Article 14 of the *Telecommunications (Jersey) Law 2002*. Condition 33.2 of JT's Licence states:

"The JCRA may determine the maximum level of charges the Licensee may apply for Telecommunications Services within a relevant market in which the Licensee has been found to be dominant. A determination may:

a) provide for the overall limit to apply to such Telecommunications Services or categories of Telecommunications Services or any combination of Telecommunications 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."

This condition allows the JCRA to regulate the prices that JT charges for telecommunications services in a way and for a time that it deems appropriate, where JT has a dominant position in the relevant market. In April 2010, the JCRA determined that JT has a dominant position in, inter alia, the following markets[3]:

- Access to the public telephone network at a fixed location for residential and non-residential customers;
- Call origination on the public telephone network provided at a fixed location; and
- Call termination on individual public telephone networks provided at a fixed location.

[3] *Response to the Consultation Paper 2009 – T3 "Review of the Telecommunication Market in Jersey" and Decision on the Holding of Significant Market Power in Various Telecommunications Markets*, 19 April 2010

4. Current price control and subsequent developments

The current three-year JT price control is due to expire at the end of December 2011. For the current price control, the JCRA concluded a price control framework for certain JT services and determined that the price control would run for 3 years with effect from 1st January 2009.

As stated earlier in this Final Notice, the regulators in the Channel Islands are working with the telecoms industry as part of a Channel Island Wholesale Access Project (***CIWAP***) initiative to look at ways of increasing competition in the provision of fixed-line services. More effective competition may provide scope to remove or reduce significantly the scope of the price controls on JT. The JCRA believes that the evidence from mobile telecommunications services, where greater competition was facilitated in 2008 through the introduction of mobile number portability (MNP), demonstrates that enabling consumers to choose from whom they get their service provides a significant boost to competition and as a result delivers lower prices and better service than regulation alone can achieve.

While a significant amount of work has been undertaken by the CIWAP, there remain a number of tasks still to be completed before any new services will be available to consumers. However, the regulators are committed to such services as can be enabled being available during 2012. Therefore, the JCRA would wish to avoid setting a price control for an unnecessarily long period, but considers equally that having no price control in place risks a situation where consumers are inadequately protected.

The JCRA has therefore decided to impose a further price control, to run until 31 December 2012. This will enable a view to be taken during 2012 on whether further price controls are required and if so what duration any further control should last for. The details of this price control are set out in the next section.

5. Initial Notice, submissions and responses

On 23 November 2011, the JCRA published an Initial Notice advising of its intention to make a price control determination with respect to certain services supplied by JT.

Two submissions were received: one from Cable & Wireless Jersey Limited (***C&WJ***) and one from JT. Neither submission contained objections to the proposed determination, so the JCRA has confirmed the determination in this Final Notice. However, both responses contained representations regarding issues related to the price control proposal and discussed in the Initial Notice. The JCRA's responses to those representations are set out below.

C&WJ

C&WJ expressed a view that JT's current price-controlled charges do not appear to be reflective of efficiently-incurred costs, and so was disappointed that the JCRA had not proposed that JT should reduce its line rental charges. In response, the JCRA notes that part of the rationale for issuing a determination that maintains the status quo (through a price freeze) is the lack of clarity as to JT's cost allocation in its separated accounts – the issue of JT's separated accounts is being pursued by the JCRA through a different process, and it is expected that the production of accounts with correctly-allocated costs will facilitate an assessment of whether prices reflect efficiently-incurred costs. C&WJ also urged caution in removing price controls on JT until pricing details for new fixed-line wholesale products (in particular, Wholesale Line Rental) had been confirmed. The JCRA notes this point, and will have regard to it when it is considering in 2012 whether price controls should be retained for JT.

In addition, C&WJ contended that any wholesale products launched as part of the CIWAP must be available at the same time and at the same price in Jersey and Guernsey, reflecting efficiently incurred costs. The JCRA notes this submission, but considers that the correct forum for a discussion on that issue is CIWAP.

C&WJ queried why leased lines were not subject to the price control, despite JT holding a position of dominance in that market. In response, the JCRA notes that that leased lines are currently subject to wholesale access, and that it intends to take further action in relation to the wholesale price and retail margin for leased lines in the near future.

JT

JT accepted that a one year price control was a sensible approach in the context of the on-going programme to introduce competition in fixed-line telecommunications. It contended that it will be necessary for the JCRA to undertake a thorough market review to define markets if the JCRA intended to retain price controls for the period from 2013, particularly in light of JT's move to a Next Generation Access network. The JCRA notes this submission, and intends to outline during 2012 the process that it will undertake in order to consider the appropriateness of price controls on JT services in the future.

JT expressed disappointment in relation to the comments in the Initial Notice regarding the JCRA's concerns about the accuracy of the underlying allocation of charges between JT's wholesale and retail businesses. It said that these concerns had not previously been raised with JT, and contended that it had prepared its latest set of separated accounts in accordance with the format required by the JCRA's consultants, KPMG. The JCRA is of the view that JT has been made aware of the JCRA's concerns about the validity of the allocation of charges in its separated accounts; in particular, the need for those accounts to be audited to a sufficiently high standard that the JCRA and other licensed operators are able to have confidence in the accuracy of those accounts. The JCRA looks forward to working with JT in relation to its separated accounts in coming months.

6. Price Control Determination

JT's dominance

As stated earlier, JT has been found to be dominant in the following markets[4] which are relevant for the purposes of this price control determination:

- Access to the public telephone network at a fixed location for residential and non-residential customers;
- Call origination on the public telephone network provided at a fixed location; and
- Call termination on individual public telephone networks provided at a fixed location.

While the finding of dominance was made in April 2010, the JCRA has reviewed the provisional market share returns provided by Jersey operators for the period to the end of December 2010. It shows that JT continues to provide 100% of all fixed lines and had a market share for calls on fixed lines of 88% (a very slight decrease in market share from 90% in 2009). This information confirms that no significant change has occurred in the market share of JT since the determination made in April 2010. In addition, the JCRA does not believe that competition from mobile telephones (as a substitute for a fixed line) or broadband-facilitated calling services (e.g. voice over internet protocol, or VoIP) as yet exert sufficient pressure on JT to justify a conclusion that fixed-line markets are competitive. Therefore, the JCRA remains of the view that JT is dominant in the markets listed above, and believes that a continuation of a control on the prices charged by JT for services in these markets is warranted in these circumstances.

Rationale for imposing price controls

In 2008, the JCRA set a price control which included the following features:

- That the appropriate level of Weighted Average Cost of Capital (***WACC***) for the period of the price control is 11.6%;
- That a price control of RPI – 3% should apply to JT in respect of its charges for local calls, calls to the UK and international calls; and
- That a sub-cap of RPI – 1% should apply to JT's charges in respect of the connection of fixed subscriber lines and line rental.

In respect of WACC, the JCRA believes that, as this is a short-term price control and given there has been little change in the markets subject to price control during the

[4] *Response to the Consultation Paper 2009 – T3 "Review of the Telecommunication Market in Jersey" and Decision on the Holding of Significant Market Power in Various Telecommunications Markets*, 19 April 2010

duration of the previous price control, it would be inappropriate for either JCRA or JT to expend the significant resources required to calculate a new WACC figure. Instead, the determination is based on a roll over of nominal prices from 2011. In the event that the JCRA were to determine that a longer price control was justified for the period from 2013 onwards, then it would intend to re-estimate the WACC for JT (or, potentially, several WACCs for different parts of JT's business) as part of that process.

With regard to the two sub-baskets of the price control, the JCRA has decided to freeze maximum charges (i.e. to allow no increase to tariffs in nominal terms) for both sub-baskets for 2012. A number of factors have informed the JCRA's determination.

As already noted, regulators in both Jersey and Guernsey are currently consulting on the development of new wholesale fixed-line access products. These products would give consumers choice in their fixed-line telecoms provider. One of the options being considered is the introduction of a Wholesale Line Rental product. Setting a wholesale price for Wholesale Line Rental would require a detailed assessment of the cost of providing line rental services, and the JCRA believes this work should provide greater clarity on what retail prices should be charged by JT for this service in the future.

The JCRA has also taken account of the fact that since the last price control was put in place in January 2009, JT has made significant changes to its cost base through its business transformation programme. It has further made significant changes to the underlying network used to deliver certain services and the JCRA expects that these combined measures would impact the cost of providing the services which are the subject of the price control. The JCRA believes that before allowing further price increases, a detailed assessment of these costs (and their impact) should be made. As it is already intended to undertake a costing exercise as part of the CIWAP initiative, the JCRA does not believe that it would be an efficient use of either its own or JT's resources to run parallel exercises in this area. The JCRA notes that even if a price freeze is adopted, JT's standard line rental, currently £12.75 per month (excluding GST), will still be significantly higher than line rental charges applied by C&W Guernsey in Guernsey (£8.99 per month) and that call charges are also higher, with a minimum call charge in Jersey of 7p compared to 2p in Guernsey.

Finally, the JCRA has reviewed the latest separated accounts provided by JT for the 2010 year. While these accounts are in draft form, and have not as yet been published, they raise questions about the underlying allocation of charges between the wholesale and retail arms of JT. The provision of robust financial accounting information remains a key priority for the JCRA so that properly informed decisions can be made on JT's charges (both retail and wholesale). In light of the issues highlighted by the draft 2010 separated accounts, the JCRA believes that any increased charge for price-controlled services could not be cost-justified.

In light of these factors, the JCRA proposes that no change should be made to the maximum price for the services covered by this determination during the period to 31 December 2012. In the event that the costing work to be undertaken in 2012 as part of CIWAP identifies reasons why this determination should be amended earlier than 31 December 2012, the JCRA will consider this at that time.

Determination

For the reasons set out above, the JCRA has decided to issue the following determination under Condition 33.2 of JT's licence:

The maximum price charged by JT for each service in the categories listed below (being the services covered by the existing JT price control in JCRA Decision T2008-1), and any new service introduced by JT that does or could compete with any such service, shall be the price charged by JT for that service on 23 November 2011:

- local calls from fixed-line telephones;
- calls to the United Kingdom, other Channel Islands and the Isle of Man from fixed-line telephones;
- international calls from fixed-line telephones;
- connection of fixed subscriber lines; and
- line rental.

This determination confirms the proposed determination set out in the Initial Notice issued on 23 November 2011.

This determination will take effect on 23 January 2012, and will terminate on 31 December 2012.

By order of the Board of the JCRA **23 December 2011**