Office of Utility Regulation

Cable and Wireless Guernsey Price Control

Consultation Paper

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Office of Utility Regulation
Suites B1 & B2, Hirzel Court, St Peter Port, Guernsey, GY1 2NH
Tel: (0)1481 711120, Fax: (0)1481 711140, Web: www.regutil.gg

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1. Introduction

On 1st April 2011, C&WG's three year price control will end. During 2009 a pan-Channel Island project was initiated to facilitate the development of wholesale access products. This aspect of the telecoms market is generally considered key to the development of fixed line competition. If successful, competitive access to C&WG's network might provide a sound basis to revisit the issue of C&WG's dominance in certain markets, with the potential to significantly reduce, or remove entirely, C&WG's products from price controls.

While progress has been made in developing new wholesale access products the timing for the completion of this pan-Channel Island project remains unclear. Given this, it appears premature to assume the future development of competition would justify the removal of C&WG's price controls at this early stage. However, the time period in which sufficient competition might develop, given this workstream, is such that the DG proposes to refrain from setting an entirely new price control for the next few years, given the resources involved and the possibility that the period of such a control would need to be relatively short.

The DG has therefore considered the option of a one year rollover, having sought comments from the industry on that proposal. Respondents have provided their views and are generally supportive of the DG's proposal, though the incumbent has raised certain issues it wishes to have considered in the event of such a decision. In particular, C&WG proposes that exchange line rental prices should increase from £7.99 to £8.99 per month. These views are assessed in this consultation document which sets out the DG's proposals given the matters raised.

The DG is consulting on these proposals. Given the limited range of issues relative to a full price control he proposes to amend the standard consultation process such that, subject to the views of interested parties, he will move straight to a final decision in January 2011.

This document does not constitute legal, technical or commercial advice; the DG 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 DG to regulate the market generally.

2. Structure of the Consultation Paper

The document is structured as follows:

Section 3:	Sets out the legal and regulatory framework for the telecoms sector;
Section 4:	Discusses the background to the current price control and subsequent developments;
Section 5:	Explains the DG's proposals for a price control rollover and an assessment of the issues raised;
Section 6 :	Outlines the next steps.

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

Office of Utility Regulation,
Suites B1 & B2, Hirzel Court
St Peter Port
Guernsey
GY1 2NH
Email: info@regutil.gg

All comments should be clearly marked "**Cable and Wireless Guernsey – Price Control Consultation**" and should arrive before 5pm on 22nd ***December 2010***.

In line with OUR consultation policy, the DG intends to make responses to the consultation available on the OUR website. Any material that is confidential should be put in a separate Annex and clearly marked so it may be kept confidential. The DG regrets that he is not in a position to respond individually to the responses in this consultation.

3. Legal requirements and Licensing framework

3.1 Legal Requirements

Section 5(1) of the Telecommunications (Bailiwick of Guernsey) Law, 2001 ("the Telecoms Law"), provides that the DG 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[1]; 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[2].

3.2 Licensing Framework

In accordance with these provisions in the Telecoms Law, both the "Fixed Telecommunications Licence Conditions"[3] and the "Mobile Telecommunications Licence Conditions"[4] awarded to C&WG include the following text:

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

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

This condition allows the DG 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 relevant market.

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[1] *Condition 5(1)(c) of the Telecommunications (Bailiwick of Guernsey) Law, 2001.*
[2] *Condition 5(1)(f) of the Telecommunications (Bailiwick of Guernsey) Law, 2001.*
[3] *Document OUR 01/18; Condition 31.2.*
[4] *Document OUR 01/19; Condition 27.2*

4. Current price control and subsequent developments

The current three-year C&WG price control is due to expire at the end of March 2011. For the current price control, the OUR issued a consultation paper in May 2007 (OUR 07/08) seeking views on a proposed new price control for C&WG. In February 2008, the DG published a final decision (OUR 08/07) following his review of C&WG'S Price Control.

The OUR is currently working with local operators as part of a Pan-Channel Wholesale Access Working Group initiative to look at ways of increasing competition in the telecoms market, since further, more effective competition may provide scope to remove or significantly reduce the scope of C&WG's price controls. However, the timing for the completion of this project is uncertain at present. In these circumstances a three-year price control risks being too long given the current workstreams and therefore inappropriate in the face of the potential for increased competition in the fixed line market. On the other hand, no price control risks a situation where consumers have inadequate safeguards.

In order to better assess the need for, and possible scope of, any future price control, given the current price control expires in 2011, the OUR has considered the option of a roll-forward of the current price review from April 2011 to April 2012, rather than a full three-year price review for April 2011 to April 2014. The DG has considered this option since it offers a proportionate approach given the current workstream.

Calls for comment

In February 2010, the OUR invited comments from all interested parties on the matter of the upcoming price control for C&WG, requesting respondents to provide their views on two areas. Respondents were asked to provide feedback on whether a roll-forward as proposed raised any issues that required further consideration, and if there were specific areas operators wish the OUR to take into account to address in the event of a roll-forward.

Responses were received from Wave Telecom and C&WG. Wave Telecom offered no specific comments on issues that may arise with a roll-forward or specific areas it would like addressed in the roll-forward. Wave's view was that a roll-forward appeared to offer a sensible approach in the circumstances. In Wave's view the work of the Pan-Channel Island Wholesale Access Working Group will not have had a significant impact on the market by the beginning of 2011, given the stage of development and normal product development cycles of 12-18 months.

In C&WG's response it considers that there is an argument that dominance does not persist in Guernsey. C&WG set out a number of developments it relies on to question which customers' interests are served by a price control during any roll over.

One of the specific issues raised by C&WG is the discrepancy between the rate of inflation assumed in the price control of 4.2% over the three years and the outturn over the period of 2009. C&WG argues this has impacted on its ability to recover the costs of its price controlled services.

A further specific issue raised is the current pricing of retail exchange lines, maintaining that prices do not enable it to recover its costs. C&WG requested the OUR to remove that product from the price control to allow C&WG to recover its costs.

5. DG's views

C&WG's dominance

C&WG's market share of voice originated minutes was 86%, while it had a 79% market share of fixed voice revenue, based on the last OUR telecoms market report. While the situation differs to some extent between residential and business customers, these market shares remain high. It therefore appears to the DG too early to justify revisiting questions of market power in the fixed telecoms market given the sustained high market shares by C&WG.

In addition, while it is the case that technologies such as mobile and other broadband facilitated services are features of the telecoms market more prevalent than even a few years ago, the extent to which these offer strong substitutes remains open to question given much of the usage of such alternatives is as a complement rather than a substitute to fixed line retail services.

Market entry is another aspect which requires consideration in assessing whether there is a strong case to revisit the finding of C&WG's dominance. The market has however further consolidated given the acquisition of Newtel Guernsey by Wave Telecom/Jersey Telecom in 2009. Furthermore, the impact on market concentration given the difficulties many businesses have in accessing capital must open at least the possibility of further consolidation in the telecoms market until the present capital market conditions change. For the above reasons it seems to the DG that making decisions about C&WG's dominance at this stage would be premature.

Inflation

In terms of the inflation issues raised by C&WG, since its response the RPI figures reported for Guernsey were 3.4%, 2.3% and 1.6% for each of the first three quarters of 2010. The latest Policy Council Report providing forecasts of inflation suggests

RPI will continue to rise, remaining close to 3%, which is the inflation target for Guernsey. There are differing views on the likely path of inflation, with Guernsey Post's most recent submission to the OUR suggesting an RPI of 3.5% on which to base its price control. An alternative view is seen from the Bank of England quarterly inflation report (August 2010). This maintains that UK inflation is likely to stay above the 2% target (for the Consumer Price Index, CPI) until the end of 2011, after which inflation is likely to fall back to target or below. Guernsey inflation is generally acknowledged to have been around 1% above UK inflation in the past.

Given the degree of uncertainty around future inflation, the DG considers one approach to address C&WG's concerns in this area is to reset inflation for the next year of C&WG's price control to the last published RPI at the time of a final decision.

The DG welcomes views on this aspect, which would not lead to a change in the price control itself, other than an adjustment to the level of RPI assumed over the coming year, in the event of a one year price control rollover.

Exchange Line rental

C&WG have also presented an argument that exchange line rental should be increased. Details of this argument are presented in a confidential annex and it is therefore not possible for respondents to make a detailed assessment of the particular circumstances set out by C&WG. The OUR has however sought to present the main tenets of the argument to allowed for informed responses on the issue.

Currently, monthly exchange line rental is set at £7.99 and has been at this level since April 2007. In his decision document OUR 08/07 the DG explained the rationale for setting the exchange line rental prices at the level he did.

"In light of the evidence provided by C&WG and in particular its 2006/07 Regulatory Accounts (which was provided to the OUR in mid December 2007) the DG has decided to extend a safety cap to both Exchange Line Rental (Basket 1) and On Island Wholesale Leased Lines (Basket 4). The Regulatory Accounts show markedly different ROCEs for these two product groupings compared with those derived from the economic modeling informed by C&WG's own inputs. The DG therefore believes it would be inappropriate for any price changes in both Basket 1 and Basket 2 [sic] *at the current time. The DG intends to review C&WG's 2008/09 Regulatory Accounts and the underlying methodologies adopted by the company in order to understand fully the profitability of the two businesses."*

In considering a rollover of the current price control, the DG has sought to more fully understand the issues raised at the time of the decision in 2008.

C&WG's regulatory accounts use the Current Cost Accounting principle. The profitability of the exchange line business is consequently affected by changes in commodity prices, and these levels can deviate from historic investment costs. A reason for the current cost accounting approach is to ensure entrants have the correct market signal whether to invest in a network themselves or effectively rent access from C&WG's existing network. Fluctuations in world copper prices over recent years have been observed given turbulent economic conditions worldwide, and these developments have created quite sizeable differences between the price at which investors would expect to receive a reasonable return based on their investment, and the price at which the exchange line business appears profitable on a CCA basis.

There is therefore an argument made by C&WG that worldwide conditions have deflated the cost of the copper network and the CCA costing basis should therefore place less reliance on this approach in these circumstances. Instead, it argues that setting of exchange line prices by the regulator should rely more on historic costs to inform pricing decisions in this area for the short to medium term. It is apparent that widely differing profitability outcomes are reported in C&WG's regulatory accounts. C&WG's 'exchange line rental & connection' business shows a loss of £0.852m for 2008/09 and a profit of £2.7m for 2009/10, despite the fact that exchange line rental prices were the same over both years. The explanation for this volatility does appear to be the significant fluctuations in world commodity prices for those commodities informing the CCA cost assessment in the regulatory accounts.

C&WG's position is that it accepted the price freeze on exchange lines in the last price control decision for only the three year period of the control, but that any rollover of the control now requires an adjustment to reflect the loss it is making on exchange line prices set at £7.99. It argues that the current limit was established outside of the normal calculated price control mechanism, as a result of alternative information having been made available to the OUR at the time. Since then, C&WG has provided additional information to the OUR which it believes provides valid justification to the OUR for it to consider a change to exchange rental prices.

Given the issues set out above it does appear to the DG that an increase in exchange line prices would be justified, in particular given the use of CCA currently provides an unreliable basis to assess the correct price at which exchange line rental should be set. Since the historic cost basis is consistent with a price of £8.99, in the DG's view he is minded to allow such a change, in the event of a price control rollover.

6. Next Steps

The DG invites views on the issues raised and, in particular, the price changes proposed by C&WG. Once the DG has considered those responses he would anticipate publishing a final decision in January 2011.