PSTN Termination Rates in Jersey

Initial Notice

Proposed direction to JT (Jersey) Limited

Document No: CICRA 12/38 **30 July 2012**

Jersey Competition Regulatory Authority,
2nd Floor, Salisbury House,
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Contents

1. Introduction

Fixed-line termination rates are the fees charged to other telecommunications companies by the operator of a fixed-line network to terminate calls on that network. They are a key component of the retail charge that telecoms customers ultimately pay for calls to a fixed line service.

In Jersey, the rate currently charged by JT (Jersey) Limited ("JT") under its reference offer for interconnection services ("RIO") for call termination on its public switched telephone network ("PSTN") in Jersey is 0.992 pence per minute ("ppm").

The issue of the level of call termination rates for PSTNs (referred to in this document as fixed termination rates, or "FTRs"), and the need to ensure such charges are set at levels that reflect the efficient and cost-effective provision of terminating services, is a matter currently under review by regulators in certain European countries. Many National Regulatory Authorities ("NRAs") in the European Union ("EU") have decided that FTRs should be based on LRIC (i.e. "Long-Run Incremental Cost") and it is anticipated that this will further reduce FTRs in the coming years.

In Guernsey, the former Office of Utility Regulation ("OUR") (now the Guernsey Competition and Regulatory Authority ("GCRA")) has carried out two separate reviews of interconnection rates (including FTRs) since 2006. The most recent review in 2009 led to Cable & Wireless Guernsey Limited ("CWG") having its FTR capped at 0.428 ppm with effect from 1 April 2010.

The Jersey Competition Regulatory Authority ("JCRA") has been reviewing the charges applied by JT for all interconnection services and this Initial Notice sets out the JCRA's proposals with regard to FTRs only. The JCRA is separately consulting on its proposals for the level of mobile termination rates ("MTRs") charged by JT and the two other existing mobile network operators in Jersey.

In this Initial Notice, the JCRA is proposing to cap FTRs for JT at 0.428 ppm, being the same rate as has applied for CWG in Guernsey since 2010. It is also proposed that the FTR cap would be back-dated to 1 April 2012. This would be a flat rate (i.e. no time of day or weekend distinction) and calls would be charged on a per second basis (no minimum call charge or call duration). This would in effect put in place a common FTR across the Channel Islands. It is proposed that this cap would remain in place until 30 September 2013 when it is intended that a further revised FTR would be determined for both Jersey and Guernsey. Account will be taken of international developments, such as the move to LRIC based pricing, before deciding whether any further change is required.

This document summarises the issues involved, and sets out the direction that the JCRA proposes to issue to JT under and Condition 34.1 of the Class III licence issued to JT by the JCRA under Article 14(1) of the *Telecommunications (Jersey) Law* 2002 (the "Telecoms Law").

It constitutes the Initial Notice of the proposed direction under Article 11(1) of the Telecoms Law. The JCRA is now inviting comments on its proposed direction.

2. Structure of the Initial Notice

2.1 Structure of Initial Notice

This Initial Notice is structured as follows:

Chapter 3: sets out the legal and regulatory background to the JCRA's proposals for regulating FTRs;

Chapter 4: sets out the developments in other jurisdictions in regulating FTRs;

Chapter 5: sets out the proposed direction to JT with respect to FTRs; and

Chapter 6: sets out the next steps.

2.2 Timetable for Responses to Initial Notice

Responses to this Initial Notice should be submitted in writing and should be received before 9.00am on 28 August 2012. Written comments should be submitted to:

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

Or by email to **daniel.vincent@cicra.je**

In accordance with CICRA's policy, non-confidential responses to the Initial Notice will be made available on CICRA's website (www.cicra.je). Any material that is confidential should be put in a separate annex and clearly marked so that it can be kept confidential.

3. Legal Background & Regulatory Framework

3.1 Legal Background

Article 16 of the Telecoms Law provides that the JCRA may include in licences such conditions as it considers necessary to carry out its functions. The Telecoms Law specifically provides that licences can include:

- conditions for the prevention or reduction of anti-competitive behaviour; and
- conditions allowing the JCRA to make determinations.

A Class III licence also includes conditions relating to the requirement to provide interconnection services and the production of a RIO. The JCRA has previously issued directions to JT on the production of a RIO[1].

3.2 Regulatory framework

In April 2010, following a review of the markets for telecoms services in Jersey[2], the JCRA made the following decision with respect to significant market power ("SMP") in markets relevant to this Initial Notice:

> *3. Call termination on individual public telephone networks provided at a fixed location: JT has SMP in this market;*

Condition 33.2 of the licence issued to JT provides that:

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

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1 *Direction of the JCRA 2004/3 Re: Jersey Telecom Limited's Reference Interconnect Offer,* 29 April 2004, see http://www.cicra.gg/_files/040429%20Initial%20Notice%202004-3.pdf

2 *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*, 21 April 2010, see http://www.cicra.gg/_files/100420%20market%20review%20decision.pdf

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 therefore allows the JCRA to regulate the prices that JT charges for telecommunications services in a way and for a time that it deems appropriate, provided that JT has a dominant position in the relevant market in which those services are supplied.

Condition 34.1(c) of JT's licence is designed to protect fair competition in the markets in which JT operates, and provides as follows:

The Licensee shall:…

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

This condition allows the JCRA to give directions to JT, including in relation to the prices that it charges.

4. Regulation of FTRs in other jurisdictions

As mentioned earlier in this Initial Notice, regulators in a number of jurisdictions have in recent years imposed specific regulatory measures aimed at requiring operators to reduce FTRs. The following provides some background on the measures adopted in certain other jurisdictions.

4.1 EU Approach to FTRs

The European Commission in 2009 published a Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU[3]. This recommendation is non-binding on NRAs within the EU; however, they are obliged take utmost account of it. The recommendation called for termination rates to be set based on a bottom-up "pure LRIC" cost model by the end of 2012. This "pure LRIC" cost model differs from the LRIC models that have previously been developed by regulators and operators (sometimes referred to as Long Run Average Incremental Cost (LRAIC) models), in that only traffic-related incremental costs can be recovered via the termination rate. All other incremental costs which are not related to traffic (e.g. coverage, spectrum and capacity related costs) cannot be recovered according to this new methodology.

NRAs have on the whole adopted the EC Recommendation as they have reviewed the call termination markets. However, many regulators have set later implementation dates than required by the Recommendation and others have indicated that they will not review termination rates until after the recommended deadline for implementation. Moreover, Ofcom, when reviewing BT's fixed termination rate in September 2009, decided not to implement the Recommendation:

> *"Ofcom acknowledges that the NCC [Network Charge Controls] cost model is not wholly consistent with the recommended approach set out by the Commission in its Recommendation, and that the ending of the new NCC (30 September 2013) falls nine months after the end date for transition to the Commission's recommended approach (31 December 2012).*
>
> *The Commission Recommendation sets out that termination service charges should be set by reference to pure long run incremental costs (LRIC) and costs modelled on the basis of next generation network (NGN) infrastructure whereas the NCC has been set using a hypothetical ongoing network model."*[4]

[3] Commission Recommendation of 7.5.2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU, Brussels,
http://ec.europa.eu/information_society/policy/ecomm/library/recomm_guidelines/index_en.htm

[4] Ofcom, *Review of BT's Network Charge Controls: Statement*, 15 September 2009, paragraph 1.13 and footnote 7

The EC Recommendation itself provides details of what regulators should do if they are unable to implement the recommended Pure LRIC model due to lack of resources. In such circumstances, NRAs can set prices based on an alternative approach (e.g. benchmarking), provided that this methodology *"results in outcomes consistent with this Recommendation and generate efficient outcomes consistent with those in a competitive market"* and the outcome *"should not exceed the average of termination rates set by NRAs implementing the recommended cost methodology"*[5].

EU (and Guernsey) Local PSTN termination rates are displayed below for comparison. Local PSTN termination rates are used, as opposed to Single Transit termination or Double Transit termination, because JT does not have national transit switches and therefore all termination is the equivalent of local termination for larger countries.

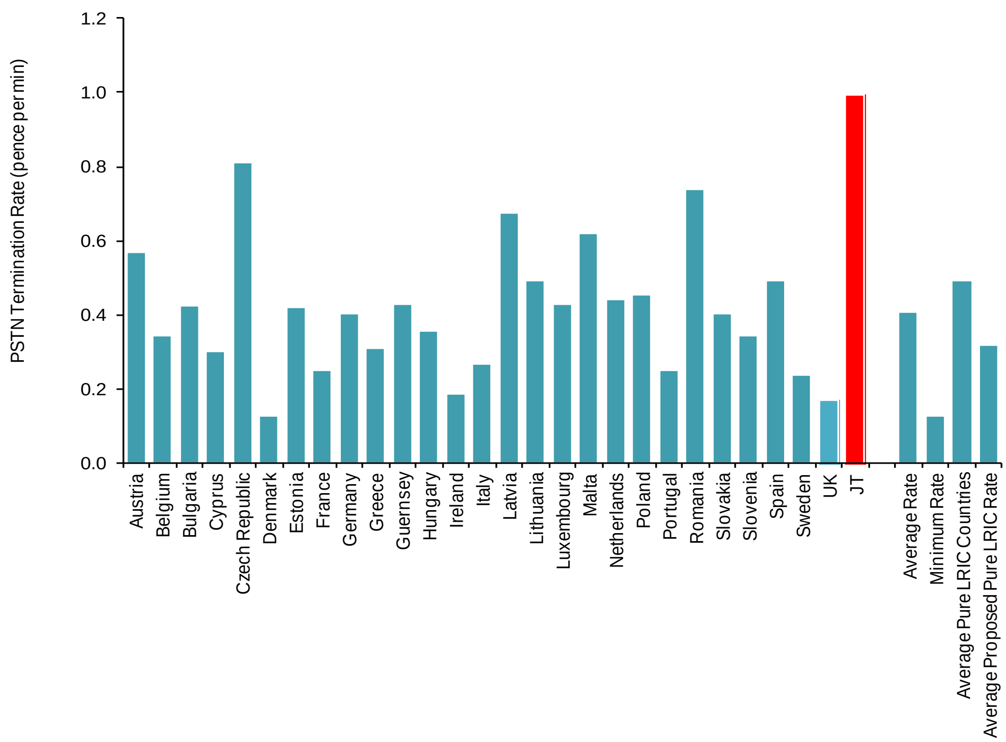

Figure 1 Comparison of Local FTRs, 1st July 2011
Source: *Review of NRA and operator websites*

4.2 Guernsey

FTRs in Guernsey have to date been set by the OUR as part of CWG's RIO.

[5] Commission Recommendation of 7.5.2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU, Brussels, 07.05.2009, paragraph 22

Those charges were first set in March 2005. The OUR indicated in October 2008 that it would commence a review of those charges. In June 2009, the OUR published a consultation document on CWG's proposed interconnection and access charges. That consultation dealt mainly with the methodology and data used by CWG to calculate interconnection and access charges, and proposed that revised rates should be based on CWG's regulatory accounts for the 2008/09 financial year, which had been due to be submitted by CWG to the OUR by the end of October 2009. In October 2009, the OUR published its draft decision on matters arising from the consultation process. In January 2010, CWG submitted to the OUR a revised set of interconnection rates, based on its 2008/09 regulatory accounts.

The current rates were announced by the OUR in July 2010, but took effect from 1 April 2010[6]. The rates are based on a flat charge; the July 2010 decision abolished the previous time of day gradient.

The FTR cap applied by the OUR to CWG under the July 2010 decision is 0.428ppm.

[6] OUR (2010), *C&WG Reference Offer and Interconnection Rates - Final Decision: OUR 10/09*, http://www.cicra.gg/_files/OUR1009.pdf

5 FTR proposal for JT

The JCRA has reviewed how FTRs in Jersey should be determined.

5.1 Level and calculation method for FTRs

EU regulators have typically set FTRs using cost-based models. Given the nature of the call termination market in the EU, which is based on Calling Party Pays (CPP) – whereby only the calling party is charged for the service provided – SMP network operators do not have an incentive to reduce rates for call termination services. Additionally, high termination rates can incentivise SMP operators to offer low prices for on-net calls[7] which may be cross-subsidised by revenue from wholesale services, such as call termination. However, even if retail services were not cross-subsidised by wholesale services and competition development was not distorted, end consumers of telecommunications services could still end up paying for inefficiency through higher prices for off-net calls. For this reason, bottom-up LRIC models which only reflect the efficiently incurred costs are often used.

The JCRA considers that there is merit in adopting a cost-based approach to setting cost-based termination rates. However, implementing a cost-based approach would require significant further input from JT, as well as a number of high level assumptions concerning forecasts of traffic on the network and/or the price trends of specific network elements.

An alternative to detailed costing calculations is to benchmark termination rates based on other jurisdictions which have undertaken the full costings and calculations for the same range of services. Setting termination rates on a basis of benchmarking is often used when it is not practicable to obtain sufficient amounts of data from the SMP operator and it is an alternative to constructing a bottom-up model, which has the drawbacks mentioned above. If the JCRA adopted a benchmarking approach, it would ensure that JT's RIO rates reflected the costs of an efficient operator providing the same RIO services. Adopting this approach would ensure that the rates in Jersey are in line with rates set by regulators in other countries and the JCRA could formalise the process for the RIO rate setting, so that JT's RIO rates are linked to the benchmark countries as their rates change going forward. This approach would also be relatively simple for the JCRA to adopt and would not require any detailed analysis of JT's actual costs. Given the resources available within the JCRA compared to other larger NRAs, the benchmarking approach would also be compatible with the EC's Recommendation on termination rates.

However, adopting a benchmarking approach would disassociate the RIO rate with the actual costs of JT, whether efficiently incurred or not. This would mean that if there were efficient reasons for an increased level of costs in Jersey compared to other countries (e.g. due to a lack of economies of scale), this would not get incorporated within the rate.

[7] "On-net" describes a call for which both the caller and the recipient are on the same network

As recorded in Figure 1 above, the average EU FTR on 1 July 2011 was 0.405ppm. While the JCRA believes that a benchmarked FTR might be justified in a Jersey context, it believes there is greater merit, in particular having regard to the interests of adopting a pan-Channel Island approach to regulating telecommunications services, to instead propose a rate cap of 0.428 pence per minute, which is the FTR currently applied in Guernsey by CWG.

It is proposed that this FTR cap would remain in place until at least 30 September 2013, by which point it is proposed that the JCRA and GCRA will have concluded their deliberations on the most appropriate manner in which to set termination rates in the Channel Islands.

5.2 How should FTRs be charged?

The JCRA also proposes to apply the same terms to the application of FTRs in Jersey as in Guernsey; namely:

- the rate shall apply with respect to all calls terminated by JT on its PSTN on a technology-neutral basis (i.e. from both fixed-line and mobile networks) and irrespective of the origin of the traffic.

- PSTN termination will be billed on a per second basis effective from the first second.

It is also proposed that the change to the FTRs should be back-dated to 1 April 2012, in keeping with the proposed date for the introduction of new MTRs. The JCRA notes that there is evidence that operators were aware, well before 1 April 2012, of the JCRA's intention to reduce FTRs in Jersey to the levels prevailing in Guernsey, on that basis there would be a case for backdating FTRs further. However, given the conflicting views on when disussions on MTRs began and to ensure the dates of implementation are consistent, the JCRA has decided to backdate FTRs and MTRs to the same date of 1 April 2012.

5.3 Is it appropriate for the JCRA to issue a direction to JT under the Fair Competition licence condition?

As noted in section 3 of this Initial Notice, Condition 34.1(c) of JT's licence entitles the JCRA to issue directions "for the purpose of preventing any market abuse or any practice or arrangement that has the object or effect of preventing, restricting or distorting competition in the establishment, operation and maintenance of Licensed Telecommunication Systems or the provision of Telecommunication Services".

As stated, the JCRA has previously found that JT is dominant (or possesses SMP, which the JCRA has regarded as synonymous with dominance for these purposes) in the market for call termination on individual public telephone networks provided at a fixed location.

Absent regulation, the JCRA considers that it is inevitable that there will not be effective competition in this market, and that a likely outcome of such a lack of effective competition is that JT will have both the incentive and the ability to set excessive FTRs. At present, we observe that JT's FTR is more than double the level charged by CWG for PSTN termination in Guernsey in 2010, on a network that is smaller in scale than in Jersey. In our view, this constitutes strong evidence that the cost of providing PSTN termination services for an efficient fixed-line operator in Jersey should be considerably less than the current rate.

On balance, then, we have concluded that charging excessive FTRs (i.e. FTRs at a level above efficient cost) is a practice that could constitute abuse of SMP. We have therefore provisionally determined that it would be appropriate to make directions under the Fair Competition conditions of JT's licence to cap its FTRs. For the reasons set out above, we have decided in the directions to adopt the FTR currently used by CWG in Guernsey.

The JCRA has considered whether it would be more appropriate for it to issue a determination in respect of JT's FTRs under Condition 33.2 of JT's licence. While the JCRA is confident that it is empowered to make a determination on JT's FTRs under Licence Condition 33.2, it is of the view that it would be preferable to proceed on the same legal basis when setting MTRs for each of the Mobile Network Operators (including JT) and FTRs for JT.

6 Proposed direction

The JCRA proposes to issue a direction to JT under Condition 34.1(c) of JT's licence as follows:

- The rate charged by JT for call termination on its PSTN in Jersey ("the fixed termination rate") shall be no more than 0.428 pence per minute;

- the fixed termination rate shall be billed on a per second basis effective from the first second; and

- the fixed termination rate shall apply with respect to all calls terminated by JT on its PSTN on a technology-neutral basis (i.e. from both fixed-line and mobile networks) and irrespective of the origin of the traffic.

The direction shall be deemed to have come into effect on 1 April 2012, and, unless otherwise stated, shall expire on 30 September 2013.

7 Next Steps

The proposed directions will take effect on 29 August 2012, unless representations or objections are received in relation to them, in which case the relevant date will be set out in a Final Notice published under Article 11(5) of the Telecoms Law.

Representations or objections in relation to the proposed directions can be made in accordance with the arrangements set out in section 2 of this Initial Notice.

CICRA has simultaneously published proposals on MTRs for all 3 main operators in Jersey and it is similarly intended that the effective date of any amended rates contained in such proposals will also be back-dated to 1 April 2012.