Retail Price Control

2016

Second Initial Notice

issued to JT (Jersey) Limited

Document No: CICRA 16/20 **April 2016**

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

CONTENTS

1. Executive summary

Retail fixed line services include calls using fixed line phones, exchange lines and a range of related services associated with having a fixed line phone service. Jersey consumers spend around £16m[1] per annum on these services provided by JT (Jersey) Limited (**JT**). This document, issued by the Jersey Competition Regulatory Authority (**JCRA**), proposes a price control on the retail fixed line services of JT, as the dominant provider of those services in Jersey. It does not cover other retail services such as residential and business broadband or leased line services.

The need for the regulatory oversight of JT's prices arises from its position of dominance, which would allow it, absent of control, to raise prices independently of its customers or its competitors. Regulatory control is therefore appropriate for as long as this concern remains. This concern would reduce if the strength of dominance is reduced due to effective competition that delivered real choice for consumers. However, given the very early stages of the development of such competition and the continued absence of consumer choice the JCRA considers it appropriate to continue to control prices. Should effective competition develop rapidly the JCRA will revisit this issue.

The effect of a new access product, currently wholesale line rental (**WLR**), on the development of effective competition has not yet been proven[2]. The JCRA therefore considers the threat of competition is not sufficient to constrain JT's dominant position and therefore the JCRA will continue to apply controls.

However, the introduction of WLR has informed the approach taken by the JCRA in setting prices for these services. Unfortunately, JT was unable to provide forecasts of costs and revenues that a price control model would require in response to information requests from the JCRA's consultant. An assessment was therefore based on current or most recent prices and costs and relied on benchmarking information.

Given the possibility that competition will develop and considering the absence of data/forecast information the JCRA has taken a light touch approach to setting the levels of

[1] *JT Separated Accounts 2013*

[2] *The telecoms industry in the Channel Islands has been working with the Channel Islands Competition and Regulatory Authorities (CICRA) on the development of new wholesale access products aimed at increasing choice and competition. WLR is a wholesale access product that affords a less extensive form of competition than those access products commonly available in neighbouring jurisdictions and was launched across both Jersey and Guernsey on 1 June 2015. WLR is also a recent development in the Channel Islands and was introduced several years later than envisaged.*

the control. This approach is predicated on the potential for the development of effective competition and the desire to avoid unnecessary regulatory burden. Should competition not develop the JCRA will reconsider this approach.

The JCRA proposes a 'price basket' control which is a light touch benchmarking approach to price control rather than a bottom up cost based approach. This approach gives JT more flexibility than alternative forms of control and therefore enables JT to respond to a greater extent to competition than a control set on a product by product basis.

The JCRA's proposed determination is that the basket of charges levied by JT for its retail fixed line services shall be reduced by RPI – 6.5% for year one, RPI – 6.5% for year two and RPI – 0% for the third and final year of this price control. Further detail is set out in this document with the timing of any final decision subject to the process set out in section 4. It is proposed that the determination will remain in place until replaced or removed following a review by the JCRA.

2. Introduction

Background

The last detailed price control review of JT, in Jersey, was set in 2008, initially covering a period up to 2011. Since then, JT has been subject to short term controls essentially allowing for price increases in line with the retail price index (RPI). This was decided on the basis that while the concerns regarding JT's dominant position remained high in the relevant market, the prospect of greater competition through the introduction of more extensive wholesale access products could have a significant bearing on the longer term regulatory approach to controls intended to protect consumers of fixed line services. In the event a less extensive form of wholesale access product, WLR, was introduced in June 2015, much later than envisaged. This informed the approach to controls given the likelihood of dominance remained high.

Given the delay in achieving the increased benefits of further competition and the less extensive form of wholesale access competition to be introduced by June 2015, the Channel Islands Competition and Regulatory Authorities[3] (CICRA) decided in 2014 to undertake a formal price control review of JT in Jersey and Sure (Guernsey) Limited (**Sure**) in Guernsey for their retail fixed line services. To support this process Frontier Economics was commissioned to carry out a review to inform any future price controls.

---

[3] *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.*

CICRA issued a pan-Channel Island consultation in March 2015 (CICRA 15/10). That document considered the appropriate forward looking price controls for Sure in Guernsey and JT in Jersey. The consultation was informed by the Frontier Economics report. A redacted version of the full report prepared by Frontier Economics was included in Annex A of the consultation document and is included with this Initial Notice. In recommending the duration, scope and form of the next price control Frontier Economics took into account the potential impact of WLR on competition.

Frontier Economics recommended regulating on the basis of a single price control basket including retail line rental, line connection and call charges. It recommended aligning more closely the average level of retail prices for fixed line services across the Guernsey and Jersey jurisdictions. In particular, Frontier Economics recommended aligning JT's average prices with those of Sure, maintaining that those offered a reasonable reference using an RPI-X% framework which is well tested from previous price controls in the Channels Islands. In its view, as a smaller island jurisdiction with similar features, Sure offered a reliable reference average price for JT's retail fixed line services.

Three responses were received to CICRA's consultation.

Following the consultation the JCRA, on 17 December 2015, issued an Initial Notice (CICRA 15/55) to JT. JT provided a response to that Initial Notice.

Following the consultation and considering the response received to the Initial Notice from JT, the JCRA has decided to issue this second Initial Notice. This document proposes the duration, form, scope and level of a future price control.

Disclaimer

This document does not constitute legal, technical or commercial advice; the JCRA 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 the JCRA to exercise regulatory powers generally.

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

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

Email: *info@cicra.je*

All responses should be clearly marked *"Initial Notice on JT Retail Price Control 2016"* and should arrive by 5pm on **26 May 2016**.

In line with CICRA's consultation policy it intends to make responses to the consultation available on the CICRA website www.cicra.je . Any material that is confidential should be put in a separate annex and clearly marked as such so that it may be kept confidential. The JCRA regrets that it is not in a position to respond individually to the responses to this consultation.

3. Responses to the Consultation

Introduction

JCRA received a total of three responses to its pan Channel Island consultation on retail price control review, from:

- Sure;
- JT, and
- Airtel-Vodafone (Airtel).

All three were provided on a pan Channel Island basis or specifically addressed both Guernsey and Jersey issues. Airtel's response was more general in nature.

In addition, JT and Sure responded to the Initial Notice (CICRA 15/55).

The JCRA would like to thank each of the respondents for their input to this process. The non confidential sections of the responses are published on the CICRA website, *www.cicra.je*.

Rationale for price control

The EU regulatory framework in its recommendation of 17 December 2007[4] states that regulatory controls on retail services should only be imposed when national regulatory authorities consider the relevant wholesale measures, or measures regarding carrier selection or carrier preselection, would fail to achieve the objective of ensuring effective competition and public interest[5].

In the Jersey fixed line services market, alternative providers do not have the necessary infrastructure to compete with JT. The market for these services has a limited form of retail competition where the wholesale products in place are essentially 'resell' services. Competitors pay a wholesale rate to JT for the equivalent JT retail services and offer them to customers. The scope for competitors to offer variety, innovation or sell at a discount to JT is limited given the nature of such wholesale products available to them. In these circumstances the challenge facing competitors to offer more attractive propositions than JT in order to win customers from JT are significant. It is also relevant that the prices of those

[4] 2007/879/EC, Commission Recommendation on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services

[5] *Paragraph 15*

key wholesale inputs are generally set by reference to JT's own retail prices; efficient wholesale charges paid by its competitors in this market therefore rely on efficient retail prices by JT.

Fixed line services in Jersey are provided to 59,765[6] customers. Those customers generated over 168 million minutes of calls in 2013[7] of which JT has a market share of approximately 88% despite the legal monopoly by JT having ended on 1 January 2003, nearly 12 years ago. The challenges competitors face in winning customers from the former monopoly is a significant contributing factor to the prevailing high market share held by JT for such a long period of time.

Wholesale measures in Jersey are not yet at a stage where they can be considered to achieve the objective of ensuring effective competition in the Jersey market. The JCRA as the regulatory body has a duty to protect consumers of telecommunication services in Jersey. As effective competition or the potential of effective competition is not yet sufficient to protect consumers interests the JCRA proposes to continue to apply price controls in the market.

Frontier Economics, in its report, concluded that: "*competition for retail fixed line services appear to remain limited in … Jersey. In particular: (i) there are limited alternative offerings to the incumbent's retail fixed access line services; and (ii) both operators[8] have retained a dominant position in their respective market for retail fixed line services*."

The following relevant features at the time of its report were noted:

- 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 was no wholesale access service, with WLR only due to be launched in June 2015[9].
- 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 access customers in the Channel Islands are substituting away from fixed access line services to these alternative products.

---

[6] *Telecommunications Statistics Market Report, 2013, CICRA 15/39, September 2015*

[7] *Telecommunications Statistics Market Report, 2013, CICRA 15/39, September 2015*

[8] *i.e., JT in Jersey and Sure in Guernsey*

[9] *WLR was subsequently launched on 1 June 2015.*

Frontier Economics found that the introduction of WLR did 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;
- JT's dominant position will continue. Dominance means that the firm can raise prices irrespective of consumers and competition and therefore price control is still needed; 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 fixed line services even after the launch of WLR, until retail competition actually emerged.

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 in the respective geographic markets of Guernsey and Jersey and there is a continued need for ex-ante price controls for Sure and JT's retail fixed access line services in their relevant markets.

Responses

Sure in its response said that until WLR becomes established across the Channel Islands it would be difficult for each incumbent operator to argue that it is not dominant in the provision of fixed line services in their respective island, i.e. Sure in Guernsey and JT in Jersey. Sure responded with in principle agreement on the need for ex-ante price controls, but had concerns as to how these might be applied. It requested that the JCRA further considers how it intends to monitor and ensure compliance particularly as bundles would soon be allowed to include retail fixed lines. Sure also considers that it is important for the JCRA to reinforce to incumbent operators that the relevant licence conditions must still be adhered to. Specifically that the JCRA should avoid any potential ambiguity with regards to what level a margin squeeze test would be set[10].

JT, in its response, stated that the introduction of WLR in the Channel Islands removes the barriers to entry which may have led the JCRA to previously designate JT as having dominance in the retail market. JT considers that regulating retail line rental prices "is an anachronistic regulatory tool, which is not appropriate in 2015 in Jersey".

Over 3,000 customers were connected using WLR in the months since its launch. JT considers that the fact that customers were able to move is such numbers demonstrates

[10] *Sure has raised concerns that margin squeeze issues may arise by intent or effect following the introduction of WLR*

that the introduction of WLR has reduced barriers to entry and/or allowed competitors to successfully enter the retail market and/or facilitated competition.

JCRA Analysis

The need for the regulatory oversight of JT's prices arises from its position of dominance, which would allow it, absent of control, to raise prices independently of its customers or its competitors. Regulatory control is therefore appropriate for as long as this concern remains. This concern would reduce if the strength of dominance is reduced due to effective competition that delivered real choice for consumers. However, given the very early stages of the development of such competition and the continued absence of consumer choice the JCRA considers it appropriate to continue to control prices. Should effective competition develop rapidly the JCRA will revisit this issue.

The introduction of the new access products, currently WLR, and its contribution to effective competition has not yet been proven. The JCRA therefore considers the threat of competition is not sufficient to constrain JT's dominant position and therefore the JCRA will continue to apply controls. However, it has informed the approach taken by the JCRA in setting prices for these services. Unfortunately, JT was unable to provide forecasts in response to information requests from the JCRA's consultant. An assessment was therefore based on current or most recent prices and costs and relied on benchmarking information.

Given the possibility that competition will develop and considering the absence of data/forecast information the JCRA has taken a light touch approach to setting the levels of the control. This approach is predicated on the potential for the development of effective competition and the desire to avoid unnecessary regulatory burden. Again, should competition not develop the JCRA will reconsider this approach.

The market in Jersey is experiencing the early stages of competition and it is difficult to predict how effective competition will be, therefore there remains a need for price control. In the absence of more extensive wholesale access products that support greater competition, where the benefits of competition for consumers are likely to be evident in greater levels of switching between providers, prices in line with relevant benchmarks, significant improvement in current customer satisfaction levels and greater variety and innovation available to consumers, the JCRA considers that appropriate certainty and protection for consumers is better provided by the use of a price control supplemented by appropriate licence conditions and other regulatory measures.

JCRA Conclusion

The JCRA has concluded that the introduction of WLR has not altered the competitive landscape to the extent that it alters a finding of significant market power (SMP) for JT in the provision of retail fixed line services in Jersey or the need to price control such services.

Period of price control going forward

Frontier Economics recommended that the JCRA considers applying a control on JT's retail prices of fixed line services each year during a price control period of three years. Views were sought on the price control period proposed.

Responses

Sure believes that for effective and sustainable competition it may be detrimental to the market for the duration of the price control to be set for a period of three years and that a one year price control might be more appropriate. Sure considers that, with the introduction of WLR, truly equivalent locally based competition can be provided in the retail fixed call market in Jersey and Guernsey. Sure goes on to state that whilst it may be appropriate for an ex-ante price control mechanism to be maintained for one year post WLR implementation, it believes that if it is kept in place for longer, e.g. up to three years, it may cause more harm than good. While Sure did note that as WLR will still physically be provided solely on each incumbent operator's network (and therefore no differentiation in the quality of network services), and so other licensed operators will need to compete entirely on the pricing of retail calls, it considers that constraining each incumbent operator's retail call charges into a second or third year might nevertheless cause a delay in the growth of effective and sustainable competition.

JT considers that the three year proposed price control is based on an inappropriate comparison of the effect of wholesale regulation seen in the UK around 2002. It believes the JCRA should be forward looking and take into account the expected benefits of wholesale regulation in the Channel Islands by considering whether retail regulation is required. JT proposed that if the JCRA insists on the need for a retail price control for an interim period then there should be a continuation of a control for a 12 month period to avoid additional uncertainty in the market. JT considers that, following the introduction of WLR in the Channel Islands, creating certainty is important and the proposed control would shift JT's retail prices down to an uncompetitive level, with significant cuts required over three years which would bring uncertainty to the sustainable long term values. Further, JT states that this aggressive three year retail price control might stifle the development of the wholesale product or end up being unnecessary due to the wholesale product being effective in promoting competition.

JCRA Analysis

Sure does not expand on why, if there is a risk of prices being above the competitive level given market dominance, price controls will do more harm than good. The response suggests consumers could rely on competition. However the JCRA's assessment above discussed the risks of concluding consumer interests are adequately protected through competition in the fixed line services market given features of the Jersey market. This analysis is also reflected in the draft decision covering the price control for Sure Guernsey where it is found to have a similar position of market power in the Guernsey market. Locally based competition has significant limitations and is considerably weaker than that of neighbouring jurisdictions.

An important factor for any existing or potential new entrant to the Channel Island market is the degree of certainty it faces as to retail price controls imposed on the dominant provider. The JCRA must therefore balance the risks of a shorter term control as argued by the incumbents in each island, against that of a longer term control. A price control of five years or more carries risks in that market developments may overtake the need for such regulatory controls. Too short a price control could be seen as a potential barrier to entry that would deter a new entrant wishing to enter the market in the face of a lack of certainty in the wholesale charges JT may make that are otherwise constrained by a cap on its retail prices.

Based on evidence in the Channel Island market the JCRA does not believe that the market would become significantly more competitive over a short period of one year. Therefore, while there is some limited form of competition, in the absence of a price control for fixed line services it is unlikely that competition offers a sufficient restraint on prices over the short to medium term. The JCRA considers that, at this present point in time a three year price control delivers an appropriate balance of stability and predictability for all players and importantly does give the opportunity for a new entrant to enter the market with a greater degree of certainty than if a retail control was set for only one year.

However, if it becomes evident that during the period of this price control, there is a significant increase in the state of competition then the JCRA would reconsider, shortening the duration of the price control.

JCRA Conclusion

The JCRA proposes to set a price control for retail fixed access line services over three years. Where competition is seen to be effective the need for the JCRA to intervene will reduce. If the market was considered to be working well for consumers the JCRA would contemplate removal of the price control in advance of the three year control period. Evidence to support reduced intervention in this area will include the availability of more extensive wholesale access products that support a greater degree of competition beyond simple retail 'resell' offers. It would be expected that the benefits of competition would manifest in the extent of switching by consumers between providers, prices that are in line with relevant benchmark, significant improvement in current customer satisfaction levels as well as greater variety and innovation in service provision.

Scope of price control going forward

Frontier Economics recommended continuing to regulate a single basket consisting of fixed line services rather than one that included broadband. It took this view, because it argued this would ensure that the most vulnerable customers (those who continue to use fixed line services rather than a bundle) are better protected by such an approach. Frontier Economics also recommended applying the price cap only to those customers who were not previously PrimeTalk[11] subscribers and manage the discontinuation of JT's PrimeTalk offer outside the next price cap in accordance with the detailed plan set out by JT.

JT in its response stated that line rental and broadband are no longer viewed as separate products by customers and it is simpler for consumers to treat these as a single product. 68% of JT customers purchase line rental and broadband together and JT argued that customers are predominantly purchasing the line rental to use for broadband services. JT believes that this provides evidence for a reassessment of whether line rental and broadband should be considered to be in the same market. JT states that it is not appropriate to regulate the price of one of the monthly charges without reference to the other.

With the majority of JT's customers buying fixed line and broadband together, and with many using the line solely for broadband, JT argued that it is inappropriate to try and regulate the line rental price in isolation. It stated that wholesale regulations look at the combined monthly charge of these two products and it is unclear to JT why any retail regulation should be different.

Sure expressed similar views to JT on this aspect of the control.

JCRA Analysis

For the avoidance of doubt the control covers all fixed line services not only fixed exchange lines and JT is able to bundle retail broadband and fixed line services as a retail offering to customers. However, a single price control that includes broadband and fixed line services introduces risks of consumer detriment from unfair cross-subsidy between these services. JT is in the process of rolling out a fibre network in Jersey which entails significant investment costs. It is not apparent why fixed line service customers should cross-subsidise the cost of fibre rollout in Jersey. We do not accept JT's arguments that fixed line (telephony) customers share in the benefits of the investment of fibre and should share in the costs. To the extent that there are benefits, these are incidental not central to the rationale for the investment decision which is fundamentally about achieving higher data speeds. The case that these customers should be required to meet costs of the investment in fibre in Jersey

[11] *http://www.jtglobal.com/Jersey/Personal/Landline/Coreline/Prime-Talk/*

has not been made by JT. We also consider the point made by Frontier Economics is relevant in that a single price control basket for fixed line services will ensure that the most vulnerable customers (those who continue to use standalone fixed line services) are better protected. Some of the arguments by the incumbents around combined fixed line and broadband services refer to flexibility available to operators in other jurisdictions which the incumbent operators should also be able to benefit from. It is the case that rebalancing between broadband and fixed line services is available in markets where competition is stronger. The flexibility available to such operators is in a context where the recovery of cost is driven by significant competitive pressures. The same reasoning cannot be applied to JT in the Jersey market.

JT cites the low spend (<£1 per month) by around 25% of its exchange line customers to support an argument that a high proportion of retail customers only take the exchange line to receive broadband. While it is likely that some customers fall into this category, it is also the case that a proportion of JT's exchange line customers take their calls using the indirect access to JT's network provided by its retail competitors. Around 11% of originated voice calls are accounted for by this indirect access service. These JT exchange line customers would not pay much more than the retail exchange line rental each month to JT as they make calls using competitor services. The fact that JT does not receive more revenue is not because they do not use call services. It is also the case that a proportion of JT's customers are likely to take a fixed line phone for reasons other than to facilitate a broadband connection. Some customers want a fixed line phone for emergencies only, or primarily to receive calls, or only make a limited number of local calls. The inference that low spend by JT's exchange line customers implies the exchange line is only used for broadband is therefore not entirely valid and the proportion of JT customers who do so is likely to be significantly less than the figure cited by JT.

JT cites charges made by Sure for alternative payment methods to direct debit, paper billing charges and late payment fees, arguing these should be included in the price control basket and in comparators. Such charges have not formed part of previous controls and they are not proposed to be included for this control. They do need to be justified by costs as dominant operators remain in a position of market power in imposing these charges even if they are avoidable for many customers, but this regulatory oversight is undertaken outside of the price control process. There is a valid argument that such charges improve efficiency of operations and therefore deliver savings and eliminate unfair cross subsidies between late payers and those that pay on time for example. It is open to JT to introduce such charges outside the price control mechanism. However, it will be required to justify such charges.

The category of PrimeTalk customers who have a very low exchange line rental and further subsidy for calls does affect the comparisons made by Frontier Economics. Having considered JT's arguments and Frontier Economics recommendation, the JCRA considers that this class of customers should be excluded from the price control basket. They are charged at significantly lower levels than other customers and JT faces a range of pressures in moving away from the current subsidised approach. The JCRA will monitor the discontinuation of JT's PrimeTalk offer outside the price cap in accordance with the detailed plan set out by JT.

JCRA Conclusion

Given JT has dominance in the provision of retail fixed line services and the risks of consumers bearing unjustifiable cross-subsidisation between fixed line services and broadband services there is a need to set a price control for fixed line services that excludes broadband. The price control proposed would cover the following retail services:

- Exchange line;
- Fixed Line local geographic calls;
- Fixed Line non-geographic calls charged at local rate;
- Fixed Line Guernsey and National calls;
- Fixed Line non-geographic calls charged at national rate;
- Fixed Line international call;
- Fixed Line calls to Channel Island mobiles;
- Fixed Line calls to Other mobiles;
- Public Payphones;
- Exchange line connection, and
- ISDN services.

The price control basket will also exclude PrimeTalk subscribers.

Level of price control going forward

An assessment of the appropriate level of a price cap is usually made on the basis of detailed financial forecasts, comparing expected future revenues and costs, and an appropriate level of efficiency gains. A price path (cap) can then be determined which allows the regulated entity the opportunity – if it acts efficiently – to earn a reasonable rate of return. This is the approach that CICRA (JCRA/GCRA) has previously undertaken. Unfortunately, JT was unable to provide Frontier Economics with such forecasts in response to its information request and therefore an assessment had to be based on the operators' current or most recent prices and costs and 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;
- Cost benchmarking – assessing the potential scope for further cost reductions based on a high-level benchmarking of JT's operating expenditures (OPEX) to those of other operators.

This analysis is set out in greater detail in the Frontier Economics report. Given the limitations in forecast data available from the incumbent operators in each island the benchmarking approach was undertaken.

However, a strong comparator for JT in Jersey is Sure in Guernsey. In making this comparison, Frontier Economics observed substantial differences in retail prices for fixed line services across the two jurisdictions of Jersey and Guernsey where the average monthly cost to consumers for fixed line services (holding usage constant) was higher in Jersey than in Guernsey.

A key driver of the observed differences in retail prices appeared to be the underlying differences in retail price caps applied to Sure and JT over previous years. In particular, Sure had generally been subject to more stringent retail price controls than JT since 2008. This was particularly true in relation to local calls basket, for which there was a RPI-11.75% regime in place for four consecutive years compared to JT, in whose case an RPI-3% was applied between 2008 and 2011. As such, these recent retail price controls appear to have at least contributed to lower retail prices in Guernsey compared to Jersey.

Frontier Economics therefore considered it important to explore whether the prevailing differences in retail prices across the two jurisdictions was justified going forward, especially where such differences could impact the structure or extent of competition in each jurisdiction. In particular, it considered whether JT is exposed to any exogenous factors which result in it having higher (efficient) costs of delivering fixed line services than Sure in Guernsey. In the absence of such exogenous cost differences or differences in demand, it is reasonable to assume that the overall level of retail prices across Jersey and Guernsey could be similar. The following factors were therefore considered and the assessment summarized below:

- Demand - There are certain economic and geographic similarities between both jurisdictions. In terms of usage patterns and take-up of fixed line services there are strong similarities between Jersey and Guernsey. As such, this did not appear to justify significant prevailing differences in overall retail price levels going forward.

- Scales of operation - Different total population sizes drive the difference in the scale of JT's and Sure's operation, in particular, it highlighted that there are around 40,000 PSTN subscribers in Guernsey and 60,000 in Jersey. This would be expected to impact on the average costs of the operators, as a larger scale of operation is likely to lead to lower per subscriber cost. As such, if at all, it would be expected that JT's larger total customer base should allow JT to benefit from higher economies of scale than Sure.

- Fibre investments - JT has in recent years invested in the roll out of its fibre network (a total of around £41.5m was invested by JT and the States of Jersey) whereas Sure chose a more incremental approach to fibre rollout. This was a decision by JT (and the States of Jersey), with the objective of enabling faster broadband speeds. Whilst this will add to JT's costs, these are associated with the fibre roll out and JT's broadband, rather than its fixed voice service. This cost difference would therefore not be taken into account in a price cap review of fixed line services.

To the extent that differences therefore appear to be either driven by different levels of efficiency, or one operator earning a rate of return in excess of cost of capital, rather than exogenous cost differences, Frontier Economics argued it seems reasonable to consider taking this into account in setting the price control for JT.

Based on its benchmarking results Frontier Economics concluded that for JT, there is both a need (based on the price benchmarking) and scope (based on the cost benchmarking) for retail price reductions as part of the next price cap. In summary, Frontier Economics conclude that JT should, in principle, be able to align its overall level of retail prices to Sure's on the following grounds:

1. JT has currently comparable operating expenditure (OPEX) per subscriber and should be able to achieve lower cost due to its larger scale of operation. If fibre related investments were not recovered from JT's retail fixed line services this would most likely further reduce the cost of its dominant business in its separated accounts;

2. JT was in any event able to generate a higher return on Mean Capital Employed in 2012 than Sure in Guernsey; and

3. The discontinuation of its PrimeTalk tariff will increase JT's revenues by more than £2m over the next four years, which will help JT to partly offset the lost revenues from lower retail prices.

Frontier Economics analysis of the retail OPEX benchmarking concluded that JT did not appear to have costs significantly above those of operators in other jurisdictions and concluded that there were no obvious indications of inefficiencies within JT from its cost benchmarking analysis, though this does not offer conclusive evidence that there was no room for achieving further cost efficiencies or offer evidence to change the conclusions of the price benchmarking.

Frontier Economics recommended that the JCRA consider applying an X-factor for JT's retail price control of fixed line services of -4% to -10% each year during a price control period of three years. The exact value of the X-Factor would depend on the relative importance of facilitating downstream competition and achieving greater parity in retail prices across the Channel Islands.

In summary, the recommended level of price control by Frontier Economics going forward in the consultation was:

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

Responses

Sure agreed with the recommended approach but reiterated, as did JT, arguments for retail broadband services to be included in the control basket, with JT citing the context in which WLR prices were set.

JT argued that there has been a shift from retail to wholesale level regulation internationally and with the introduction of WLR in the Channel Islands the JCRA should follow the international trend and remove the retail price control.

Sure stated that JT's prices are significantly higher than its own in Guernsey and that the JCRA should not allow JT to continue to benefit from continuing to charge prices that are greater than Sure's for 35 months (duration of the price control before JT's prices align with Sure's). Whilst Sure and JT agreed to review the pan Channel Island WLR product elements six months after launch, Sure raises the question of what would happen if JT refused to reduce its wholesale call rates such that as an RPI – 10% price control took hold at the retail level JT could create deliberate margin squeeze. Sure believes it would be penalised by this action and could be the cause of customers not switching to Sure.

JT in its response argued that the benchmarking and conclusions presented by Frontier Economics are not fit for purpose. The price benchmarking was, in JT's opinion, based on an inadequate selection of comparators and incorrect data from those countries. JT considers it is inappropriate to directly compare Sure and JT's line rental. JT has considered that the JCRA have merely compared JT's price with Sure's price and have proposed reducing JT's price so that it is the same. JT cites a number of reasons why such an approach is not appropriate:

- Historically JT and Sure's line rental prices have differed;
- JT and Sure's differing cost structures make direct comparisons difficult making it inappropriate to try and fix one element of the pricing;
- JT's line rental reflects the significant investment it has made in fibre, and
- Sure's line rental price used in Frontier Economics' analysis misrepresents the price paid by customers. There are a number of regular charges paid by Sure's line rental customers which JT does not impose on its customers.

In its response JT highlighted a number of issues with the benchmarking:

- JT's standard rental price cannot be used in isolation. Prime Talk must be accounted for within JT's price;
- Sure's line rental price. The comparison used out of date information as JT believes that the JCRA was aware of the changes Sure implemented to its line rental (increasing line rental by £2 whilst at the same time reducing its broadband rental by £2) during the period of the review;
- Other line rental:
    - Use of the wrong Manx Telecom tariff;
    - Exclusion of recent BT line rental in one of Frontier Economics' comparisons;
    - Quoting wrong price for TI San Marino's line rental, and
    - Quoting wrong price for LIME Cayman Islands.

JT in its response has compared revised benchmarking figures which show the JT average line rental (£10.59) being below the benchmarked average (£13.06) with the JT standard line rental being slightly above the benchmarked average. This re-analysis by JT also shows JT's average line rental price to be 12% lower than Sure's.

Airtel, in its response, stated that based on the evidence that JT's prices were 33% higher than those in Guernsey it believed that consumers should not have to wait three years to achieve parity when a onetime drop of 30% would achieve that immediately.

JCRA Analysis

Some of the points raised in this section have been dealt with in previous sections and are not restated in full here.

The responses by JT and Sure appear to suggest there was a formal price control set by the JCRA and the GCRA in respect of the WLR price. The JCRA did not set the pricing for WLR; while the JCRA provided guidance to the parties by drawing on margin squeeze test principles the operators negotiated the wholesale price at launch. The JCRA recognises there has been a shift from retail to wholesale level regulation internationally. However, competition is still in its early stages in Jersey compared to other jurisdictions.

Much of JT's concern with the persuasiveness of benchmarked prices focused on the exchange line price. As explained above Frontier Economics recommended that the price control should be a basket approach. The mix of fixed line services is therefore relevant to the benchmarking conclusions rather than individual service prices in setting price caps. A single basket price control for fixed line services also provides JT with greater flexibility than alternative forms of control in that it can adjust prices for services within the overall basket subject to complying with an overall cap. This is less prescriptive than a control that sets individual prices and gives JT some ability to respond to competition while providing an aggregate level of protection of consumers who take fixed line services.

JT highlighted certain errors in Frontier Economics comparators, citing Isle of Man, TI San Marino, LIME Cayman Islands and BT prices different to those in the report. The benchmarking has been used to ensure that Channel Island retail price is not out of line with benchmarked countries.

The key basis for the recommended level of control did not ultimately rely on these comparator jurisdictions. Frontier Economics in fact noted in its report that the sample they were able to assemble is relatively small due to the lack of data availability and this aspect of their analysis should therefore be treated with caution. For this reason the assessment looked in greater detail at what was considered the strongest comparator in the Guernsey market given the similarities between that jurisdiction and Jersey. It notes that both in an international benchmarking and in a direct comparison with JT, Sure's basket of retail line and calls compares well and concludes that it is therefore reasonable to establish whether there are sound reasons for differences in what consumers in Jersey are paying compared to those in Jersey.

The JCRA, since it first Initial Notice in December 2015 has carried out further research and investigations on the price control basket differences between Sure and JT.

Both operators over the past year, have amended prices and therefore it is difficult to take a static point in time to consider the price difference between JT and Sure. At the time of the assessment by Frontier the difference between the operators basket was 33% with JT being the highest. Price changes, by both operators, over the period of the process of review and setting of the price control have resulted in a narrower gap, even after both operators have raised prices.

Over time the price baskets for JT and Sure can be shown as follows:

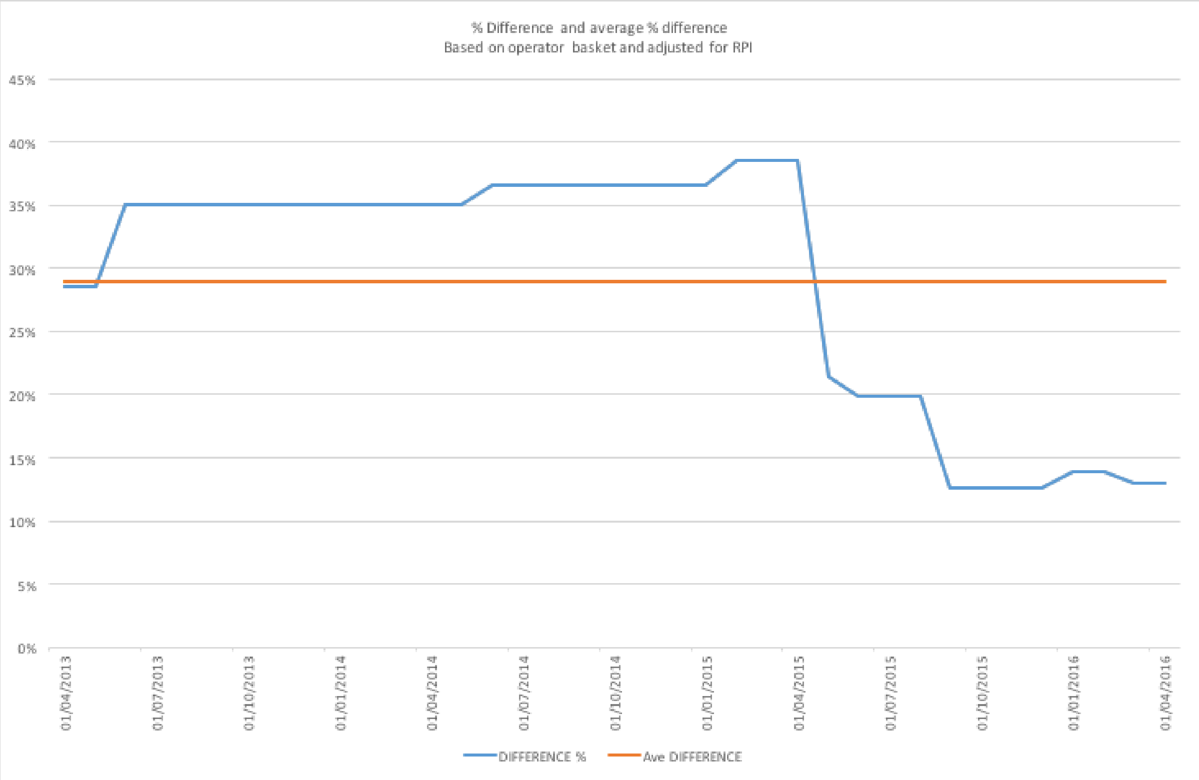

Figure 1: Percentage and average percentage difference between Sure (Guernsey) and JT (Jersey)

The graph shows the percentage difference of price control basket between the two operators. The baskets are based on the operator's volume of calls (as supplied to Frontier Economics) and taking into account the OECD methodology. Prices have also been adjusted for RPI using RPI data for both islands.

The graph clearly shows that over the period of the analysis the average difference between JT and Sure has been greater than 30%. However, owing to recent price changes by both operators over the last 12 months prices are now around 13% different.

Taking into account the call volume profiles of JT and Sure as well as the effect of RPI over the three year period Figure 1 above shows that the averaged difference between the JT prices in Jersey and the prices in Guernsey, over the three year period April 13 to April 16 is now closer to 30%. The first two years analysed show a difference in the area of 35%.

Based on the range advised by Frontier Economics, taking into account the changes since the consultation was issued and carrying out further analysis of historical prices changes, the JCRA has revised the price control on JT to the following:

The last twelve months the price difference is closer to 13%. Whilst consumers have, during the three years of the analysis been subject to prices that appear higher than was justified given this pricing differential between the two islands the JCRA has taken into consideration that the last year has seen this average reduce. Therefore the JCRA is proposing the following price control on JT in Jersey.

Year	Price Control
1	RPI – 6.5%
2	RPI – 6.5%
3	RPI – 0%

JCRA Conclusion

The JCRA proposes to impose the following retail price control on JT in Jersey where increases are limited to no more than: Year 1: RPI – 6.5%, Year 2: RPI – 6.5% and Year 3: RPI – 0%.

Monitoring and enforcement

In the consultation the JCRA stated that its assessment of JT's compliance with this price control will be undertaken retrospectively on an annual basis. This annual assessment will require submission of timely information by JT. The JCRA would seek to review the compliance statement within three months of receipt. In addition the JCRA would be able to use its relevant powers to inspect JT's financial records to verify the accuracy of its submission in demonstrating its compliance with the price control regime.

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

Responses

Sure welcomed the JCRA's proposal in relation to the average weighting of prices during the relevant price control period as it will, in Sure's opinion, disincentivise operators from timing price changes to maximise profit/minimise losses. Sure considers that in addition to the JCRA requesting the timely submission of the compliance statements, the JCRA should also review the submissions in an equally timely manner.

JT did not address this question in its response.

JCRA Analysis

The JCRA proposes that the approach proposed is suitable. In addition the JCRA notes Sure's additional request to ensure that the JCRA should review compliance statements in an equally timely manner. In addition, the control period will start on the effective date of this Notice. For completeness, the compliance monitoring methodology is included in Annex 2 of this Initial Notice.

JCRA Conclusion

The proposed price control compliance methodology will be implemented at the same time as the introduction of the new retail price control. The control period will commence on the effective date of the new price control.

4. Initial Notice

The JCRA gives Initial Notice of its decision to make a determination under Condition 33.2 of JT's licence as follows:

> That by reference to the monitoring and enforcement framework in Annex 2 of this Initial Notice the charges levied by JT shall be reduced by RPI – 6.5% for year one, RPI – 6.5% for year two and RPI – 0% for the third and final year of this price control.

It is proposed that the determination will take effect no later than **one calendar month from the date the final decision is issued and** will remain in place until replaced or removed following a review. In the situation of the price control being in place for longer than the three years the third year's RPI – 0% will remain in place. In the event that representations or objections are received in response to this Initial Notice, the effective date of the determination will be set out in a Final Notice under Article 11(4) of the *Telecommunications (Jersey) Law 2002.*

Annex 1: Legal Background and licensing framework

Legislative background and regulatory duties in the Channel Islands

The legislative basis for this Initial Notice in Jersey is provided by the Competition Regulatory Authority (Jersey) Law 2001 and the Telecommunications (Jersey) Law 2002. Any decision resulting from this consultation will be based on relevant laws and duties of the JCRA.

The relevant duties of the JCRA in the telecommunications sector are those defined in Article 7 of the Telecommunications (Jersey) Law 2002. In addition, there is scope for the States of Jersey to give directions to the JCRA.

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[12]:

- 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.

[12] *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*

Annex 2: Monitoring and Enforcement

The price control will be based on a weighted average basket price index. The JCRA's assessment of JT's compliance with this price control will be undertaken retrospectively on an annual basis. This annual assessment will require submission of timely information by JT. The JCRA would seek to review the compliance statement within three months of receipt. In addition the JCRA would be able to use its relevant powers to inspect financial records to verify the accuracy of submission in demonstrating compliance with the price control regime.

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

Compliance Procedures

In order to demonstrate annual compliance[13] with the price controls for the services included in the price control JT will need to undertake a number of tasks comprising:

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

The list of relevant services in the price controlled basket are:

- Exchange line;
- Fixed Line local geographic calls;
- Fixed Line non-geographic calls charged at local rate;

[13] *JT should also follow these steps when notifying JCRA of changes in the prices of price controlled products for the duration of the price control.*

- Fixed Line Jersey and National calls;
- Fixed Line non-geographic calls charged at national rate;
- Fixed Line international call;
- Fixed Line calls to Channel Island mobiles;
- Fixed Line calls to Other mobiles;
- Public Payphones;
- Exchange line connection, and
- ISDN services.

NOTE – PrimeTalk customers are excluded from the price control basket.

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 the service during the relevant price control period;

P_{t-1} = The weighted average price for the service during 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. For example, 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[14].

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:

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

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

Where:

IPi = Indexed priced for service i 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 over the previous year. Thus the sum of the weights of all the services within the basket equals 1.

Thus:

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

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 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 prior year of the relevant price control period. This is obtained from Statistics Unit of the States of Jersey. The December RPI figure will be used.

X = the efficiency factor applied to the basket in a given year.

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 JT would have failed to comply with the price control regime.

However, if JT'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 the JCRA's approval. Conversely, if JT's average charge is higher than the required level, it will be obliged to remedy the situation as the JCRA may reasonably require. The JCRA may also impose sanctions on JT for failing to comply with the price control regime it has imposed.

In the event of negative inflation the approach set out in the analysis section will apply. As an illustrative example, if the relevant RPI in a year were to be -2% followed by 4%, while the PCI would reduce to 98 in the first year, JT would not be required to reduce its API by 2% in that first year. But JT could also not raise its average prices by 4% the following year. The ceiling for any rise would be capped by the 101.92 index for any average price the following year, essentially limiting such increases to 1.92% for that subsequent year.