Wholesale Leased Lines: Review of Price Controls

Initial Notice

Proposed directions to JT (Jersey) Limited

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

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1. Introduction

A leased line is a communication service that provides dedicated transmission capacity between fixed locations, which can be used to carry voice and data traffic. Many organisations use leased lines to provide a wide variety telecommunications services, such as access to the internet, private voice and data networks, backup and disaster recovery and remote monitoring.

Leased line[1] charges and the need to ensure such charges are set at levels that reflect the efficient and cost-effective provision of providing the service is a matter that has been considered by regulators across Europe. Ofcom in particular, is currently conducting a review into the pricing of leased lines in the UK. In Guernsey, the regulated prices of leased lines have been frozen since 2008; prior to this, the price of leased lines was controlled on the basis of a RPI-16% pricing mechanism.

The current pricing methodology in Jersey differs from that implemented in Guernsey. The JCRA has implemented a price cap for leased lines using a 'retail-minus' pricing mechanism, so that, at present, leased lines are sold by JT (Jersey) Limited ("JT") at its retail price minus a 9% discount. This pricing mechanism has remained unchanged since the telecommunications market in Jersey was liberalised. This Initial Notice proposes a revision to the pricing calculation such that the 9% discount from the retail price used to calculate the price cap for leased lines purchased by wholesale customers from JT is increased to 20%. It is proposed that this revision be backdated to 1 April 2012.

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

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

[1] For the purpose of this Initial Notice the term 'leased lines' refers to on-island wholesale leased lines unless explicitly stated otherwise.

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 leased lines;

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

Chapter 5: sets out the proposed directions with respect to leased lines for Jersey; 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 by the JCRA before 5.00pm 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 the JCRA's policy, non-confidential responses to the Initial Notice will be made available on the JCRA'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.

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:

- ***On-island Wholesale Leased Lines:*** *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*
>
> *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

[2] JCRA, *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

that JT has a dominant position in the relevant market in which those services are supplied.

Additionally, Condition 28.1 (d) states:

> *28.1 The Licensee shall offer to lease out circuits or partial circuits for any lawful purpose:*
> *…*
> *(d) at prices that do not exceed levels determined from time to time by the JCRA.*

This condition provides the JCRA with the specific authority to set the maximum price JT may charge for the provision of leased lines.

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 Leased Lines 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 fixed network operators to update their leased line charges. The following section provides some background on the measures adopted in a number of jurisdictions.

4.1 UK

On 5 July 2012, Ofcom issued a consultation on its proposed new charge controls for certain leased line services. The consultation was launched following a Business Connectivity Market Review Consultation ("the BCMR Consultation") in which Ofcom set out its analysis of competition in the provision of leased lines services in the UK. This analysis found that BT has SMP in the provision of a number of wholesale leased lines services. To address the finding of SMP, remedies were proposed, including charge controls in some of the relevant markets that had been identified.

In developing and designing the charge control proposals, Ofcom had regard to a number of objectives, including:

- wanting to ensure that the prices for wholesale leased lines services are not excessive and are broadly in line with the cost of provision; and
- seeking to promote efficiency in the provision of wholesale leased lines services.

Ofcom proposes to introduce an RPI-X type control for the main basket controls. This type of control aims to align prices, by way of a glide path, with cost at the end of the charge control period (i.e. 2015/16).

Similarly to the existing leased lines charge controls in the UK, Ofcom proposes charging for control traditional interface ("TI") and Ethernet services (known as alternative interface ("AI") in separate baskets.

Ofcom propose RPI+3.25% and RPI-12% pricing constructs for the TI basket and Ethernet basket respectively.

The consultation closes on 30 August 2012.

4.2 Isle of Man

The Isle of Man Communications Commission ("the Communications Commission") published a consultation reviewing the telecommunications markets in June 2011. A response to consultation and Decision Notice was published on 4 October 2011 but the

Decision Notice was withdrawn on 30 November 2011 to allow further review. At that time, it was decided to issue three separate Decision Notices covering retail fixed markets, wholesale fixed markets and mobile communications markets.

On 23 February, the Communications Commission issued a consultation paper covering wholesale fixed markets. In this consultation, the Communications Commission considered the market for Wholesale Dedicated Capacity (Leased Lines), and issued a proposed decision notice that designated Manx Telecom with SMP in the market for leased lines and implemented obligations in relation to:

- Access;
- Non-discrimination;
- Transparency;
- Accounting separation; and
- Not causing margin/price squeeze.

The Communications Commission also directed Manx Telecom to comply with the rules which the Communications Commission may make in relation to cost orientation, while in the interim retaining a retail minus 15% price mechanism.

4.3 Guernsey

In Guernsey, the Office of Utility Regulation ("OUR") carried out a number of separate reviews of leased line prices in the period between 2005 and 2011. The first review determined that prices for on-island leased lines should be set using an RPI-16% mechanism for the period 1 October 2005 to 31 March 2008. In February 2008, the OUR decided to freeze the price of on-island wholesale leased lines from 1 April 2008 until 31 March 2011. Once again, in January 2011 the OUR decided to freeze prices for wholesale on-island leased lines from 1 April 2011 until 31 March 2012.

A further review in March 2012 decided to extend the enforced pricing of wholesale on-island leased lines until the completion of the Channel Islands Wholesale Access Project (CIWAP). The CIWAP does not consider wholesale on-island leased lines directly, however, it is likely to materially alter the competitive landscape for fixed telecom services in Guernsey and the OUR decided to leave the regulated price of leased lines unchanged until the effect of the CIWAP is more easily observed. Accordingly, the OUR has frozen leased line prices for the duration of the CIWAP.

5 Proposed Leased Lines Price Control for JT

The JCRA has received numerous complaints from other licensed operators (OLOs) that the margin between the wholesale and retail leased line services is insufficient to cultivate material competition at the retail level. For example, particular reference has been made to the current wholesale charges for a 2Mbit/s private circuit not allowing OLOs to replicate JT's ISDN 30 retail offering.

Based on its draft separated regulatory accounts for 2010, JT's on-island wholesale leased lines business segment appears to be earning a return well in excess of its cost of capital. This seems to suggest that there is significant scope to increase the current margin between retail and wholesale charges (as the current charges appear to be above the cost of delivering these services).

The current wholesale pricing construct of retail minus 9% is small when compared to the margins between wholesale and retail prices observed in Guernsey and the Isle of Man where they are approximately 20%[3] and 15% respectively. Further, the current retail minus value is smaller than in many other European jurisdictions where wholesale leased line services are still regulated on a 'retail minus' basis (i.e., Spain, Portugal and Hungary). In those countries, a retail margin of 15% to 28% is applied[4].

As noted earlier in this Initial Notice, the CIWAP is likely to alter materially the competitive landscape of the fixed telecommunications market in the Channel Islands. Accordingly, the OUR (as it was known at the time) recognised that an investigation of the appropriate price mechanism for leased lines was not appropriate, given the on-going CIWAP, and when the regulation expired in early 2012, chose to retain the existing prices until the impact on the leased line market of the CIWAP is more evident.

The JCRA considered retaining the existing price regulation on leased lines, but is of the view that the current margin between wholesale and retail prices is insufficient and is likely to be materially restricting competition in the retail market for leased lines. In addition, the JCRA notes that the retail minus 9% price mechanism has not changed since the telecommunications market in Jersey was liberalised, despite significant changes in the market over this time.

The magnitude of the change that has occurred in the market since liberalisation is clearest when a comparison is drawn between the margin afforded on leased lines and margins allowed on other regulated wholesale products in Jersey that have more up-to-date pricing and which are priced in the same manner (retail minus) as leased lines. For example, wholesale copper and fibre broadband services in Jersey are priced using retail

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[3] Cable & Wireless Guernsey Limited contends that the current retail margin for (on-island) leased line services in Guernsey is approximately 22%: Cable & Wireless Guernsey, 'Channel Island Wholesale Access Project - C&W's response to CICRA's Consultation Document (Published version)' dated 20 January 2012

[4] For example, in Spain, (Ethernet) leased lines charges are set based on a 'retail minus 15%' regime, in Portugal a value of 'retail minus 26%' was applied to leased lines service until recently and Hungary a value of 28% applies to monthly fees for leased line services over 128 kbps

minus method and in each instance the discount on these services ranges from 20% to 40%[5]. The JCRA notes that copper broadband services are priced at a uniform retail minus 20%, whereas the discount on the recently introduced fibre broadband services ranges from 20% up to 40%. This suggests that the appropriate margin for wholesale services may be increasing over time. These more recent price calculations indicate a step change may have occurred that is not reflected in the current leased line pricing.

The JCRA's preliminary view is that the current retail minus 9% pricing approach does not provide OLOs sufficient ability to provide material competition to JT for the provision of retail leased lines and that the continued implementation of a 9% discount on wholesale leased lines will only further entrench the current market failure and stifle the development of competition, to the detriment of Jersey consumers.

The JCRA notes that the completion of the CIWAP is expected to alter the fixed line telecommunications market in Jersey and sees no net benefit in engaging in a lengthy investigation of the most appropriate cost-oriented price for leased lines before the completion of the CIWAP. It is clear, however, that maintaining the status quo until the conclusion of the CIWAP will unnecessarily damage the market. The JCRA considers the best way to address this issue is to implement an interim measure, that:

- can be implemented quickly;
- is consistent with the pricing of other regulated wholesale services in Jersey;
- replicates conditions in a closely comparable market (i.e. Guernsey); and
- reduces a significant barrier to competition.

The JCRA's preliminary view is that the most appropriate way to achieve these four conditions is to apply a retail minus mechanism that replicates the margin between the price of the wholesale and retail leased line services in Guernsey and other regulated services in Jersey. Accordingly, the JCRA proposes to cap the wholesale on-island leased lines services provided by JT at a level of JT's retail price minus 20%.

[5] The JCRA is currently analysing the pricing of JT's wholesale fibre broadband services. Reference to the retail minus pricing construct currently employed by JT for these services does not imply an endorsement by the JCRA of these prices.

6 Proposed directions

The JCRA proposes to issue a direction to JT under Condition 33.2 of JT's licence as follows:

Wholesale on-island leased line services provided by JT shall be priced at no more than the retail price charged by JT for the same service minus 20%.

The direction shall be deemed to have come into effect on 1 April 2012.

7 Next Steps

The proposed direction will take effect on 28 August 2012, unless representations or objections are received in relation to it, 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 direction can be made in accordance with the arrangements set out in section 2 of this Initial Notice.

The JCRA and the Guernsey Competition and Regulatory Authority intend to undertake a further review of leased line pricing in both Guernsey and Jersey following the conclusion of the CIWAP.