Pan-Channel Island Consultation on Broadband Price Control Review

Consultation Document

Channel Islands Competition and Regulatory Authorities

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1. Introduction

A competitive communications market benefits consumers by providing better choice, value for money and greater innovation in the services available. Individual consumers experience those benefits directly, while those benefits to business customers also contribute to improving the overall competitiveness of the economy.

This consultation considers the need for, and potential nature of price controls on broadband services in the Channel Islands provided by Sure (Guernsey) Limited ("**Sure**)" in Guernsey and JT (Jersey) Limited ("**JT**") in Jersey. Sure and JT are the two major providers of those services in their respective islands and each historically have strong positions of market power in the provision of broadband services. The consultation does not cover other fixed line services such as residential and business exchange line rental and calls, or leased line services.

The need for regulatory oversight of prices for broadband services should take into account the nature of choices through competition available to customers or other constraints that safeguard consumers and competition. The weaker those constraints the greater the regulatory role necessary to ensure the benefits of competitive communications markets to consumers.

Following an investigation of whether the pricing of JT in the broadband market in Jersey constituted a margin squeeze, the Jersey Competition Regulatory Authority (the "JCRA") communicated its finding in the form of a decision to JT on 23 June 2016. That communication set out that the JCRA was of the view JT had contravened Licence Condition 34 of its Class III Telecommunications Licence granted by the JCRA by effecting a margin squeeze for its JT Broadband Home Product and JT Complete Product. In reaching its decision the JCRA drew on what is referred to as a 'margin squeeze' test and directed JT to ensure that its current pricing met this test.

The JCRA stated in its decision that *"to ensure against future contraventions of this nature, the [JCRA] intends to commence a wider industry review to inform a formal longer term broadband price control in both Jersey and Guernsey by the end of Q3 2016"*.

The margin squeeze test referred to above was utilised for a specific licence condition contravention whereas this consultation starts CICRA's review of the need and form for longer term broadband price controls for both Jersey and Guernsey.

2. Purpose of consultation

This document consults on the need for broadband price controls for Sure (in Guernsey) and Jersey Telecom (in Jersey) and considers the appropriate controls in future if such a need is identified[1]. Given the current designations of market power in this area and provisional evidence available to it, the Channel Islands Competition and Regulatory Authorities ("**CICRA**") seeks views on the approaches that might be appropriate should a price control be required and in particular discusses the approach recently undertaken in Jersey. This is set out in further detail for comment as part of this consultation.

Following an assessment of responses to this consultation and other relevant evidence CICRA will publish its conclusions.

Disclaimer

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

[1] *Broadband is a way of connecting to the internet. It allows information to be carried at high speed to your personal computer, laptop, tablet, smartphone, smart TV or other web-enabled device. Broadband has largely replaced the original 'dial-up' (narrowband) method of connecting to the internet, which was much slower.*

3. Structure of the Consultation

The consultation document is structured as follows:

Section 4:	Sets out CICRA's assessment of broadband price control
Section 5:	Next steps in this consultation
Annex A	This section outlines the legal bases for the GCRA's and the JCRA's roles in the setting of a broadband price controls.

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

Suite 4, 1st Floor, Plaiderie Chambers La Plaiderie St Peter Port Guernsey GY1 1WG Email: info@cicra.gg	2nd Floor, Salisbury House 1-9 Union Street St Helier Jersey JE2 3RF Email: info@cicra.je

All comments should be clearly marked "*Pan-Channel Island Consultation on Broadband Price Control Review*" and should arrive by 5pm on Friday 18 November 2016.

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

4. Broadband Price Control

The need for an ex-ante price control going forward

Broadband services

Both of the incumbent operators have previously been designated as having positions of market power in their respective jurisdictions in the provision of broadband services. Competition for broadband services continue to be limited in Jersey and Guernsey.

On the retail side, there are a limited number of alternative to the retail offerings of the incumbent operators. The last published information from CICRA on the retail broadband market shows that at the end of 2014 the market size in Guernsey was 23,484 broadband connections with Sure having 82% (19,305) of the connections. The remaining 18% (4,179) connections were provided by JT (Guernsey). In the case of the Jersey market the total market size was 36,420 with JT having 72% (26,385) of the connections with Sure (Jersey) having 16% (5,796) and Newtel 12% (4,239) of connections.

The telecoms statistics for the end of 2015 are currently being finalised and remain unpublished. However, initial findings are that there is no material change in the market shares held by JT in Jersey and Sure in Guernsey. The 2015 statistics include mobile connections that are sold as fixed line replacements and the initial findings are that any growth in the market has been provided by a small amount of substitution to the mobile connections.

On the wholesale side, both JT and Sure remain the only wholesale provider of broadband services in their respective jurisdictions. Operators that wish to compete with the retail arms of the two incumbents must rely on them for essential wholesale inputs that comprise a significant proportion of retail costs. The stage of development of wholesale access products is such that retail competitors are limited in the type and range of broadband service they can offer. Differentiation in terms of the core broadband product is therefore not an option for them at the present time.

In summary, the basis for competition appears to be limited by features of the market in both jurisdictions which suggests market power of the two incumbent operators continues to be significant in the respective islands. Specific features that may inform the need for any ex-ante price control of broadband services are:

- Both Sure and JT remain the sole providers of wholesale broadband services in Guernsey and Jersey respectively and there are few alternative retail broadband service providers present in either market.
- Wholesale broadband access services are only available from the vertically integrated incumbent operator in each jurisdiction.
- Despite the increasing presence of mobile broadband services (3G and 4G), there appears to be limited evidence to suggest that fixed line broadband customers in the Channel Islands are substituting away from fixed line broadband access services to these alternative broadband products to an extent that significant constraints apply to the retail prices charged by Sure or JT.

Given the above, CICRA's provisional view is that both Sure and JT are likely to maintain a dominant position in the provision of retail broadband services and there is a continued need for ex-ante price controls in the market for broadband access services.

Question 1

Views are sought on what features of any relevant markets CICRA should take into account in forming a view on market power for the provision of retail and/or wholesale fixed line broadband services in each island?

Respondents are asked to set out in full their reasoning and evidence for their position. In particular whether they consider Sure and/or JT to have significant market power in the provision of broadband services and what the relevant markets are for such an assessment?

Question 2

If Sure and/or JT are considered to have significant market power in the provision of retail and or wholesale fixed line broadband services in each island, respondent views are sought on whether a price control of those services is an appropriate means of addressing risks to consumers and competition? In particular, respondents are asked to comment on what key factors CICRA should take into account in coming to a view whether any price control is appropriate in the relevant market/s?

Form, scope and duration of broadband price control

If SMP is found to exist in the relevant Jersey or Guernsey market and a need to ensure some form of forward price control is considered appropriate, the form, scope and duration of any such control would need to be informed by a number of factors.

JT and Sure have chosen different approaches to investment and therefore have different investment profiles in the provision of broadband services. Such investment decisions inevitably involve trade-offs between a number of factors that commercial businesses must take account of. The broadband context is one where broadband is an increasingly vital service for households and businesses, and where data usage is growing at a pace that is increasingly difficult to predict with any confidence beyond the short term. Network technology evolution and usage patterns driven by new applications also contribute to a dynamic landscape. Regulatory intervention in setting price controls in such circumstances therefore requires careful consideration.

Retail minus price setting approaches provide assurance of margins for competitors but are arguably more appropriate in certain contexts. For example, in setting any broadband price control CICRA would want to ensure it is resilient to market changes. The development of wholesale access products may for example be accelerated and lead to entrants making retail offers available in the market where the core retail broadband product portfolio differs from that of the incumbent. A

retail minus price control framework for wholesale charges by the incumbent may not be a suitable fit in such a context. However, protection of competition is if anything of even greater importance to ensure the dynamic efficiencies are achieved in the provision of such a key service.

Cost plus price setting has obvious risks given the dynamic nature of the broadband market as discussed above. The European Commission's Recommendation on costing methodologies to promote competition and enhance broadband investments are referred to below to inform responses. This states the following[2]:

- *A costing methodology that leads to access prices replicating as much as possible those expected in an effectively competitive market is appropriate.*
- *Such a costing methodology should be based on a modern efficient network, reflect the need for stable and predictable wholesale copper access prices over time, which avoid significant fluctuations and shocks, in order to provide a clear framework for investment and be capable of generating cost- oriented wholesale copper access prices serving as an anchor for NGA services, and deal appropriately and consistently with the impact of declining volumes caused by the transition from copper to NGA networks, i.e. avoiding an artificial increase in wholesale copper access prices which would otherwise be observed as a result of customers migrating to the NGA network of the SMP operator.*
- *Cost recovery is a key principle in a costing methodology. It ensures that operators can cover costs that are efficiently incurred and receive an appropriate return on invested capital.*
- *A costing methodology that provides the appropriate 'build-or-buy' signal strikes an appropriate balance between ensuring efficient entry and sufficient incentives to invest and, in particular, to deploy NGA networks and hence deliver new, faster and better quality broadband services.*
- *The bottom-up long-run incremental costs plus (BU LRIC+) costing methodology best meets these objectives for setting prices of the regulated wholesale access services. This methodology models the incremental capital (including sunk) and operating costs borne by a hypothetically efficient operator in providing all access services and adds a mark-up for strict recovery of common costs. Therefore, the BU LRIC+ methodology allows for recovery of the total efficiently incurred costs.*
- *The BU LRIC+ methodology calculates the current costs on a forward-looking basis (i.e. based on up-to-date technologies, expected demand, etc.) that an efficient network operator would incur to build a modern network today, one able to provide all required services. Therefore, BU LRIC+ provides correct and efficient signals for entry.*
- *Where cable, fibre (FttX) and, to a lesser extent, mobile networks (in particular Long Term Evolution or LTE mobile networks) are competing against copper networks, SMP operators react by upgrading their copper networks and progressively replace them with NGA to address this competitive threat. Therefore, since no operator would today build a pure copper network, the BU LRIC+ methodology calculates the current costs of deploying a modern efficient NGA network.*
- *In the light of the principle of technological neutrality and in view of different national circumstances, NRAs need a degree of flexibility to model such a modern efficient NGA network. The NGA network can therefore be based on any of the various access technologies and network topologies available to operators for rolling out an NGA network.*

[2] *Commission Recommendation on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment (C(2013)5761 final), 11/09/2013, OJ L 251 of 21/9/13*

There is a question whether the use of the BU LRIC+ methodology is appropriate for jurisdictions such as Jersey and Guernsey. CICRA considers that the regulatory methodology utilised should be proportionate and not incur significant burdens for dominant operators.

The Commission Recommendation further states that:

"*In view of the benefits of pricing flexibility in these circumstances, under the recommended approach, wholesale access prices for passive NGA wholesale inputs or non-physical or virtual NGA wholesale inputs offering equivalent functionalities are deemed to be sufficiently constrained (i.e. price-related competition problems are considered to be effectively addressed) when: (i) there is a demonstrable retail price constraint resulting from the infrastructure competition or a price anchor stemming from cost oriented wholesale copper access prices, and (ii) the ex-ante economic replicability test is in place in those cases where wholesale price regulation should not be imposed, and (iii) there is an obligation of providing wholesale access services on the basis of EoI. In other words, where EoI is applied and NRAs consider that the above competitive safeguards are in place, they should not impose a regulated access price for those NGA wholesale inputs.*"

The above raises the questions whether different price setting approaches might be justified in Jersey and Guernsey and whether the circumstances in either island support such an approach.

Question 3

Respondents are asked to set out those factors relevant to considering any possible approach to setting a price control framework for broadband services in Jersey and/or Guernsey. Explanation of those factors and specific evidence and studies to support respondent views should be provided and set out as comprehensibly as possible

In particular respondents are asked to set out whether a cost plus or retail minus price setting approach is appropriate to the circumstances of Jersey and/or Guernsey, providing all evidence available to them to support their position.

An alternative approach is a margin squeeze methodology where considerations of technology deployment decisions and investment decisions are not a key element is the price setting decision. The use of margin squeeze test means that dominant operators can set their retail prices based on market conditions.

In its 2014 Recommendation[3] BEREC[4] provided the concept of an economic replicability test (ERT) and said that from a practical point of view:

"*the ERT can be considered as a specific type of ex-ante margin squeeze test, which is already known from both, current practice from the regulators and also in ex-post form as a practice known (in principle) from competition law.*".

Alternative operators often depend on wholesale services of operators with significant market power (SMP). By setting either wholesale or retail prices (or both), the SMP-operator which are in

[3] *BEREC (2014), BEREC Guidance on the regulatory accounting approach to the economic replicability test (i.e. ex-ante/sector specific margin squeeze tests), BoR (14) 190, 5 December 2014*

[4] *Body of European Regulators for Electronic Communications*

principle vertically integrated firms, can define the margin between the wholesale and retail price level. BEREC also state:

"The use of the margin squeeze test allows SMP operators more flexibility in setting prices than cost-orientated prices could provide, where the absolute values of prices are controlled. Providing SMP operators with a certain level of pricing flexibility would allow them to test price points and conduct appropriate penetration pricing. Given the uncertainties surrounding current demand for NGA-based retail services, SMP operators could use penetration pricing strategies in order to foster retail demand for NGA-based retail services. The purpose of the economic replicability test is to ensure, in combination with other competitive safeguards introduced[5], that SMP operators do not abuse this pricing flexibility in order to exclude (potential) competitors from the market."[6]

In considering the appropriate approach to testing whether JT's pricing for fixed line broadband services in Jersey represented a contravention of JT's obligation as regards fair competition, CICRA assessed whether a margin squeeze was in effect in the Jersey market.

Given the evidence available to CICRA, the use of the margin squeeze test was considered to provide a best fit for setting pricing restraints appropriate to the market conditions and context. The principle of a competing operator having a viable margin and the specific framework adopted in that decision may therefore be appropriate to any future longer term price control approach. Respondents are referred to the decision issued by CICRA in June 2016 where the approach is set out in further detail[7].

Question 4

Respondent views are sought as to whether any CICRA price control for broadband services, should be based on the use of an appropriate margin squeeze analysis, should the need for a price control be identified?

Price control based on a margin squeeze test

In setting the level of any price control going forward CICRA is informed by the findings of its recent margin squeeze investigation into JT's broadband services. In the following section CICRA sets out an approach to setting a margin squeeze test for the broadband price control consistent with that decision.

That decision explained that ensuring that there is an appropriate 'margin' between retail and access prices for efficient competitors is critical to the success of competition in many regulated industries.

A key factor is in the level at which the wholesale access prices are set relative to the retail prices that entrants will be able to charge in the competitive market. A large enough gap between the two prices allows for sufficient room for profitable entry and expansion. Too narrow a gap would 'squeeze' the margin of an entrant to such an extent that the entrant may not be able to recover its

[5] *E.g. EoI, the technical replicability test, and a demonstrable retail price constraint resulting from a copper anchor or alternative infrastructures*

[6] *BEREC (2014)*

[7] *http://www.cicra.gg/_files/Signed%20Redacted%20Letter%20MS.pdf*

retail costs including a reasonable rate of return. This could lead to an entrant being foreclosed from the market.

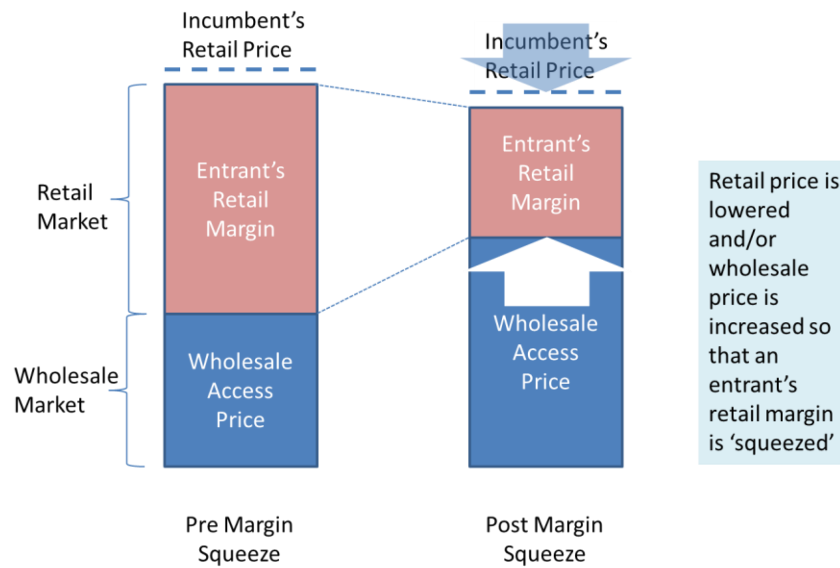

Figure 1: The principles of margin squeeze

Approaches to setting a Margin Squeeze Test

In this section we set out a number of the key elements that were taken into account when constructing a model to test for a margin squeeze in Jersey.

Equally Efficient and Reasonably Efficient Competition

A question that has been debated in relation to a margin squeeze test is whether the competitor should be as efficient as the dominant firm (Equally Efficient Operator – EEO) or reasonably efficient (Reasonably Efficient Operators – REO).

In competition law, the standard assumption is that a competitor should be equally efficient as the dominant firm and that competitors should not be protected from any inefficiencies they may have. There is also an assumption that it would be unfair to expect the dominant firm to know the costs of its rivals or artificially alter the playing field to 'reward' inefficiency.

However, in a market subject to *ex-ante* regulation where competition is being introduced, there is an argument that the entrant could not be as efficient as the incumbent where the incumbent benefits from advantages that are not a function of its own efficiency but from legacy advantages. To overcome this legacy advantage and allow competition to develop an alternative REO standard might be justified that effectively addresses this.

In its Recommendation on the regulation of Next Generation Access (NGA), the European Commission stated:

> *"In the specific context of ex-ante price controls aiming to maintain effective competition between operators not benefiting from the same economies of scale and scope and having*

> *different network costs, a 'reasonably efficient operator test' will normally be more appropriate."*[8]

The European Commission did not, however, define what it meant by a REO which is the role of the National Regulatory Authorities (NRAs).

A position is that if a margin squeeze test was the appropriate approach entrants in the broadband markets in Jersey and Guernsey could not be expected to enjoy the same advantages as the incumbent and therefore a REO standard should be used to ensure that sufficient margin is available for new entrants. It may be argued that entrants' disadvantages come from three sources:

- Economies of scale and scope;
- Data volumes (i.e. consumption in terms of GB/month), and
- Average customer lifetime (ACL).

Question 5

Does the respondent agree that a Reasonably Efficient Operator (REO) is an appropriate approach when applying a margin squeeze test for the broadband service market? If the respondent does not agree with this then please provide a full justification for the response and how this is consistent with CICRA's duties in Jersey and/or Guernsey law?

Respondents are also asked to provide their view on whether the three factors identified are valid and exhaustive? Should additional or alternative factors be considered?

A comprehensive explanation of that position is sought with any relevant evidence provided to support CICRA's consideration?

Economies of Scale and Scope

In the paragraph from the EC Recommendation referenced above, the Commission specifically referred to economies of scale and scope. Not allowing for these would mean that a competitor with the same average cost curve as the incumbent, but which does not produce at the same volume, would be placed at a cost disadvantage. Thus if the entrant were equally as efficient as the incumbent the fact that it is smaller than the incumbent would mean that its average costs would be higher.

The European Commission noted in its decision on the *Telefonica*[9] margin squeeze case that the EEO test favoured Telefonica, as given the economies of scale and scope it enjoyed, "*its unit costs can be expected to be lower than those of its reasonably efficient rivals*". The Commission recognised that a reasonably efficient competitor, which shared the same cost structure as Telefonica but which did not have the same economies of scale, would inevitably have higher unit costs.

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[8] *European Commission (2010) 'Commission Recommendation of 20th September 2010 on regulated access to Next Generation Access Networks' SEC (2010) 1037*

[9] *Case COMP/38.784 – Wanadoo España vs. Telefónica*

In the UK, Ofcom has also recognised that an entrant will not have the same scale advantages as the incumbent. In its Virtual Unbundled Local Access (VULA) margin squeeze test, Ofcom deploys what it calls an Adjusted EEO model where, *inter alia*, the scale of the benchmark operator is adjusted to reflect the retail market share of BT's main competitors. Ofcom's benchmark operators will have an existing subscriber base "*in the vicinity of*" 20% of the residential broadband market, in line with Sky, TalkTalk and Virgin Media. This market share allows the benchmark operator to benefit from some economies of scale but not at the same level as BT.[10]

In Ireland, ComReg, applies what it calls a Similarly Efficient Operator (SEO) and again assumes a market share of around 25%.[11]

Currently, JT as the incumbent operator in Jersey enjoys a market share of 82%[12] and Sure has a market share of 72%[13] in Guernsey with the economies of scale and scope that accompany such shares. An entrant could not have the same market share as these incumbents given the household penetration of broadband in Jersey and Guernsey respectively. In developing a margin squeeze test, we have considered the market shares at 10% and 25%, i.e. at the actual share of entrants and at the level of the highest share adopted by other NRAs. We believe this range is a reasonable range on which to focus the consultation on this area given the development of competition in Jersey and Guernsey and the maximum market share an entrant might reasonably be expected to acquire.

Question 6

Respondent views are sought on the appropriate market share assumption to draw on to take into account economies of scale and scope in carrying out any margin squeeze test based on the REO principles for the broadband service market if such a framework were applied to a price setting decision?

Entrant Specific Costs

A recent academic article by Gaudin and Saavedra[14] examined in detail what was meant by a REO. In addition to economies of scale and scope, they identified what they called "entrants' specific costs". These are costs that entrants incur but incumbents do not. They state "entrants may have to bear specific costs relative to market entry or to interconnection to the incumbent's essential facilities, such as equipment collocated costs. When this is the case the test may be adjusted. If the test is not adjusted, it is suggested it offers the incumbent a competitive advantage due to cost asymmetries." If these costs are not taken into account in the margin squeeze test, the authors conclude an incumbent would never potentially face constraints on its ability to compete with entrants.

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[10] *Ofcom (2013) 'Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30: Consultation on proposed markets, market power determination and remedies' 3 July 2013. (Paragraphs 11.427 – 11.429)*

[11] *ComReg (2013) 'Next Generation Access: Remedies for Next Generation Access Markets' 31/01/2013*

[12] *CICRA 2014 Telecoms Market Statistics*

[13] *Ibid*

[14] *Gaudin, G. and Saavedra, C. (2013) 'Ex-ante margin squeeze tests in the telecommunications industry: what is a reasonably efficient operator' Telecommunications Policy 38 (2014) 157 - 172*

Examining the situation in Jersey and Guernsey, three entrant specific costs may be relevant, these are:

- the joining link between the entrant and the incumbent;
- monthly usage, and
- average customer lifetimes.

Question 7

Respondents are asked to provide their view on whether the three entrant specific costs identified are valid and exhaustive if the REO approach were applied to a price setting decision? If additional or alternative factors are considered relevant these should be set out and defined.

A comprehensive explanation of respondent position is sought with any relevant evidence provided to support CICRA's consideration?

Joining link

The joining link can be incorporated into a margin squeeze approach as a direct cost dependent on the necessary throughput. The remaining two more indirect costs are discussed below in further detail.

Monthly usage

An operator will bear a cost for the volume of data that the average user transmits and receives. It is also possible for an operator to charge a customer who exceeds a monthly allowance. This is termed 'overage'. Evidence presented to the JCRA during its margin squeeze investigation suggested that competitive operators have challenges competing with a dominant operator charging overage. The suggestion is that the stage of development of wholesale access products is such that retail competitors are restricted in the type of broadband service they can offer to that provided by the incumbent. Differentiation in terms of the broadband product itself is therefore arguably not an option for entrants given the market context to the extent it is for an incumbent.

Residents of the Channel Islands have access to the same content as residents in the UK, and in particular to data intensive content such as BBC iPlayer, ITV player and Netflix. It is possible that consumers that have particularly high average monthly usage may well be the first to switch to unlimited offers from the incumbent operators to entrants to take advantage of lower bills. It may therefore be the case that those Channel Islands residents that switch provider consume more data than those that stay with the dominant operator to take advantage of the unlimited offer of the competitors and that this is a key competitive advantage offered by those competitors that would be undermined or significantly diminished if entrants were to introduce overage charges.

Increasing data usage also contributes to increasing on-island and off-island backhaul capacity and this has to be recovered from the retail charge. An operator that charges overage is able to raise additional revenue above the retail subscription price to pay for the additional backhaul, whereas its competitors may face significant limitations given the limited bases on which they can present alternative compelling offers in the market due to the unavailability of more advanced wholesale access products. Therefore competing operators bear the costs of providing unlimited monthly usage but arguably may face constraints in the options available to recover such costs, where an incumbent operator who levies an overage charge arguably might not.

Question 8

Does the respondent agree that monthly usage is an appropriate adjustment to be applied to a margin squeeze test for the broadband service market if the REO approach were applied to a price setting decision? Respondents should set out a comprehensive set of reasons for their position.

Question 9

Respondent views on whether overage charges should be taken into account when assessing revenues earned by an efficient retail competitor in a margin squeeze assessment? Respondents should set out a comprehensive set of reasons for their position.

Average Customer Lifetime (ACL)

A broadband service provider incurs some customer acquisition costs that need to be recovered during the lifetime of the relationship with the customer. The longer the relationship the lower the monthly amortisation charge. The EC recommendation states “The relevant period for this ex-ante economic replicability test should be set in accordance with the estimated average customer lifetime”[15]

There is evidence that entrants have a shorter average customer lifetime ACL than incumbents and so must adjust their pricing to amortise customer acquisition costs over a shorter ACL.

One of the adjustments that Ofcom makes to the EEO in its VULA margin squeeze test is to take account of lower ACL for BT’s competitors. Based on evidence presented by BT’s competitors, Ofcom concluded that “there is material difference in the ACL between BT and other CPs” (Para 6.454). Ofcom also considered “that, on balance, this would appear likely to be an advantage of BT that other operators cannot match” (para 6.455). Finally, it concluded: “other operators are likely to have a materially shorter ACL than BT” (para 6.458).

[15] *European Commission (2013) ‘Recommendation on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment’ Annex II(v)*

In the VULA statement, Ofcom sets the ACL for entrants at 5 years based on data received from BT's rivals. However, it noted BT's argument that the ACL for superfast broadband is likely to be longer than the standard broadband due to the more compelling services and subsequent higher levels of customer satisfaction. This finding is also recognised by the European commission. In its Recommendation on non-discrimination it states:

> *When estimating the average customer lifetime, NRAs should take due account of the different characteristics and competitive conditions of the provision of services over NGA networks compared to the legacy copper network, where these are likely to result in users of NGA networks having different average customer lifetimes compared to users of the copper network.*[16]

In the Channel Islands the two network operators have different strategies for the implementation of Next Generation Access. However, it is clear that the transition to NGA-based services is relatively recent and that any change of behaviour of customers with respect to the ACL is by no means clear.

The approach to considering an appropriate ACL is discussed at length in Telefonica (paragraphs 475-489). The European commission notes that Telefonica is likely to have a longer ACL than would occur in a competitive market, simply because of its dominant position (para 478) and that Telefonica's method of calculation 'considerably overstates' the actual ACL (para 479). The commission concluded that in that case an ACL of 3 years was appropriate, but accepts that this period favoured Telefonica because its business plan assumed an ACL of 2 years for the purposes of amortising customer acquisition costs (para 489).

During its margin squeeze investigation the JCRA was presented with evidence that an appropriate ACL was two years.

Question 10

Respondent views are sought on whether average customer lifetime is an appropriate adjustment to be applied to a margin squeeze test for the broadband service market if the REO approach were applied to a price setting decision?

Evidence is sought on the average customer life and what a reasonable period might be? Where respondents rely on their own research or surveys these should be referenced in order to allow CICRA to verify the evidence submitted to it.

Discounted Cash Flow or Static Model

The European Commission and some national regulators (e.g. ComReg in Ireland) suggest applying a discounted cash flow (DCF) model for assessing a margin squeeze. ComReg chooses the DCF model 'given the uncertainty over volumes in the context of the fibre network rollout and the fact that some offers, in order to be any interested consumers, may have to be priced at a loss at small volumes in the early days of their availability'.[17]

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[16] *ibid*
[17] *ComReg (2013) 'Next Generation Access: Remedies for Next Generation Access Markets' 31/01/2013*

A DCF model may provide little added value over a period (ACL) of 2 or 3 years. The model, however, does take account of the cost of capital and early period (introductory) discounts. On balance the position taken by CICRA in carrying out its recent investigation was to adopt the alternative approach of a static model.

Question 11

Respondent views are sought on which Model is most appropriate in applying any margin squeeze approach? The reasons for any stated preference and the availability of information to support such an approach should be made evident in the submission in order to inform CICRA's views of the feasibility of such Model approaches.

Retail Costs

"Retail costs" means all costs in addition to the wholesale cost paid to the incumbent operator for the service in question. Therefore this will include network costs borne by the entrant in addition to costs (such as sales and marketing) normally associated with retail activities.

A margin squeeze test examines whether the REO could profitably compete with the vertically integrated firm given the price of the wholesale input and the retail price of the vertically integrated firm.

To establish whether a margin squeeze is taking place the model needs to determine whether a REO has retail costs less than the difference between the wholesale input cost and the retail price of the vertically integrated firm.

Such retail costs would be calculated from information supplied by the incumbent operators and other operators as well as from benchmarked industry knowledge from other margin squeeze cases. The suggested areas covered by these costs are:

- Other (non-regulated) wholesale inputs from the dominant operator;
- Other wholesale inputs;
- Own network and equipment costs;
- Retail, sales, marketing and provisioning costs, and
- Business-related operating costs ("overheads").

Question 12

Does the respondent agree that the retail costs listed above are appropriate inputs to a margin squeeze test for the broadband service market if the REO approach were applied to a price setting decision? If the respondent is of the view the list includes costs that should not be included or additional or alternative costs should be included they are asked to set those out and the reasons for their position, in particular the likely materiality of such costs.

5. Next Steps

CICRA will consider responses received and the evidence provided to inform its position on Broadband Price Controls for JT (Jersey) and Sure (Guernsey). Following consideration of the responses received, as a next step, CICRA would then intend to engage with respondents prior to coming to any formal decision.

Appendix A - Legislative and Licensing Background

Legislative background and regulatory duties in the Channel Islands

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

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

Article 7 of the Law lists the statutory duties of the JCRA. These include performing its functions under the Law in such a manner it considers is best calculated to ensure telecommunications services are provided as satisfy all current and prospective demands for them.

Where it is consistent with this duty, the Law lists further objectives for the JCRA, including:

- Protecting and furthering the short-term and long-term interests of users within Jersey of telecommunications services;
- Promoting competition among persons engaged in commercial activities connected with telecommunications in Jersey;
- Promoting efficiency, economy and effectively in commercial activities connected with telecommunications in Jersey, and
- Furthering the economic interests of Jersey.

In addition, Article 7(3) of the Law requires the JCRA, inter alia, to have regard to whether telecoms services provided in Jersey are accessible to and affordable by the maximum number of business and domestic users.

To carry out these duties, Article 14 of the Law provides the JCRA with the authority to grant licences for the running of telecommunications systems in Jersey.

In 2010, following a review of the markets for telecoms services in Jersey, the JCRA made the decision that JT has SMP in the market defined as 'Wholesale broadband services provided on a fixed line network.

Part IV of JT's licence outlines provisions that apply to services provided in markets in which the JCRA has determined that JT possess SMP.

Condition 33.2 of JT's licence 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 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 the determination applies."[18]

This condition, coupled with the finding that JT holds SMP in the market for wholesale broadband services provided on a fixed line network, therefore allows the JCRA to regulate the prices that JT charges for wholesale broadband services.

In establishing a price for these services, Licence Condition 33.3 provides the basis on which prices should be set:

"All published prices, discount schemes and special offers of, or introduced by, the Licensee for Telecommunications Services shall be transparent and non-discriminatory; all prices and discount schemes shall be cost-justified and all special offers shall be objectively justifiable.[19]

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

- Conditions intended to prevent and control anti-competitive behaviour[20]; and
- Conditions regulating the price premiums and discounts that may be charged or (as the case may be) allowed by a licensee which has a dominant position in a relevant market[21].

In accordance with these provisions in the Telecoms Law, both the "Fixed Telecommunications Licence Conditions"[22] and the "Mobile Telecommunications Conditions"[23] awarded to Sure (Guernsey) include the following text:

"The Director General may determine the maximum level of charges the Licensee may apply for Licensed Telecommunications Services within a Relevant Market in which the Licensee has been found to be dominant. A determination may:

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[18] *Class III Licence issued to Jersey Telecom Limited*
[19] *ibid*
[20] *Condition 5(1) (c) of the Telecommunications (Bailiwick of Guernsey) Law, 2001*
[21] *Condition 5(1) (f) of the Telecommunications (Bailiwick of Guernsey) Law, 2001*
[22] *Document OUR 01/18; Condition 31.2*
[23] *Document OUR 01/19; Condition 27.2*

a) *Provide for the overall limit to apply to such Licensed Telecommunications Services or categories of Licensed Telecommunications Services or any combination of Licensed Telecommunications Service;*
b) *Restrict increases in any such charges or to require reductions in them whether by reference to any formula or otherwise; or*
c) *Provide for different limits to apply in relation to different periods of time falling within the periods to which the determination applies."*

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

The OUR (the predecessor to the GCRA in Guernsey) found in 2001 that Guernsey Telecom (now Sure (Guernsey) Limited) was "*Dominant in the fixed telecommunications networks and services markets and the mobile telecommunications networks and services market in the Bailiwick of Guernsey.*"[24]

[24] *Document OUR 01/14, Decision under The Telecommunications (Bailiwick of Guernsey) Law, 2001*