Pan-Channel Island Consultation on Retail Price Control Review

Consultation Document

Channel Islands Competition and Regulatory Authorities

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1. Introduction

Retail fixed line services include call charges using fixed line phones, exchange line charges and a range of related fees associated with having a fixed line phone service. This document has been published by the Channel Islands Competition and Regulatory Authorities (CICRA) which is seeking stakeholders views on the need for and extent of price controls on retail fixed line services to be placed on Sure in Guernsey and JT in Jersey, as the two major providers of those services in their respective islands. It does not cover other retail fixed line services such as residential and business broadband or leased line services.

In general the nature and extent of regulatory oversight of prices for retail fixed line services depends on the extent of choice through competition available to customers. The weaker those choices the greater the regulatory role in ensuring prices are fair.

The telecoms industry in the Channel Islands has been working together with CICRA on the development of new wholesale access products aimed at increasing choice and competition in fixed-line telecoms services. Creating fairly-priced wholesale access products is central to the development of fixed-line competition.

Wholesale Line Rental (WLR) is to be launched across both islands on 1 June 2015. However, the time period in which sufficient competition might develop in the fixed-line services market is not known. This has been taken into account for any future price control of fixed line phone services which is the subject of this consultation.

2. Purpose of consultation

The purpose of this document is to seek views on the retail price controls in place for Sure (in Guernsey) and JT (in Jersey) and consider what controls may be needed in future.

The last full price controls for Sure in Guernsey and JT in Jersey were set in 2008, initially covering a period up to 2011. Since then, both JT and Sure have been subject to yearly roll overs and an interim price control, allowing for price increases in line with the respective island's retail price index (RPI). At the time, CICRA[1] (the Channel Islands Competition and Regulatory Authorities) considered that maintaining a price control was appropriate as both operators still held a dominant position in the relevant markets.

Given the delay in introducing choice to consumers, in particular WLR, the increased benefits of competition have not been realised and CICRA decided in 2014 to undertake a formal price control review. To support this process Frontier Economics was commissioned to carry out a review of the price controls applied to retail fixed line services in the Channel Islands to inform CICRA's views on any future price controls.

This consultation document is informed by Frontier Economics' report. A redacted version of the full report presented to CICRA is included in Annex A of this consultation.

Following an assessment of responses to this consultation, CICRA will determine the requirement for a price control, the duration of the control as well as the level of future price controls.

Disclaimer

This document does not constitute legal, technical or commercial advice; CICRA is not bound by this document and may amend it from time to time. This document is without prejudice to the legal position or the rights and duties of CICRA to exercise regulatory powers generally.

1 The Jersey Competition Regulatory Authority (JCRA) and the Guernsey Competition and Regulatory Authority (GCRA) are together referred to as CICRA and unless otherwise stated, all references to CICRA in this Decision are to each of the JCRA and GCRA

3. Structure of the Consultation

The consultation document is structured as follows:

Section 4:	Sets out CICRA's assessment of the evidence available to it
Section 5:	Next steps in this consultation
Annex A	Redacted Frontier Report
Annex B:	This section outlines the legal bases for the GCRA's and the JCRA's roles in the setting of retail price controls.

Interested parties are invited to submit comments to CICRA in writing or by email on the matters set out in this paper to the following addresses:

Suites B1 & B2 Hirzel Court St Peter Port Guernsey GY1 2NH Email: info@cicra.gg	2nd Floor, Salisbury House 1-9 Union Street St Helier Jersey JE2 3RF Email: info@cicra.je

All comments should be clearly marked "*Pan-Channel Island Consultation on Retail Price Control Review 2015*" and should arrive by 5pm on Friday 8 May 2015.

In line with CICRA's consultation policy, it is intended that responses to the consultation will be made available on the CICRA website, the combined website of the GCRA and JCRA. Any material that is confidential should be put in a separate annex and clearly marked as such so that it may be kept confidential. CICRA regrets that it is not in a position to respond individually to the responses to this consultation.

4. Retail Price Control

The purpose of this section is to set out CICRA's assessment of the evidence and its views based on that evidence that inform the proposed Retail Price Controls.

The need for an ex-ante price control going forward

Fixed Line access services

Frontier Economics, in its report to CICRA, concluded that: "*competition for retail fixed line access services appears to remain limited in both Guernsey and Jersey. In particular: (i) there are limited alternative offerings to the incumbent's retail fixed access line services; and (ii) both operators have retained a dominant position in their respective market for retail fixed line access services*."

Relevant features are that:

- Both Sure and JT remain the sole providers of PSTN access lines in Guernsey and Jersey respectively and there are few alternative fixed network operators present in both markets.
- Barriers to entry to the market remain high as there is currently no wholesale access service, with WLR only due to be launched in June 2015.
- Despite the increasing presence of mobile voice services and availability of over the top (OTT) Voice over Broadband (VoB) services, there is limited evidence to suggest that fixed line customers in the Channel Islands are substituting away from fixed access line services to these alternative products.

Given the above, Frontier Economics concluded that both Sure and JT are likely to maintain a dominant position in the provision of retail fixed lines and therefore there is a continued need for ex-ante price controls for Sure and JT's retail fixed access line services.

Question 1

Does the respondent agree that a dominant position is held by Sure and JT in the provision of retail fixed line access services? If the respondent does not agree then please provide a full justification for the response citing relevant evidence.

Question 2

Does the respondent agree that there continues to be a need for ex-ante price controls for Sure and JT's retail fixed access line services in the respective jurisdictions of Guernsey and Jersey? If the respondent does not agree then please provide a full justification for the response citing relevant evidence.

Fixed call services

Frontier Economics found: "*…limited evidence to suggest that the market has become sufficiently competitive to remove fully ex-ante regulation*."

Relevant features are that:

- Despite the presence of alternative network operators and indirect call service providers in both jurisdictions, Sure and JT remain the main providers of retail fixed call services in their respective markets.
- Fixed call volumes have dropped over the last few years in both Guernsey and Jersey. This is likely to be the case due to two factors: Fixed-to-mobile substitution and OTT-based VoIP and instant messaging services. However, this does not provide compelling evidence that the market is effectively competitive.
- Recent call prices developments under the existing price control regime suggests that both JT and Sure have not used their full pricing flexibility provided under that price control (i.e. they have not increased prices in line with what is allowed in the price control). This could suggest that both operators feel to some degree constrained in their pricing flexibility.

The analysis suggests the emergence of alternative services and changing consumer demands may constrain, at least to some extent, the operators' ability to price these services above a competitive level (absent any regulation) and these constraints may increase over the forthcoming years. However, it appears that JT and Sure currently, and will continue to, retain a strong position in the provisioning of retail fixed call services.

Frontier Economics concluded that there remains a need for some form of ex-ante price regulation for retail fixed call services.

Question 3

Does the respondent agree that given the strong positions held by both Sure and JT in the provision of retail fixed call services there continues to be a need for ex-ante price controls for Sure and JT' retail fixed call services in the respective jurisdictions of Guernsey and Jersey? If the respondent does not agree then please provide a full justification for the response citing relevant evidence. What alternatives would you suggest and why?

Recommended form, scope and duration of next price control

Frontier Economics noted in its report that CICRA has been in continuous discussions with JT and Sure regarding the introduction of WLR and the relevant WLR charges. Frontier Economics found that the introduction of WLR does not merit a removal of the price control regulation based on the following factors:

- Operator's preliminary forecasts (to 2018) of the expected WLR take-up indicate it may only have limited impact on the market for retail fixed line services, and
- In line with approaches adopted elsewhere (i.e., by Ofcom and ComReg), there is likely to be a need to retain some form of ex-ante regulation on retail access line services even after the launch of WLR, until retail competition actually emerged.

In examining a price control Frontier Economics have therefore taken into account the impact of WLR on competition and recommend that CICRA should consider setting a price control for a single basket consisting of retail fixed access line services and retail fixed call services for a period of three years.

Question 4

Does the respondent agree that CICRA should set a price control for a single basket consisting of retail fixed access line services and retail fixed call services? If the respondent does not agree with this then please provide a full justification for the response. What alternative would you suggest and why?

Question 5

Does the respondent agree that if CICRA sets a price control for a single basket consisting of retail fixed access line services and retail fixed call services then the duration of the price control should be three (3) years? If the respondent does not agree with this then please provide a full justification for the response. What alternative would you suggest and why?

Level of price control going forward

In calculating the level of any price control going forward, Frontier Economics informed its analysis through:

- Price benchmarking – how the current level of retail prices in the Channel Islands compares to other comparable jurisdictions, followed by
- Cost benchmarking – assessing the potential scope for further cost reductions based on a high-level benchmarking of JT's and Sure's operating expenditures (OPEX) to those of other operators.

Based on the price benchmarking analysis Frontier Economics found that JT's retail prices in Jersey are on average 33% higher than Sure's retail prices in Guernsey. On the basis of the price benchmarking alone, a safeguard price control on the basket of retail line rental (including line connection) and calls is recommended for Sure.

Given such a wide discrepancy of 33% in average prices between jurisdictions where many features are comparable and that on a like for like basis prices in Jersey should benefit from economies of scale over Guernsey, in the absence of compelling evidence explaining such a wide difference there is evidence to suggest Jersey prices should be more closely aligned to those in Guernsey. It is acknowledged that different market features might support different average prices between two jurisdictions that are in many ways similar. However, compelling evidence to explain the existing wide differences would be needed if more significant reductions in JT's prices in Jersey were not appropriate given such a clear and obvious benchmark as prices by Sure in Guernsey, which provides evidence that Jersey consumers are paying significantly more for their fixed lines phone services.

The results of the retail OPEX benchmarking concludes that JT and Sure do not seem to have costs significantly above those of operators in other jurisdictions[2]. Frontier Economics found no obvious indications of inefficiencies within Sure or JT from its cost benchmarking.

Frontier Economics therefore concluded that the cost benchmarking does not indicate that either operator has unit costs clearly out of line with comparators and therefore recommends that the price control going forward is set primarily on the basis of the retail price benchmarking.

Question 6

Does the respondent agree that any price control should be set primarily on the basis of retail price benchmarking? If not why and what alternative would you suggest?

Recommendations

The results from the retail price benchmarking suggests that, both in an international benchmarking and in a direct comparison with JT, Sure's basket of retail line rental and calls is among the least expensive. In addition, the current price differential of 33% between JT and Sure is substantial without there being any apparent justification for such a significant difference to continue going forward.

From the cost benchmarking it has been identified that Sure's total retail OPEX per subscriber is marginally lower than JT's and both JT's and Sure's cost per subscriber are below the sample average in the benchmark set.

Based on these benchmarking results Frontier Economics conclude that there is no immediate need for a price control that would require Sure to reduce retail prices further. For JT, Frontier Economics found that there is both a need and scope for a retail price reduction as part of the next price control.

Frontier Economics recommends regulating a single basket including retail line rental, line connection and call charges. In addition, Frontier Economics recommends aligning more closely the retail prices for fixed line services across both jurisdictions by means of the next price control. A safeguard control on Sure, allowing for price increases in line with inflation is therefore recommended. Frontier Economics

2 Frontier Economics notes that the sample size is relatively small due to the lack of data availability further recommends aligning JT's prices with Sure's using an RPI-X% framework which is well tested from previous price controls in the Channels Islands.

Considering the difference in retail prices that consumers in Jersey are facing compared to those for consumers in Guernsey it is feasible that CICRA could consider forcing an immediate reduction in Jersey (i.e. bringing the retail prices closer to Guernsey by means of a single reduction of around 33%). Frontier Economics recommends that CICRA considers applying an X-factor for JT's retail prices for (standalone) fixed line services of -4% to -10% during the next price control period. The exact value of the X-Factor will depend on the relative importance of facilitating downstream competition and achieving greater parity in retail prices across the two Bailiwicks.

To summarise, the recommended level of price control going forward is:

Operator	**Recommended price control**
Sure	RPI – 0%
JT	RPI – 4% to -10%

Question 7

Does the respondent agree that CICRA should apply a RPI – 0% price control for Sure (Guernsey)? If the respondent does not agree with this then please provide a full justification for the response and suggest an alternative

Considering the 33% difference between JT's basket and that of the similar basket of Sure, CICRA is of the view that it should address this difference in the period of this price control. Therefore, CICRA is minded to apply the maximum price control recommend by Frontier Economics for the period of this price control and proposes applying a RPI – 10% price control to JT in Jersey over the term of the control.

Question 8

Does the respondent agree that CICRA should apply a RPI – 10% price control for JT (Jersey)? If the respondent does not agree with this then please provide a full

justification for the response and suggest an alternative.

The proposed duration of this price control is three (3) years. The development of competition and the choice available from WLR suggests that a longer term price control might risk placing a regulatory control in a market that is not proportionate. A short term control would not appear to allow for sufficient time to reflect market developments from WLR and/or other changes in the market that would provide sound evidence to inform subsequent controls.

Question 9

Does the respondent agree that this price control should apply for a period of three (3) years? If the respondent does not agree with this then please provide a full justification for the response and suggest an alternative

Monitoring and enforcement

CICRA's assessment of the operator's compliance with their price controls will be undertaken retrospectively on an annual basis. This annual assessment will require submission of timely information by the operators. CICRA would seek to review the compliance statements within three months of receipt. In addition CICRA would be able to use its relevant powers to inspect the operators' financial records to verify the accuracy of the operators' submission in demonstrating its compliance with the price control regime.

In addition, when an operator wishes to introduce a price change, it will need to submit an assessment to CICRA to demonstrate its compliance with the price control by completing the five steps described below. Whilst operators will not need CICRA's approval of individual price changes, these submissions will assist CICRA in assessing compliance at the end of the relevant period. CICRA may intervene however if it considers that proposal are likely to be non-compliant. In complying with the price control, operators are also required to comply with other relevant licence conditions.

Compliance Procedures

In order to demonstrate annual compliance[3] with the price controls for the services included in the price control the operators will need to undertake a number of tasks comprising:

- Quantifying the price changes for each services;
- Indexing the price changes;
- Weighting the services on the basis of revenue earned in the 12 months prior to the relevant period;
- Deriving the weighted average basket price index; and
- Comparing this with the Price Control Index incorporating RPI.

Quantify the price change for each service

This information is derived by comparing the historical (i.e. nominal) prices for each service in the price control periods.

Simply, this is the differential between the old and the new price, represented by:

$$\delta P = \frac{P_t - P_{t-1}}{P_{t-1}}$$

Where:

P_t = The weighted average price for service during the relevant price control period;

P_{t-1} = The average price for the previous relevant period.

Note that P_t should be weighted to take into account the phasing of any price changes during the relevant period. If the price change were introduced at the start of a relevant period then the new price could be used as P_t for the purposes of the calculation. If however the price change were introduced midway through the year, then the P_t would need to reflect 0.5 of P_{t-1} and 0.5 of the new price to reflect the average price for the service over the period[4].

[3] Operators should also follows these steps when notifying ICRA of changes in the prices of price controlled products for the duration of the price control.

[4] In calculating average prices over a price control period, the operator should use of a weight of n/365 for a price that was offered for n days.

Index the price change for each service

Once the price change has been quantified, the next step is to index the price changes. The indexed price (IP) for each service is derived from the following formula:

$$IP_i \ = 100 * (1 + \ \delta P)$$

Where:

IP_i = Indexed priced for service one within a basket

Weight services based on revenue in the relevant period

Weights for each service in the basket are derived from each service's percentage share of total revenue in that basket. Thus the sum of the weights of all the services within the basket equals 1.

Thus:

$$W_i \ = \frac{R_i}{R_B} \ subject \ to \ 1 \ = \sum_i^n W_n \ and \ R_B \ = \sum_i^n R$$

Where:

W_i = weight for a given service in the basket;

R_i = the amount of actual revenue for the previous relevant period that is derived from that individual service;

R_B = the amount of total revenue in the previous relevant period that is derived from a combination of all services in the basket.

Derive the weighted average basket price index (Actual Price Index)

The Actual Price Index (API) is calculated by combining the weights for each individual service with the indexed price changes and summing the products.

$$API = (IP_1 * W_1) + \ (IP_2 * W_2) + \cdots + (IP_n * W_n)$$

Compare with Price Control Index incorporating RPI

The final step involves:

- Calculating the Price Control Index (PCI) for the basket; and
- Comparing the PCI with the API to assess compliance.

The PCI is:

$$PCI = 100 * (1 + RPI - X)$$

Where:

RPI = the measure of inflation for the relevant price control period. This is obtained from the Economics and Statistics Unit within government.

X = the efficiency factor applied to the basket.

The Compliance Decision

The Basic Price Control Rule is that the API over the relevant period must be equal to or less than the PCI.

$$i.e. API \leq PCI$$

If the API is greater than the PCI then the operator would have failed to comply with the price control regime.

However, if the operator's API for a basket at the end of the relevant period is lower than required by the PCI, it ***may*** be able to carryover the difference into the next charge control year subject to CICRA's approval. Conversely, if the operator's average charge is higher than the required level, it will be obliged to remedy the situation as CICRA may reasonably require. CICRA may also impose sanctions on an operator for failing to comply with the price control regime imposed by CICRA.

Question 10

Does the respondent agree with the price control compliance methodology proposed by CICRA? If the respondent does not agree with this then please provide a full justification for the response and suggest an alternative

5. Next Steps

CICRA will consider responses received and the evidence provided to inform its position on Retail Price Controls for JT and Sure. Following consideration of the responses received, as a next step CICRA would then intend to issue an Initial Notice in Jersey and a Draft Decision in Guernsey.

Annex A – Frontier Economics Report

Annex B - Legislative and Licensing Background

Legislative background and regulatory duties in the Channel Islands

The legislative bases for this consultation in Jersey are provided by the Competition Regulatory Authority (Jersey) Law 2001 and the Telecommunications (Jersey) Law 2002. In Guernsey, the relevant legislation is The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001, The Guernsey Competition and Regulatory Authority Ordinance, 2012 and The Telecommunications (Bailiwick of Guernsey) Law, 2001. Any decision resulting from this consultation will be based on relevant laws and duties of the GCRA and the JCRA respectively.

The relevant duties of the JCRA in the telecommunications sector are those defined in Article 7 of the Telecommunications (Jersey) Law 2002; the relevant duties of the GCRA are those defined in Section 2 of The Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 and transferred to it by Section 5 of the 2012 Ordinance mentioned above. In addition, there is scope for the States of Guernsey and States of Jersey to give directions to the GCRA and the JCRA respectively.

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

"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 its 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[5]:

- 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

[5] *Responses 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*

- Call termination on individual public telephone networks provided at a fixed location.

In Guernsey, Section 5(1) of the Telecommunications (Bailiwick of Guernsey) Law, 2001 ("the Telecoms Law"), provides that the AUTHORITY may include in licences such conditions as he considers necessary to carry out his functions. The Telecoms Law specifically provides that such conditions can include (but are not limited to):

- Conditions intended to prevent and control anti-competitive behaviour[6]; and
- Conditions regulating the price premiums and discounts that may be charged or (as the case may be) allowed by a licensee which has a dominant position in a relevant market[7].

In accordance with these provisions in the Telecoms Law, both the "Fixed Telecommunications Licence Conditions"[8] and the "Mobile Telecommunications Conditions"[9] awarded to Sure (Guernsey) include the following text:

"The Director General may determine the maximum level of charges the Licensee may apply for Licensed 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 Licensed Telecommunications Services or categories of Licensed Telecommunications Services or any combination of Licensed Telecommunications Service;
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 the determination applies."

This condition allows the AUTHORITY to regulate the prices that a licensee charges for its telecommunications services in a way and for a time that he deems appropriate, where the licensee has a dominant position in the market.

[6] *Condition 5(1) (c) of the Telecommunications (Bailiwick of Guernsey) Law, 2001*
[7] *Condition 5(1) (f) of the Telecommunications (Bailiwick of Guernsey) Law, 2001*
[8] *Document OUR 01/18; Condition 31.2*
[9] *Document OUR 01/19; Condition 27.2*