Retail Price Cap Review in the Channel Islands

A REPORT PREPARED FOR CICRA

March 2015

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1 Introduction

CICRA commissioned Frontier Economics to carry out a review of the price cap applied to retail fixed line services in the Channel Islands. The last price caps for Sure (in Guernsey) and Jersey Telecom (in Jersey) were set in 2008, initially for the period up to 2011. Since then, both JT and Sure have been subject to yearly roll overs and an interim price cap, allowing for price increases in line with the respective retail price index (RPI). At the time, CICRA argued that maintaining a price cap was appropriate as both operators still held a dominant position in the relevant markets. Given the delay in wholesale line rental (WLR) being launched the increased benefits of competition have not be realised and therefore CICRA decided in 2014 to undertake a formal price cap review. We understand that our report forms part of this review.

The remainder of this document is structured as follows.

- Firstly, in **Section 1**, we set out our approach to assessing the need for and the appropriate level of any continued price control and the context within which this price cap review is taking place

- This is followed by our analysis of the need for and scope of any continued retail price control for fixed line services in the Channel Islands. We first confirm in **Section 2** the need for a price control based on a review of the current market developments since the last review. **Section 3** then sets out the recommended form, scope and duration of next price control, taking into account recent regulatory developments (such as WLR pricing) and CICRA's wider policy objectives.

- **Section 4 t**hen presents our recommendations on the level of the next price control, followed by some concluding comments in **Section 5**.

Throughout our analysis we take into account recent developments such as proposed retail price changes and the proposed introduction of WLR in June 2015. Supporting material underlying our findings, including all charts and tables, is presented in the **Annexe**.

1.1 Approach to the 2015 Price Cap Review

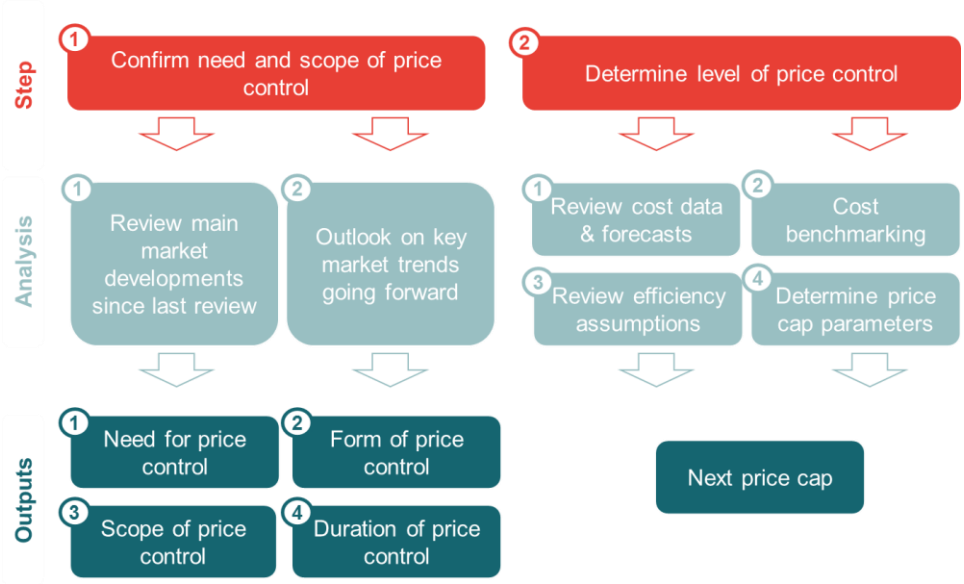
This price cap review is undertaken in two main steps as shown in **Figure 1**:

- First, we assess the need for an ex-ante price control in the Channel Islands. This takes account of current and expected competitive

conditions in the market for retail fixed line services in Jersey and Guernsey.[1]

- If we find that there is a continued need for a price control, we then determine the appropriate level of the next price cap.

Figure 1. Overview of overall approach to the price cap review



Source: Frontier Economics

1.2 Process summary

At the start of the project in mid-August 2014, we organised initial meetings with CICRA and both operators to discuss the overall approach to this review and the key factors of relevance to it. This was followed up with targeted information requests that were sent to both operators, taking into account publicly available information and that held by CICRA. This was followed by several calls and internal discussion papers on emerging findings, recent developments in the market (such as, the proposed WLR pricing) and their implications for the retail price caps for fixed voice services going forward.

[1] This common step in any price cap review, ideally requires a full market review process, where CICRA would define the relevant product and geographic markets, assess the level of competition within each market, and design regulatory remedies (such as ex-ante price controls) to address any risk of a dominant operator engaging in anti-competitive behaviour. However, CICRA, as part of this assignment, wishes us to only conduct a high-level review of the current and expected competitive conditions in the market for retail fixed line services in the Channel Islands in order to confirm the need for retail price controls going forward.

The recommendations in this report are based on the understanding that the currently proposed WLR prices are final.[2] We further note that given the introduction of WLR there are two potential ways to set a new retail price cap:

- taking the current WLR prices as given and then setting a price cap such that if the regulated operator priced up to the cap, potential access seekers would be able to earn a sufficient margin on a bundle of services, so enabling them to enter profitably the market and compete with the regulated operator; or
- considering the end-to-end cost for price cap services and assessing what levels of retail prices are required for the regulated operators to earn a reasonable return under the assumption that the operators are cost efficient.

In principle, if WLR prices are indeed cost reflective both approaches should lead to the same result. We consider both options, but our main recommendations are based on the latter approach. The reasons for this are described in **Section 4** below.

Finally, it is important to note that we have not received complete responses to the information requests sent to the operators.[3] Most importantly we have not received complete financial forecasts from either party or conclusive evidence about the impact of OTT-VoIP and messaging services. In the absence of financial forecasts we made use of the operators' separated accounts in our analysis. We note that due to significant year-on-year variability of the financial performance of the relevant business segments within the separate accounts it was difficult to fully assess, among others, the operators' profitability on fixed line services.[4] As such, this report summarises our findings on the need and the level of ex-ante price controls going forward to our best knowledge. We base our assessment on publicly available data such as CICRA market reports and information received from the operators and CICRA to date.

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2 As of January 2015, CICRA and the operators have provisionally agreed on WLR price of £10.00 in Guernsey and £11.10 in Jersey. Together with the respective wholesale broadband access (WBA) prices this results in a "bundled" wholesale price of £24.90 in both Bailiwicks for narrowband and broadband services.

3 For example, Sure noted that it could not provide any financial forecasts of its retail fixed voice business due to changes in the reporting requirements and the approach to business planning at the group level. It further noted that any forecasts underlying its previous years' business planning processes would be outdated and not representative anymore.

4 A detailed analysis of the operators' separated accounts and the drivers of the observed year-on-year variations in performance is beyond the scope of the price cap review.

1.3 Context and initial observations

Before we present the results of our analysis we set out the context in which this retail price cap review is taking place.

As we discuss in more detail in **Section 4,** we observe substantial differences in retail prices for fixed line services across the two jurisdictions – in particular, the average monthly cost to consumers for fixed line services (holding usage constant) is circa 33% higher in Jersey than in Guernsey.

A key driver of the observed differences in retail prices could be the underlying differences in retail price caps[5] applied to Sure and JT over recent years.[6] In particular, Sure has generally been subject to more stringent retail price controls than JT since 2008 (see **Table 2**). This is particularly true in relation to Sure's local calls basket, for which there was a RPI-11.75% regime in place for four consecutive years compared to JT, in whose case an RPI-3% was applied between 2008 and 2011. As such, the recent retail price controls appear to have at least contributed to lower retail prices in Guernsey compared to Jersey.[7]

Given the recent move to closer co-operation between the JCRA and GCRA Guernsey and the general focus on a pan-Channel Island regulatory approach under CICRA, it is important to explore whether the prevailing differences in retail prices across the two Bailiwicks are justified going forward, especially where such differences could impact the structure or extent of competition in each jurisdiction.[8] In particular, we consider it is important to determine whether JT is exposed to any exogenous factors which results in it having higher (efficient) costs of delivering fixed line services than Sure. In the absence of such exogenous cost differences or differences in demand, it appears reasonable to assume that the overall level of retail prices across Jersey and Guernsey could be similar.

Below we briefly explore potential drivers and assess whether these may justify prevailing differences in retail prices for fixed line services.[9]

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5 It is our understanding that the difference in retail price caps is partly due to the fact that, at the time, the JCRA and the GCRA, the respective regulators in Jersey and Guernsey, did not coordinate their regulatory decisions to the extent they do today under CICRA.

6 We note that a different starting levels of prices might be another reason for price differences observed today

7 We note that previous retail caps seem to be the main drivers of past price reductions, as the operators have changed retail prices broadly in line with their allowance (see **Figure 8**)

8 Note, we have not as part this price cap review assessed the merits of previous price caps applied to Sure or JT.

9 We note that there are other potential drivers of both operators' cost base which we do not explore here. For example, there are differences in ownership structure and overall footprint of both companies.

- **Demand** – We understand that there are certain economic and geographic similarities between both jurisdictions. Also in terms of usage patterns and take-up of fixed line services there are strong similarities between the two Bailiwicks.[10] As such, this does not appear to justify significant prevailing differences in overall retail price levels going forward.

- **Scales of operation – Different total population sizes drive** the difference in the scale of JT's and Sure's operation – in particular, there are around [● **confidential**] PSTN subscribers in Guernsey and [● **confidential**] in Jersey.[11] We would expect this to impact on the average costs of the operators, as a larger scale of operation is likely to lead to lower per subscriber cost. As such, if at all, JT's larger total customer base should allow JT to benefit from higher economies of scale than Sure.

- **Fibre investments –** JT has in recent years invested heavily in the roll out of its fibre network (a total of £41.5m was invested by JT and the States of Jersey) whereas Sure has not made such investments. We understand that this was not a regulatory requirement but a commercial decision by JT (and the States of Jersey), with the objective of enabling faster broadband speeds. Whilst this will add to JT's costs, it is our view that such additional costs associated with the fibre roll out should be recovered from JT's broadband, rather than its fixed voice service. This means this cost difference should not be taken into account in this price cap review (see **Annexe 6.1.11** for a more detailed discussion).

We are not aware of other major reasons for there being exogenous cost and hence price differences between JT's and Sure's fixed line operations. To the extent that those differences are driven by different levels of efficiency, or one operator earning a rate of return in excess of cost of capital, it thus seems reasonable to consider taking such differences into account in setting the price control.

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10 According to 2011 CICRA Market Report the respective fixed line penetration rates (per population) were 66% (Jersey) and 65% (Guernsey). We further know from the operators' responses to our information request that the average minutes per subscriber line are broadly similar. In 2013, Guernsey had on average [● **confidential**] and Jersey [● **confidential**] minutes per line. See also **Figure 6** and **Figure 7**.

11 Response of operators to our information request

2 The need for an ex-ante price control going forward

It is important to consider the continued need for a price control separately for each service group currently being regulated. As such, in the below we first review, in both Jersey and Guernsey, the current and expected market developments for **fixed line access** services, followed by **fixed call services**.[12]

Our findings in this section are mainly based on publicly available information and documents provided to us by CICRA and the operators as of September 2014. We discuss more recent developments as of January 2015 and our final recommendations regarding the need for an ex-ante price control in **Section 3**.

2.1 Fixed Line access services

Competition for retail fixed line access services appears to remain limited in both Guernsey and Jersey. In particular: (i) there are limited alternative offerings to the incumbents' retail fixed access line services; and (ii) both operators have retained a dominant position in their respective market for retail fixed line access services.

- Both Sure and JT remain the sole provider of **PSTN access lines** in Guernsey and Jersey respectively and there are few alternative fixed network operators present in both markets. For example, whilst there are **fixed wireless network operators** present in both jurisdictions,[13] these providers predominantly focus on serving business customers and offering broadband services. According to the latest data available to us, their market shares in the retail fixed narrowband access market are negligible.[14]

- **Barriers to entry** to the market remain high as there is currently no wholesale access service (i.e., WLR or local loop unbundling) available in either jurisdiction, but WLR is due to be launched in June 2015.[15]

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12 We note that whilst both operators' current retail price controls covered connection, line rental and call services, Sure's price control also included on-island wholesale and off-island retail leased line services. However, we understand that CICRA's recent findings from its business connectivity market review (CICRA 14/41) were that there is currently no need for ex-ante price control for retail leased line services in Guernsey.

13 For example, Airtel is active in both jurisdictions and Newtel and Nitel in Jersey only.

14 2011 CICRA market report. No exact numbers available as only graph provided

15 We note that even after the introduction of WLR it is likely to take some time for the relevant retail market to become more competitive. In the UK, for example, retail price controls were removed four years after the introduction of the first WLR product.

- Despite the increasing presence of **mobile voice services** and availability of **over the top (OTT) Voice over Broadband (VoB) services,**[16] there is limited evidence to suggest that fixed line customers in the Channel Islands are substituting away from fixed access line services to these alternative products. In particular, the total number of fixed access lines in service in Guernsey and Jersey has remained broadly constant since 2008 (see **Figure 2**). A likely reason for this is that fixed access lines are required for both making and receiving fixed voice calls and for broadband (DSL) services.

  There is no evidence to suggest that prices for retail fixed access line services have fallen over recent years, in response to, for example, increasing competitive pressure. Instead, Sure and JT have kept prices in line with their price cap for retail fixed access line services (i.e., predominantly set at RPI-RPI, plus a one-off increase agreed outside of the price cap in 2012).[17]

Given the above, we conclude that both Sure and JT are likely to maintain a dominant position in the provision of retail fixed lines. We therefore conclude that there is a continued need for ex-ante price controls for Sure and JT's retail fixed access line services.

2.2 Fixed call services

As the demand for retail fixed call services has fallen over recent years, Sure has expressed the view during our initial meeting that a continuation of the retail price control is not needed on the basis that the market for fixed calls is declining. However, this alone does not merit a removal of price controls and we find there is limited evidence to suggest that the market has become sufficiently competitive to remove fully ex-ante regulation.

- Despite the presence of **alternative network operators** and **indirect call service providers** in both jurisdictions, Sure and JT remain the main providers of retail fixed call services in their respective markets. For example, based on the latest CICRA Market Report, both operators accounted for more than 85% of total outgoing fixed call traffic in 2011 in their respective islands.[18] Indirect access call volumes represented less than

16 OTT-based VoB services are offered by international providers (such as Skype or Viber). Users require an internet connection and a personal computer, laptop, tablet or mobile smartphone in order to access the VoB service which is provided via an OTT software solution (e.g. a mobile app) from the service provider.

17 According to Sure's 2012 Price Cap Compliance file a [● **confidential**] increase in its monthly line rental was agreed with CICRA outside the RPI+/-X framework

18 We have not received more up to date market share information than available in the 2011 market report.

12% of total call traffic in Jersey and Guernsey, and the market share of fixed wireless providers was less than 2% (see **Figure 3**). Based on the recent fixed call traffic trends we expect that these high market shares are likely to prevail.

- We note that fixed call volumes have dropped over the last few years in both Guernsey (**Figure 4**) and Jersey (**Figure 5**)**.** This is likely to be the case due to two factors: Fixed-to-mobile substitution and OTT-based VoIP and instant messaging services. However, this does not prove that the market is effectively competitive.

  - There appears to be a degree of **fixed-to-mobile substitution** for calls services taking place in Guernsey; however this trend has halted since 2011 (**Figure 6**). Similarly, the data available to us for Jersey also indicate some fixed-to-mobile substitution (**Figure 7**).

    However, we note that while fixed call volumes have decreased and mobile call volumes have increased this does not necessarily suggest that consumers substitute one for the other in the event of a relative price increase of fixed calls.[19]

    Fixed-to-mobile substitution partly occurs because mobile post-pay plans often include free minutes (and data allowances).[20] However, these pay-monthly mobile plans usually only include calls to local and national (and in some cases to UK) landlines and mobile phones, but exclude international calls.[21] Given this and prevailing differences in call charges for international calls from a mobile and a fixed line,[22] there is a limited degree to which fixed-to-mobile substitution takes place for international calls.

    We show in **Figure 9** that the monthly **call cost** (excluding line rental, monthly payments for mobile handsets etc.) of the average Channel Islands consumer[23] is lower for fixed services than for any mobile plan.

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19 We provide an overview of changes in retail price changes driven by previous price caps in **Table 2**.

20 As part of its response to the information request, Sure noted that Sure, Airtel and JT all include free SMS and call minutes within their post-pay mobile packages in Guernsey resulting in *"nearly all post-pay users in Guernsey benefitting from free minutes to local and UK destinations"*.

21 For example, JT offers 3 different Airtime plans for mobile customers. These range from £6.99 (including free minutes to JT and JT Mobile customers) to £17.99 (free minutes to All Channel Islands and UK). Sure's free minutes include calls to Channel Islands and UK but exclude other international destinations.

22 JT divides international destinations into 5 regions ranging from £0.30 to £0.75 per minute for mobile calls. Similarly, Sure divides international destinations into 4 regions ranging from £0.25 to £0.75 per minute, plus a connection charge of £0.05 per call.

23 See **Table 9**

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Assuming that the average consumer has both a fixed and a mobile connection,[24] he has limited economic incentives to substitute from fixed to mobile for international calls. We note however that customers who mainly use local and national calls have a stronger incentive to substitute from fixed to mobile as these are usually included within the free minutes of a mobile plan. Overall, we would therefore only expect **partial** fixed-to-mobile substitution to take place, which is in line with our initial observations.

Finally, fixed calls remain significantly more important than mobile calls in absolute terms.[25]

- The demand for fixed call services is further likely to be dampened by the emergence of **OTT-based VoIP and instant messaging services**. JT submitted a piece of analysis[26] suggesting that PSTN lines account for only [● **confidential**]% of call minutes. Based on a one week sample of [● **confidential**] households in Jersey, JT notes that mobile accounts for [● **confidential**]% of total call volumes and VoIP for the remaining [● **confidential**]%. Information from other jurisdictions indicates that the demand for fixed voice calls declines as people use VoIP (**Figure 10**) or messaging services (**Figure 11**) as alternatives means to communicate. This evidence suggests that there is an increasing demand for OTT-based VoIP and instant messaging services. However, whilst we have no reason to believe this general trend will not apply to the Channel Islands, it remains unclear whether the observed uptake in instant messaging is a compliment or substitute for other telecommunications services, including fixed voice services. It is also not clear that this would mean that these alternative sources act as a competitive constraint on the pricing of PSTN voice services for those consumers who still use such services.

- In contrast, recent call prices developments under the current price cap regime suggest that **both JT and Sure have not used their full pricing flexibility provided under the price cap** (i.e. they have not increased prices in line with what is allowed in the price cap). This could suggest that both operators feel to some degree constrained in their pricing flexibility

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24 We believe this is a reasonable assumption, because according to the 2011 Market Report, the mobile penetration rate (in terms of population) was 134% in Jersey and 108% in Guernsey (compared to 129% in the UK at the time). These are likely to have increased further in recent years.

25 The latest data suggests that, per subscriber, fixed call volumes in Guernsey are 4 times higher than mobile call volumes (**Figure 6**). And similarly, JT's fixed call volumes per subscriber are twice as high as its mobile call volumes (**Figure 7**).

26 JT response to question 2 of the information request

(**Figure 8**). However we note that this could also be due to behavioural rather than economic reasons: The operators might be reluctant to incrementally increase retail prices every year even if the price cap gives them enough flexibility to do so for various reasons.[27]

In summary, the emergence of alternative services and changing consumer demands may constrain, at least to some extent, the operators' ability to price these services above a competitive level (absent any regulation). Furthermore, these constraints may increase over the following years. However, JT and Sure retain a strong position in the provisioning of retail fixed call services. **Given this and the growing importance of data usage going forwards, we conclude that there remains a need for some form of ex-ante price regulation for retail fixed call services.**

[27] It is not uncommon to observe that operators do not fully utilise their pricing flexibility foreseen under any given retail price cap regime. This can be a result of, for example, the fact that consumers are generally averse to regular changes in prices (in particular, price increases); and that there is a certain cost in relation to changing prices (such as updating websites, printing new information material and informing customers).

The need for an ex-ante price control going forward

3 Recommended form, scope and duration of next price control

This section considers the appropriate scope of the next price cap. In doing so, we take into account recent regulatory developments and their potential impact on the next price control.

In particular, CICRA has been in continuous discussion with the operators regarding the introduction of WLR and WLR charges. We find that the introduction of WLR does not merit a removal of the price cap regulation. We also discuss the operators' proposed changes to retail prices[28] and other developments, and conclude with our recommendations concerning the form, scope and duration of any price control going forward.

3.1 The introduction of WLR

The introduction of WLR in June 2015 might change the competitive landscape in the line rental market, and potentially also a broader market for fixed telecommunications to some extent. This is because WLR lowers the barriers to entry by enabling alternative providers to offer retail line rental services without having to deploy their own end-to-end network infrastructure and thus compete against the incumbents in their respective markets.

However, our view is that the introduction of WLR does not justify the removal of the current price cap on the following grounds:

- Sure's preliminary forecast (to 2018) of the expected WLR take-up in both jurisdictions suggests that WLR may only have a limited impact on the market for retail fixed line services;[29,30] and

- In line with approaches adopted elsewhere (i.e., by Ofcom[31] and Comreg[32]), there is likely to be a need to retain some form of ex-ante regulation on retail

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28 We note that JT increased its retail line rental price in early 2015 from £12.99 to £13.24. For the purpose of our analysis we assume that this is in line with the current price cap and take the new line rental price as given.

29 Sure expects a total of [● **confidential**] WLR connections in Jersey and [● **confidential**] WLR connections in Guernsey by 2018. Based on current subscriber numbers (around [● **confidential**] in Guernsey and [● **confidential**] in Jersey) this would represent approximately [● **confidential**]% of the respective markets.

30 We have not received such forecasts from JT in response to our data request

31 In the UK, BT launched the first basic WLR product (WLR1) in September 2002, with a more developed offering (WLR2) being made available in March 2004. However, it was not until January 2006 that the retail price control on access line services was relaxed to RPI-0% and subsequently

access line services even after the launch of WLR, until retail competition has actually emerged.

3.1.1 The proposed WLR charges

We understand that JT and Sure have reached a joint agreement (during discussions facilitated by CICRA) that there will be a common wholesale bundle price across the islands of £24.90 for line rental and broadband access. The WLR price in each jurisdiction will therefore be determined as the difference between the total bundle price and the current WBA (wholesale broadband access) price. This results in WLR prices of £10.00 in Guernsey and £11.10 in Jersey, as shown in **Table 3**.

We further understand that wholesale call prices are likely to be set on the basis of a 'retail minus' approach.

3.1.2 Implications for price cap review

WLR could be used by competitors to offer either standalone voice services to consumers, or a bundle of voice and broadband services. However, for competition to be effective, new entrants must be afforded a sufficient margin to compete with the incumbent. This has a clear implication for the price cap. For example, a cap which forced retail price reductions on the operators, within a fixed WLR price, could limit the potential emergence of competition.

In examining a price cap we have therefore taken into account the potential impact of retail price reductions on the prospects for competition to emerge through the use of the WLR product. In doing so, we have focussed on the ability of new entrants to offer a voice and broadband bundle in competition with the incumbent in each market. This is because a new entrant is unlikely to compete only for voice services. This is for two reasons:

- Firstly, the margins available to downstream competitors may not be conducive to entry in the standalone line rental segment (see **Table 4** and **Table 5**); and

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removed later that year. This was in light of a significant uptake in WLR (e.g. two million WLR lines) and LLU in the UK, reducing BT's market share of total retail fixed access lines.

32 In 2003, Comreg relaxed the price cap for fixed access line services to CPI-0% in anticipation of the introduction of WLR in 2004. In 2007, after having considered removing the price cap, Comreg decided there was a continued need for price cap on access service (again set at CPI-0%) as eircom was still found to be dominant in the relevant market.

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- secondly, the most valuable customers are likely to also take a broadband service.[33]

3.2 Proposed changes to retail prices

[● **confidential**]

3.2.1 JT

[● **confidential**]

3.2.2 Sure

[● **confidential**]

3.3 Recommended form, scope and duration of next price control

Given our findings in this section, we recommend that CICRA should consider setting a price cap for a **single basket** consisting of **retail fixed access line services** and **retail fixed call services**[34,35] for a period of three years.

Setting a three year price cap would provide certainty to the market and consumers on future prices, and limit the regulatory burden of adopting shorter price cap periods, whilst still allowing CICRA to assess the impact of WLR on downstream markets (i.e. once any new entrant has been established in the market).

Given that competition is expected to take place on the basis of a bundle of retail line rental, calls and broadband, we recommend continuing to regulate a **single basket consisting of standalone services** rather than the price of the bundle. We take this view, because it will ensure that the most vulnerable customers (those who continue to use standalone services rather than a bundle) are protected.[36] That is, changes in the prices of voice and broadband bundles would

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33 Neither of the operators is currently offering a bundle consisting of retail line rental and calls (and broadband), but both have stated their intention to launch such bundles going forward. This is further in line with market trends elsewhere.

34 We mentioned previously that new entrants are expected to offer a bundle of line rental, calls and broadband. However we note that retail broadband prices will not be regulated as part of this price control.

35 [● **confidential**]

36 Bundles are usually priced at a discount compared to the sum of the underlying standalone services. This approach will therefore indirectly constrain the prices of bundles as well.

not, under this recommendation, be taken into account in determining compliance with the price control.

Recommended form, scope and duration of next price control

4 The level of the price cap going forward

In the previous section we concluded that in our view there is a continuing need for a retail price cap in the Channel Islands for both fixed line access and fixed call services based on a single basket. We now turn our attention to the recommended level of the price cap in both islands. The objective of this is to determine the appropriate price path for a basket consisting of retail line access and retail calls taking into account the operators' incentives absent any regulation, market developments and an international comparison among similar operators.

An assessment of the appropriate level of a price cap is usually made on the basis of detailed financial forecasts. By means of comparing expected future revenues and costs, and an appropriate level of efficiency gains, a price path (cap) can be determined which allows the regulated entity the opportunity – if it acts efficiently – to earn a reasonable rate of return. We understand that this is the approach that CICRA (JCRA/ GCRA) have previously undertaken. Unfortunately, the operators were unable to provide us with such forecasts in response to our information request. We therefore make our assessment based on the operators' current or most recent prices and costs.

In particular our analysis is informed by a:

- **Price benchmarking** – how the current level of retail prices in the Channel Islands compares to other comparable jurisdictions; followed by a
- **Cost benchmarking** – assessing the potential scope for further cost reductions based on a high-level benchmarking of JT's and Sure's operating expenditures (OPEX) to those of other operators.

4.1 Evidence from the retail price benchmarking

It is common practice to compare prices of any regulated business against those in similar jurisdictions as part of a price control. We also note that both operators have repeatedly made reference to the situation and current developments in countries such as the UK. Therefore, as a first step to assessing the appropriate level of retail prices in the Channel Islands, we have benchmarked retail prices benchmarking.

We started the benchmarking process by selecting a set of suitable comparator countries. The criteria included amongst others GDP per capita, population density and fixed line penetration. This resulted in a list of 11 suitable

jurisdictions[37] plus the UK. We then carried out this benchmarking by comparing prices offered by the incumbent operator in each jurisdiction for various OECD usage baskets. These usage baskets include assumed call volumes, in order that prices can be compared on an equivalent basis across countries (i.e., by comparing how much customers in each country would pay for a given volume of calls). Our analysis is based on data retrieved from the operators' websites as of September 2014.

We first show the results of our benchmarking in the line rental only segment and then extend our analysis to line rental and calls combined, using the methodology mentioned above.

- **Line rental only –** As we show in **Figure 12**, JT's and Sure's current retail line rental prices of £13.24 and £9.99 are above (JT) and below (Sure) the sample average.[38] JT's retail line rental would be substantially above the average if BT was excluded from the sample (it is included for economic and regulatory similarities). However we note that this is based on current retail line rental prices. [● **confidential**]. Currently, JT's line rental price is around 33% higher than Sure's (see also **Table 10**)

- **Line rental and calls (residential) –** As illustrative examples we show a comparison of domestic calls baskets with 20 and 140 call minutes in **Figure 13** and **Figure 14**. We observe that in both cases Sure has lower prices than JT (not taking into account JT Primetalk) and generally belongs to the least expensive operators in the sample. JT's bundle price is in line with the average in the case of the 20 calls basket and below average in the 140 calls basket.

- **Line rental and calls (business) – Figure 15** and **Figure 16** illustrate our findings on business tariffs, using the 100 and 260 minute business calls baskets. We observe the same pattern by which Sure has lower prices than JT and is among the cheapest operators of our comparator sample.

Based on our findings above, we conclude that **Sure's** retail prices are generally below the average price in our comparator sample. Nevertheless, this does not mean that prices are close to efficient cost, or could be expected to remain so absent regulation. We further note, that even though **JT's** retail prices are in line with the benchmarking sample average, they are substantially higher than Sure's. In particular, we compared the monthly cost of a basket comprising retail line

37 Bermuda, Cayman Islands, Cyprus, Gibraltar, Guernsey, Isle of Man, Jersey, Liechtenstein, Luxembourg, Malta, Hull

38 We exclude JT and Sure from the sample averages

rental (incl. line connection) and calls of the average Channel Islands customer.[39] Based on this analysis we find that JT's retail prices are on average 33% higher than Sure's (see **Table 10**).

As we mentioned in **Section 1.3** above, we are not aware of any exogenous reasons for the retail price levels of fixed line services to differ to such an extent across the two jurisdictions. We find that both operators have historically changed retail prices in line with the price cap (**Figure 8**), which suggests that a key reason for the observed price differential is that the price caps on JT required it to reduce prices by less than Sure was required to in recent years. This is confirmed by our review of retail price caps in the Channel Islands since 2008 (**Table 2**).

Based on the above, we conclude that there is no evidence, from the benchmarking, to suggest that Sure's prices should be subject to further regulatory reductions. Moreover, for the reasons mentioned above, there could be merit in CICRA deciding to introduce a new retail price cap on JT's charges, such that over the course of the cap its prices are brought more in line with those of Sure.

On the basis of the price benchmarking alone, and subject to the results of the cost benchmarking, we therefore recommend that CICRA considers maintaining a safeguard price cap on the basket of retail line rental (including line connection) and calls for Sure. CICRA could, however, introduce a cap on JT's prices to align them more closely to those of Sure.

4.2 Evidence from the OPEX benchmarking

The price benchmarking above is an 'outward looking' approach, in the sense that it compares Sure and JT's retail prices to those of other operators. The **cost benchmarking** on the other hand is 'inward looking' as it aims to assess whether based on the **currently** reported costs of JT and Sure (as of the 2013 separated accounts), there is evidence of any inefficiencies which operators could be expected to remedy over the course of the price control.[40]

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39 This is based on information we received from the operators on average minutes of use for local and national fixed to fixed, fixed to mobile and international calls. We used the call distribution of the 60 calls basket (as this yields total minutes of use close to the actuals) as per OECD guidelines to split these by day, evening & weekend calls. This resulted in an average usage profile shown in **Table 9**

40 We note that there are two further approaches which can be used to help to inform the performance of regulated businesses: (i) Analysis of **historic costs** and (ii) future **cost forecasts**. We have decided against using the former, as the separated accounts are quite volatile when comparing service unit costs between years and there are therefore doubts about how meaningful a comparison over time would be. We also note that it was not possible to conduct the latter analysis as we have not received detailed business plans from the operators.

While benchmarking costs is a widespread tool to compare the performance of regulated business against each other, it also needs to be conducted carefully. This is particularly the case as efficient costs may differ between jurisdictions and costs can also be recorded in different ways. We started the cost benchmarking exercise with the same comparator sample as for the price benchmarking. Unfortunately our sample size was reduced to four comparators (excluding Sure and JT), because the regulatory accounts (and therefore the cost data) are not publically available in all cases.

We focus our analysis on **OPEX (including depreciation) per subscriber** in the fixed retail business as a whole, and split by fixed line rental and fixed call services separately. The OPEX of the respective retail businesses includes transfer charges from the wholesale business thereby allowing us to compare the cost incurred for the end to end services.

- **Total retail –** We show in **Figure 17** that Sure and JT's total retail OPEX per subscriber belong to the lowest in our comparator sample. This is particularly true when comparing the operators against those with similar subscriber numbers (we note that KCom is an extreme outlier). We also observe that Sure has marginally lower OPEX per subscriber than JT.

- **Retail line rental and calls separately** – For both Sure and JT, the OPEX of the retail calls (**Figure 18**) and retail line access (**Figure 19**) businesses in isolation are in line with or below the sample average.[41] In retail calls, Sure has higher per subscriber OPEX than JT and in retail fixed line access, JT's OPEX is higher. However, this is to be expected, given JT's recent investment in the fibre network and its apparent accounting treatment of this cost (as it will lead to initially higher depreciation charges in the line rental business). We discuss this issue in **Annexe 6.1.11**.[42]

Given the results of our retail OPEX benchmarking we conclude that JT and Sure do not seem to have costs significantly above those of operators in other jurisdictions – although we note that our sample is relatively small due to the lack of data availability and this analysis should therefore be treated with caution.

We find no obvious indications of inefficiencies within Sure or JT from our cost benchmarking. Thus, in the absence of detailed business plans from which cost forecasts could be deducted it is difficult to assess whether it could be reasonable

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41 We note that not all operators report line rental and calls separately which leads to an even smaller comparator sample.

42 Given the approach to setting the price control, it has not been necessary to 'strip out' the fibre cost from JT's line rental business costs. However, we propose that CICRA should require JT to do this as part of its future separated accounts.

to assume that the operators could achieve general improvements in productivity beyond those implicit in general economy-wide inflation.

The cost benchmarking does not indicate that either operator has unit costs clearly out of line with comparators. We therefore recommend that the price control going forward is set primarily on the basis of the retail price benchmark.

4.3 Recommendations

As discussed in **Section 3** above there remains a need for some form of price cap going forward. Absent operator forecasts we have conducted a retail price and OPEX benchmark to inform the level of the next price cap.

The results from our **retail price benchmarking** suggest that, both in an international benchmarking and in a direct comparison with JT, Sure's basket of retail line rental and calls is among the least expensive. Furthermore, the current price differential of 33% between JT and Sure is substantial (see **Table 10**), without there being any apparent justification for such significant differences to be maintained going forward. As such, in absence of any justifiable, exogenous cost difference, and given the drive by CICRA to promote similar regulatory conditions in both markets, we consider it could be reasonable for CICRA to determine a price control which would more closely align retail prices in Jersey with those in Guernsey.

Further, from our **cost benchmarking** we find that Sure's total retail OPEX per subscriber is marginally lower than JT's (which may in part be driven by JT's treatment of fibre in its separated accounts) and both JT's and Sure's cost per subscriber is below the sample average. While this seems to suggest that the operators are not inefficient compared to those in other jurisdictions, it does not offer conclusive evidence that there is no room for achieving further cost efficiencies or offer evidence to change the conclusions of the price benchmarking.

Based on these benchmarking results we conclude that there is no immediate need for a price cap which would require **Sure** to reduce retail prices further. In turn for **JT**, we find that there is both a need (based on the price benchmarking) and scope (based on the cost benchmarking) for retail price reductions as part of the next price cap. We observe in Sure's latest available separated accounts (Dec and Mar 2013) that it was able to earn a positive return on mean capital employed (ROCE) in its retail (line rental and calls) business (see **Table 6**). We further note that JT has earned a negative ROCE in its retail business according to the latest separated accounts. Despite this, we find that JT should in principle be able to align its overall level of retail prices to Sure's on the following grounds:

- JT has currently comparable OPEX per subscriber and should be able to achieve lower cost due to its larger scale of operation. We also note that if fibre related investments were not recovered from JT's retail fixed line services this would most likely further reduce the cost of its SMP business in its separated accounts;
- JT was able to generate a positive return on MCE in 2012 (see **Table 6**);[43] and
- [● **confidential**]

4.3.1 Main findings

Based on the above, and on our initial observation that there are no obvious reasons for material exogenous cost differences which may justify the observed average price differences across both jurisdictions, we see merits in more closely aligning the retail prices for fixed line services across both jurisdictions by means of the next price cap. We recommend achieving this by applying a safeguard cap on Sure, allowing for price increases in line with inflation. We further recommend aligning JT's prices with Sure's using an RPI-X% framework which is well tested from previous price controls in the Channel Islands.

We inform our recommendation regarding the X-factor (which determines the annual price decrease) by the observed average price differential between JT and Sure. Given that JT's prices are on average 33% higher than Sure's and that we recommend a duration of three years for the next price cap, this would imply decreasing JT's retail prices (in nominal terms) on average by 11% per annum in order to potentially achieve price parity between the two operators. This can be achieved, for example, based on an RPI-12.5% price cap.[44] We note, however, that requiring JT to reduce its (nominal) retail prices by this amount is an ambitious target to be achieved within the proposed time frame of the next price control (i.e. over a three year period), and would impose a large regulatory burden on JT's operations. We further note that the application of an RPI-12.5% price cap would potentially mean a new entrant operator in the downstream market in Jersey would be unable to make a positive return by the end of the

43 As mentioned in **Section 1** the regulatory accounts are quite volatile across the years, but in the absence of financial forecasts it is the only way to assess the operators' profitability. We also note that an in depth interrogation of the accounts is beyond the scope of this price cap review.

44 This is derived by (100-12.5%) x (100-12.5%) x (100-12.5%) = 67% i.e. a 33% reduction in the (nominal) retail price compared to the current level.

price control period (assuming all other things the same), thereby limiting the possibility for new enhanced downstream competition to occur.[45]

Given the above, we propose to find a middle ground that will start the process of aligning retail prices of the two operators without unduly restricting downstream competition to emerge in Jersey. We consider that an X factor of 4% could be a suitable lower bound of this range, as this would, after three years, lead to a retail margin for new entrants in Jersey that is comparable to the retail margin new entrants would currently be able to earn in Guernsey (that is, 8%, see **Table 4**). We further find that a potential upper bound of this range is 10%, as this is the X factor that would lead to a break-even retail margin for new entrants in Jersey after three years. Based on international precedent (see (**Table 11**) and on previous price caps applied to Sure (see **Table 2**), annual efficiency gains of this magnitude appear generally achievable for fixed line operators.[46,47]

Based on the above we recommend that CICRA considers applying an X-factor for JT's retail prices for (standalone) fixed line services of 4% to 10% during the next price control period. The exact value of the X-Factor will depend on the relative importance of facilitating downstream competition and achieving greater parity in retail prices across the two Bailiwicks.

4.3.2 Other considerations

In addition to our main recommendations above, we take note of [● **confidential**] and the need for CICRA to consider the potential impact of a potential Quality of Service (QoS) review:

- [● **confidential**]
- **QoS target review –** We note that CICRA is contemplating the imposition of new QoS targets as part of this price control and is therefore interested in the impact any such targets would have on the reasonable level for a price control. The relationship between QoS and cost is very complex and in the absence of specific QoS targets and comprehensive information on current QoS levels it is difficult to make such an assessment. We understand that CICRA will hold separate discussions with the operators to agree on QoS targets on the basis of our recommendations set out in **Table 1**.

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45 This is based on the assumption that a new entrant would have the same retail cost as JT and that WLR prices remain at current levels.

46 We note that there is an important link between changes in retail prices and retail margins, and therefore the ability of new entrants to compete in the downstream market. It is therefore necessary to consider the pricing of wholesale products going forward in the light of any reductions in retail prices resulting from the next price cap.

47 A three year application of an X factor of 4% (10%) would lead to total price reductions of 12% (27%) after three years, respectively.

We summarise our recommendations in **Table 1** below.

Table 1. Recommended level of the price cap going forward[1)]

Operator	Recommended price cap
Sure	RPI-0%
JT[2)]	Range from RPI-4% - RPI-10%

Notes:

1) We recommend regulating a single basket including (the standalone services) retail line rental, line connection and call charges. Further, we propose a length of three years for this price cap. (see **Section 3**)

2) As mentioned above, we recommend to apply this price cap only to JT's main customer base [● **confidential**]

5 Conclusion

In this report, we have reviewed the need for CICRA to impose a new retail price control on Sure and JT and the appropriate level of any such control. In **Section 2,** we examined the state of the market in Guernsey and Jersey and concluded that Sure and JT are likely to remain the dominant operators in their respective markets for retail fixed line access. While there are some signs that fixed-to-mobile substitution and competition from OTT-VoIP providers is emerging, it is not clearly the case that this competitive pressure is strong enough to lift price controls without their being a risk of this being detrimental to consumers.

We concluded in **Section 3** that whilst the introduction of WLR might lead to more competition, experience from other jurisdictions does not suggest that price regulation can be removed straight away. However, in setting any price control, it will be important for CICRA to take account of the impact of changes in retail prices on the margin between wholesale (WLR) charges and retail prices, and hence on the ability of new entrants to compete. CICRA takes the view that competition would be likely to emerge on the basis of bundles consisting of line rental, calls and broadband service). As broadband services are not part of this price cap review, we recommend setting a price cap for a single basket of standalone services including line rental and connection and voice calls. This will ensure vulnerable users (who are likely not to use bundles) are protected as these customers are likely to see less directly the impact of competition.

Typically, setting a price cap would rely on forecasts of potential efficiency savings, with the cap set to enable the dominant licensee to earn a reasonable return on the capped services. However, in order to inform our recommended level of the price cap going forward, and in the absence of financial forecasts (which were not provided by the operators), we conducted a price and a cost benchmarking in **Section 4**.

- The results of our retail price benchmarking suggest that current prices are in line with or below the average price of international comparators and that for the Channel Islands customer, Sure's retail prices are 33% than JT's;

- Secondly, our cost benchmarking suggests that JT's and Sure's OPEX per subscriber are among the lowest in an international comparison, and that Sure's OPEX is marginally below JT's.

Given the similarities between the two Bailiwicks, we would not expect to observe such a substantial price differential in the long run. A potential explanation for at least some of the observed difference in prices is that, historically, Sure was subject to stricter price caps than JT. In line with CICRA's objectives, it could be appropriate to use the next price control to start to align the operators' retail prices.

We do not find evidence, from the benchmarking, to suggest that Sure's prices should be subject to further regulatory reductions, and therefore propose that CICRA considers applying a safeguard cap on Sure (RPI-0%). However, there could be merit in CICRA deciding to introduce a new retail price cap on JT such that prices are brought more into line with those of Sure. Achieving price parity between the two islands within the next price control period would be difficult to attain and we therefore propose to start the process of aligning JT's retail prices with those of Sure by applying an RPI-X% to JT where the X factor is set in between 4% to 10% over the next price control period (with the ultimate level of X being determined by the relative importance of facilitating downstream competition and achieving greater parity in retail prices between JT and Sure). We summarise these findings in Table 1.

Conclusion

6 Annexe

Below we present the supporting evidence referred to in the main section.

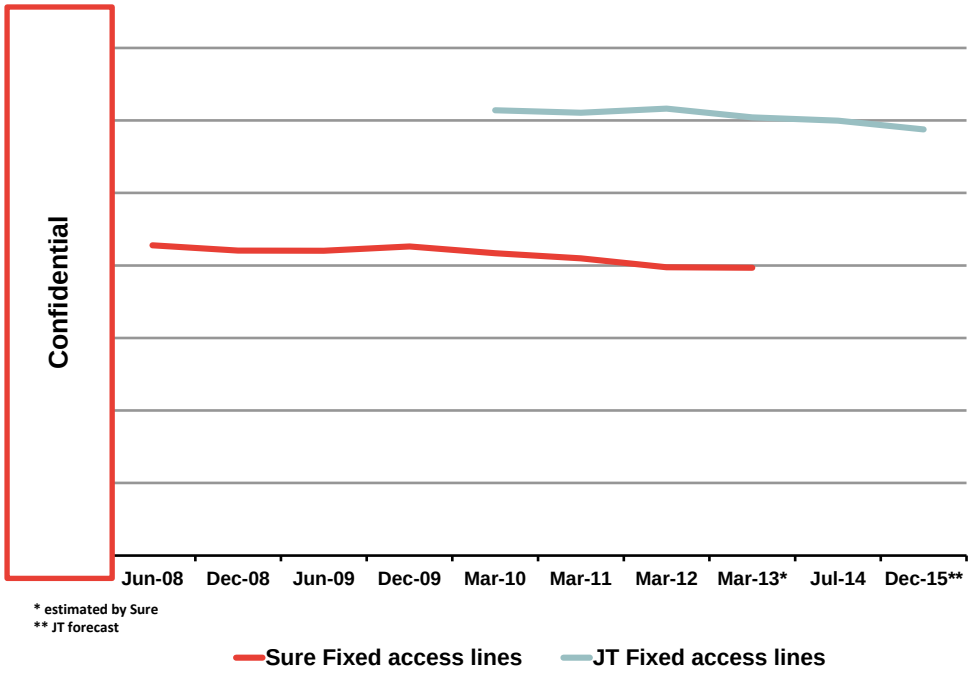
6.1.1 Previous retail price controls in the Channel Islands

Table 2. Overview of previous retail price controls in the Channel Islands

Period	Sure	JT
2008-2011	Line rental: RPI-RPI Local calls: RPI-11.75% Main basket: RPI-4% (one-off increase in retail line rental of £1)	Line rental: RPI-1% Local, UK and International calls: RPI-3%
2012	Line rental: RPI-RPI Local calls: RPI-11.75% Main basket: RPI-4%	Line rental and calls: RPI-0%
2013	Line rental and calls: RPI-RPI	Line rental and calls: RPI-0%
2014	Line rental and calls: RPI-0%	Line rental and calls: RPI-0%

6.1.2 Retail fixed access line services

Figure 2. Sure and JT fixed access lines

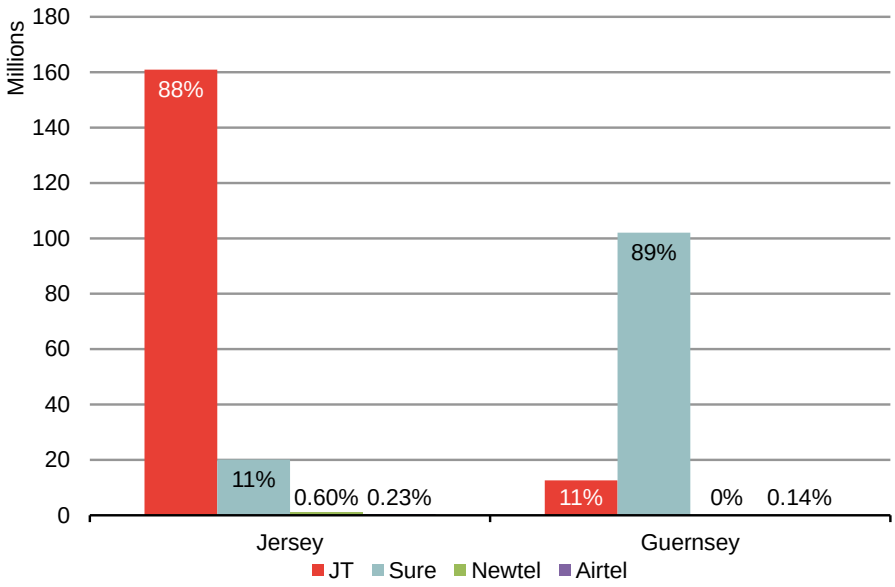


Source: Sure and JT response to question 1

Annexe

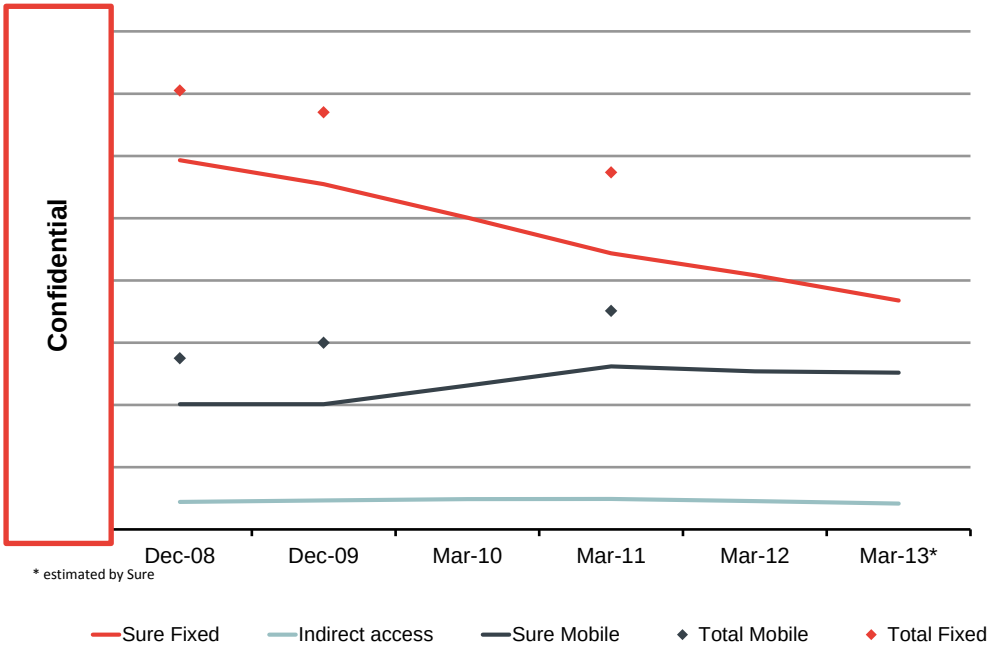
6.1.3 Retail fixed call line services

Figure 3. 2011 shares of fixed originated minutes



Source: 2011 CICRA market report

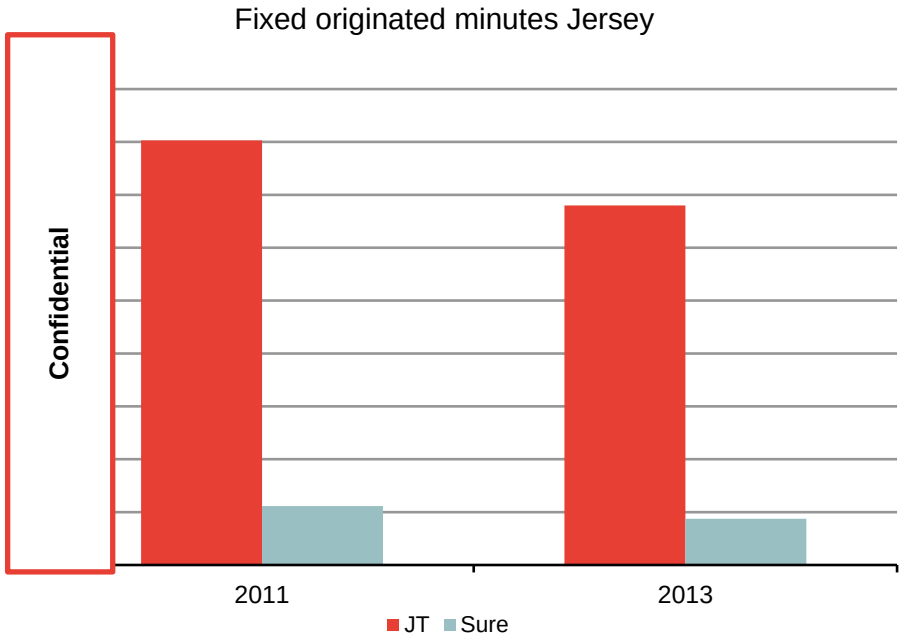
Figure 4. Guernsey call volumes



Source: CICRA market reports and Sure response to question 1

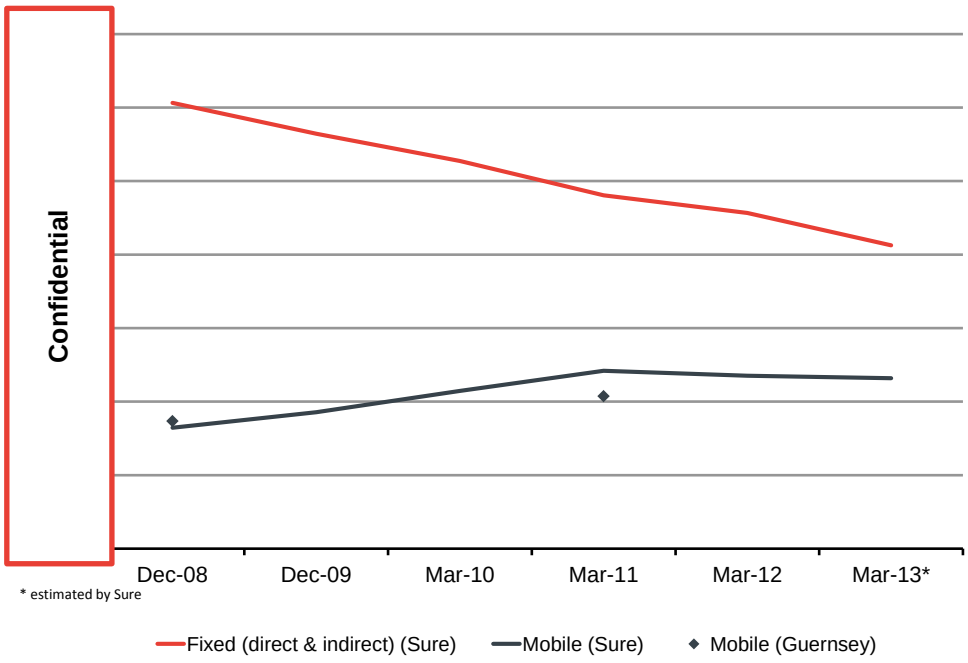
Annexe

Figure 5. Fixed originated minutes Jersey



Source: 2011 CICRA market report, 2013 JT compliance file, Sure response to question 1

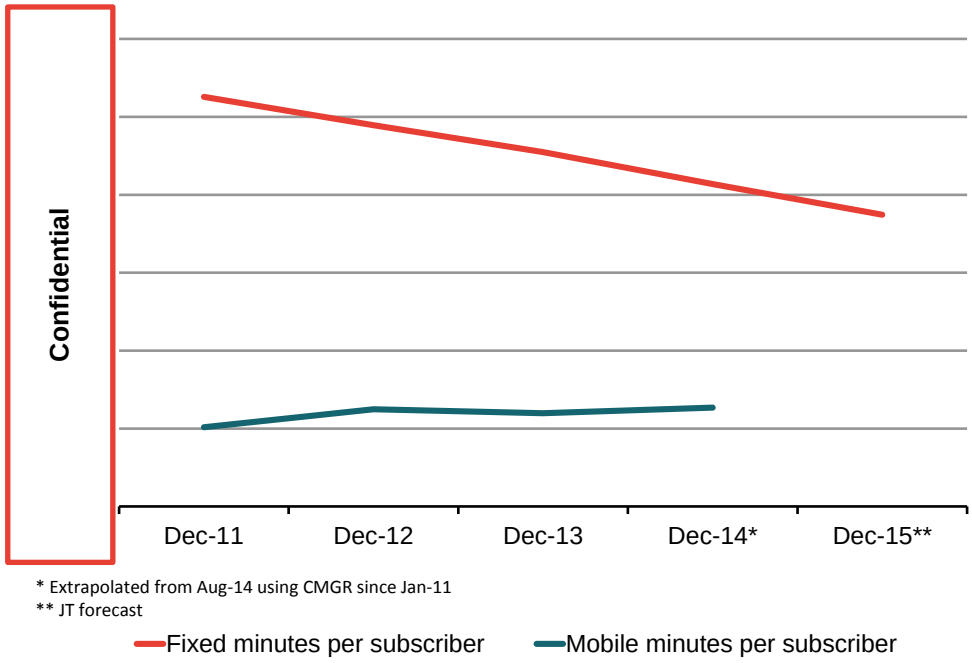
Figure 6. Guernsey average annual call volumes per subscriber



Source: Sure response to question 1, CICRA 2009 and 2011 market report

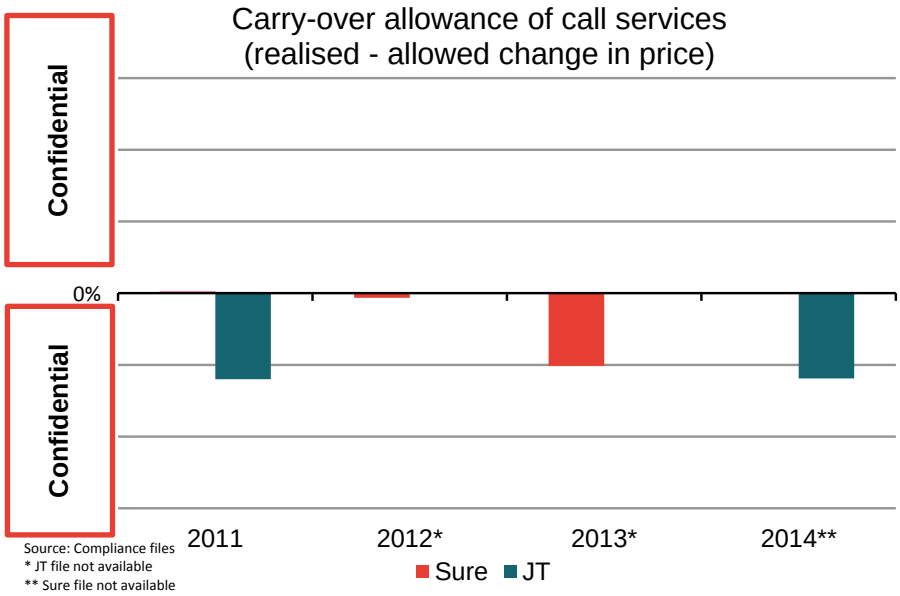
Annexe

Figure 7. JT average annual call volumes per subscriber



Source: JT response to question 1

Figure 8. Carry-over allowance of fixed retail call services (i.e., realised - allowed change in price)[48]



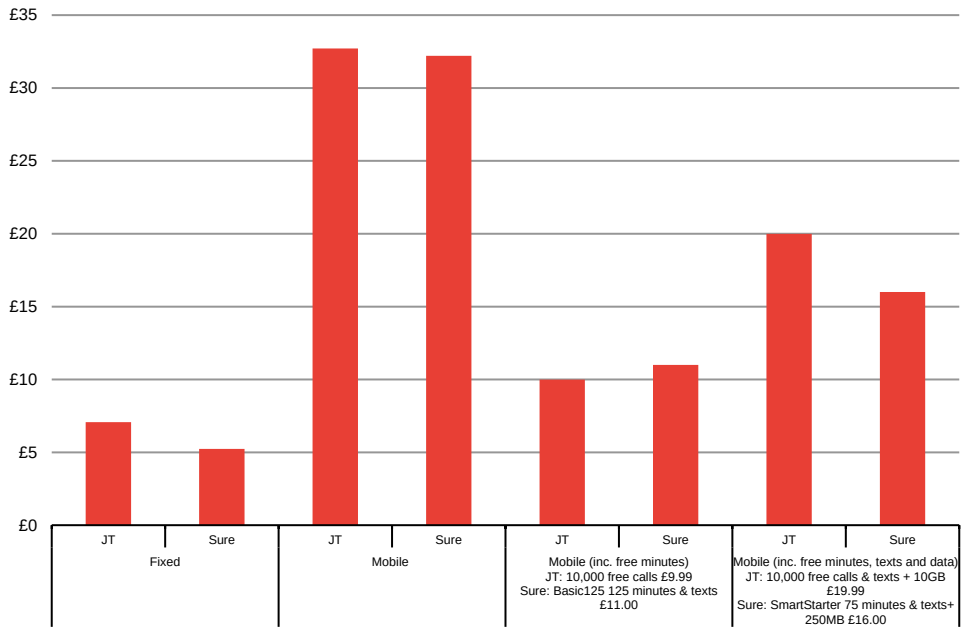
Source: Compliance files

The above graph shows that between 2011 and 2012, both operators have mostly increased average prices across the fixed retail call services by less than what was allowed under their price cap (i.e., a negative percentage reduction in any year implies that the average actual price increases are less than the allowable price changes that year).

48 This graph covers call services only and thus, will differ from the overall carry-over allowances from the price cap baskets in any year (which cover both access line and call services since 2013 onwards).

6.1.4 Fixed and retail price comparison

Figure 9. Monthly retail call price comparison average Channel Islands usage basket



Source: Frontier Economics based on operators' websites

In the above figure we show a comparison between monthly retail call cost of the average user in the Channel Islands.[49] We compare the **cost of calls** (excluding line rental, cost of telephone, mobile phone etc.) between fixed and mobile users in the Channel Islands. The question we are trying to answer is whether or not the average user has an incentive to substitute away from fixed calls to mobile calls, given that he has both a fixed and a mobile connection and device. We consider 3 alternative options to fixed voice calls:

- No monthly mobile plan, i.e. the user pays for all calls;
- The cheapest mobile plan including free minutes; and
- The cheapest mobile plan including free minutes and a data allowance.

6.1.5 Impact of OTT-VoIP and messaging services

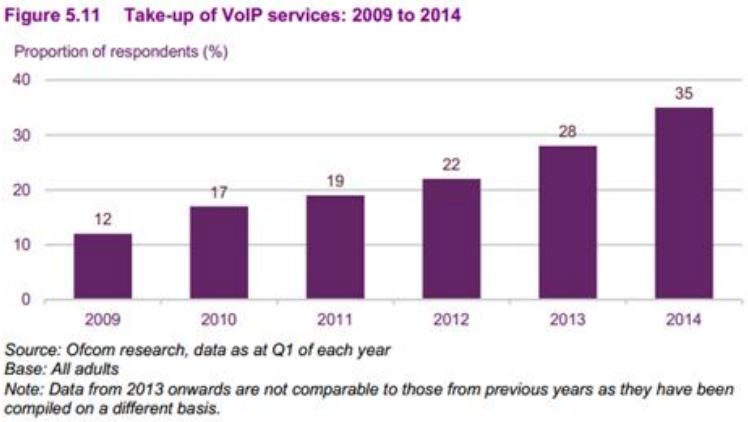
With reference to a recent Ofcom report[50] Sure stated that *"With the increase of Smartphone take-up we expect the Guernsey market trend to track developments in the UK"*[51]

49 We use the average fixed usage pattern across both islands.

50 http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr14/2014_UK_CMR.pdf

where 35% of the respondents to a survey indicate that they are VoIP users (see graph below). Sure was of the view that a similar trend is occurring in Guernsey.

Figure 10. Take-up of VoIP in the UK

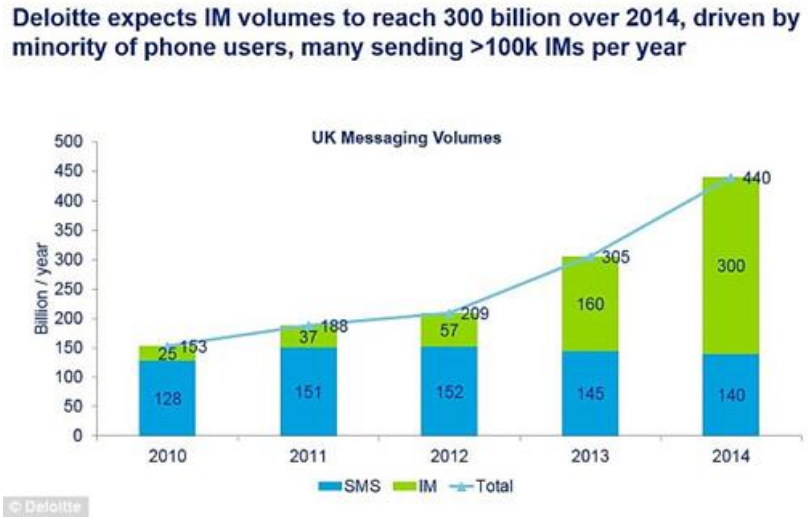


Source: Ofcom

Sure further referred to a report by Deloitte which found that in the UK there was an increasing demand for instant messaging services in recent years (**Figure 11**). However, it remains unclear to us whether the observed uptake in instant messaging is a compliment or substitute for other telecommunications services, including fixed voice services.

[51] Sure response to question 2

Figure 11. UK Messaging volumes



Source: Deloitte

6.1.6 Current WLR proposal

In **Table 3** below we show the WLR prices as of January 2015.

Table 3. Proposed WLR and WBA charges in Guernsey and Jersey (£/month)

	JT	Sure
WBA	**Confidential**	
WLR		
Total		

Source: Information provided by CICRA

6.1.7 Available margins for fixed voice services

Below we show the results of our high-level analysis of the available margins for fixed voice services in both Bailiwicks under the current WLR pricing proposals. This is undertaken for line rental services only and then extended to product bundles of line rental, fixed call and broadband services. The latter is reflective of the likely range of retail product offerings that service providers will place in the downstream market (i.e. it is unlikely that an entrant would seek to offer voice only services to consumers).

We carried out this analysis as part of our second note to CICRA in December 2014 and updated it with the latest WLR prices as of January 2015, and new retail prices for JT as of February 2015. Please refer to this document for details.

Annexe

Table 4. Available margins for different product bundles in Guernsey

	Access	Access & calls	Access, calls & BB
Wholesale charges	£10.00	£12.30	£27.20
Retail costs	**Confidential**		
Total costs			
Retail price (current)			
Margin (current)			
% margin (relative to current retail price)	**-14%**	**3%**	**8%**
Retail price (proposed)	**Confidential**		
Margin (proposed)			
% margin (relative to proposed retail price)	**5%**	**14%**	**13%**

Source: Frontier analysis based on operator data

Table 5. Available margins for different product bundles in Jersey

	Access	Access & calls	Access, calls & BB
Wholesale charges	£11.10	£13.40	£27.20
Retail costs	**Confidential**		
Total costs			
Retail price (current)			
Margin (current)			
% margin (relative to current retail price)	**2%**	**17%**	**13%**

Source: Frontier analysis based on operator data

Annexe

6.1.8 Proposed changes to retail prices

[● **confidential**]

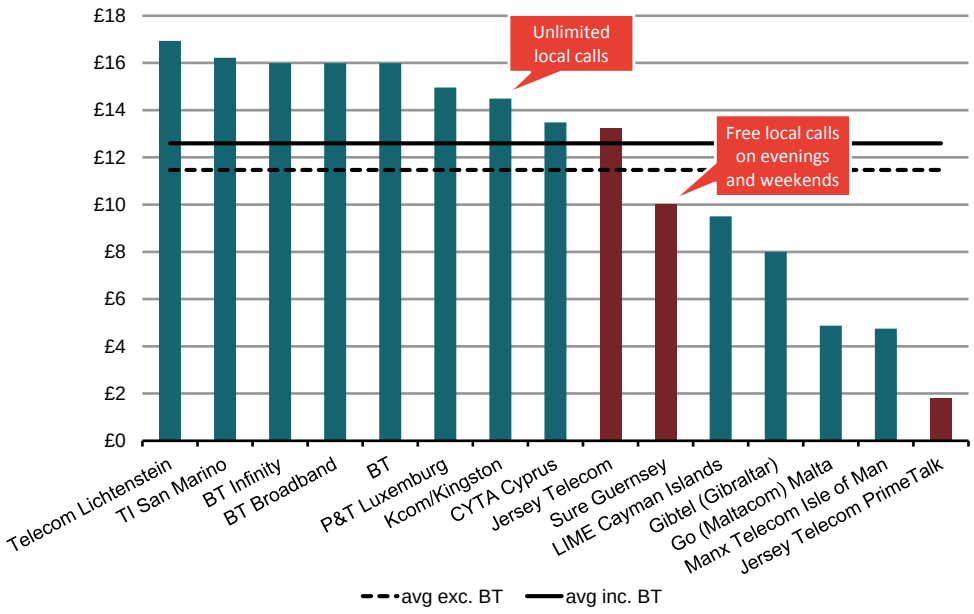
Annexe

6.1.9 Evidence from price benchmarking

Below we show the results of our price benchmarking. We retrieved the raw data from the operators' websites in August 2014. Since then retail prices may have changed. We note for example that BT has increased its retail line rental price from £15.99 to £16.99 in December 2014, and JT increased its retail line rental from £12.99 to £13.24.

We first compare retail line rental prices only.

Figure 12. Line rental cost of the cheapest scheme for the 20 calls residential basket

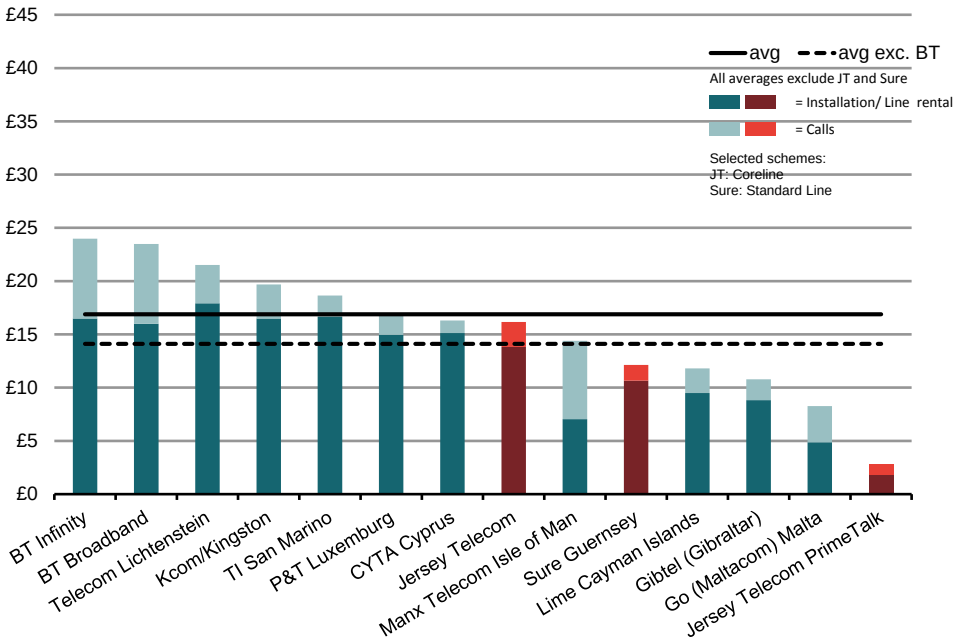


Source: Operator's websites as of August 2014, OECD basket methodology

As a next step we compare bundles of retail line rental and calls together. The underlying framework is the OECD basket methodology. We show the 20 and 140 domestic calls and the 100 and 260 business calls baskets for illustrative purposes.

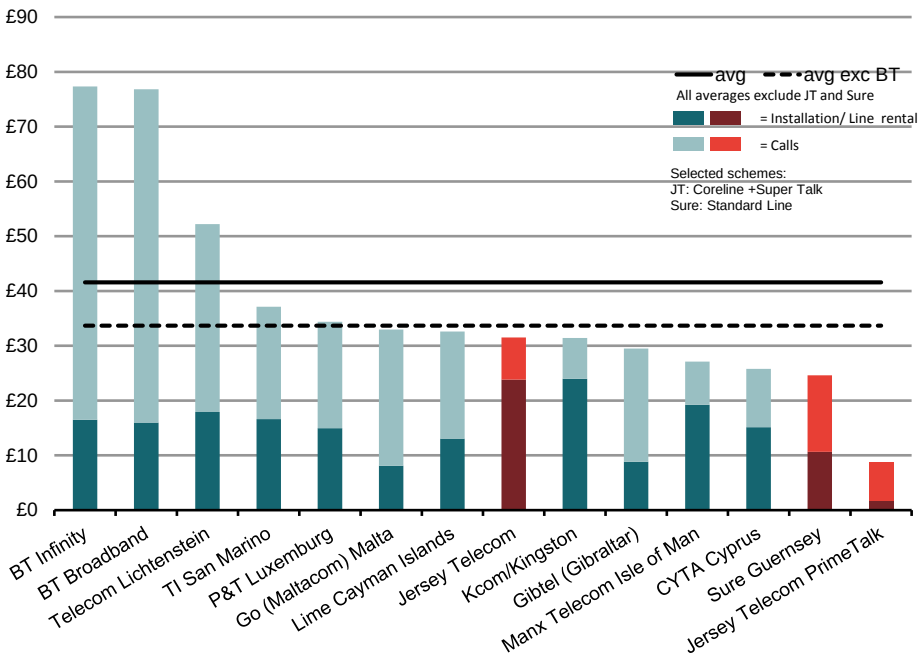
Annexe

Figure 13. Basic scheme 20 calls basket residential



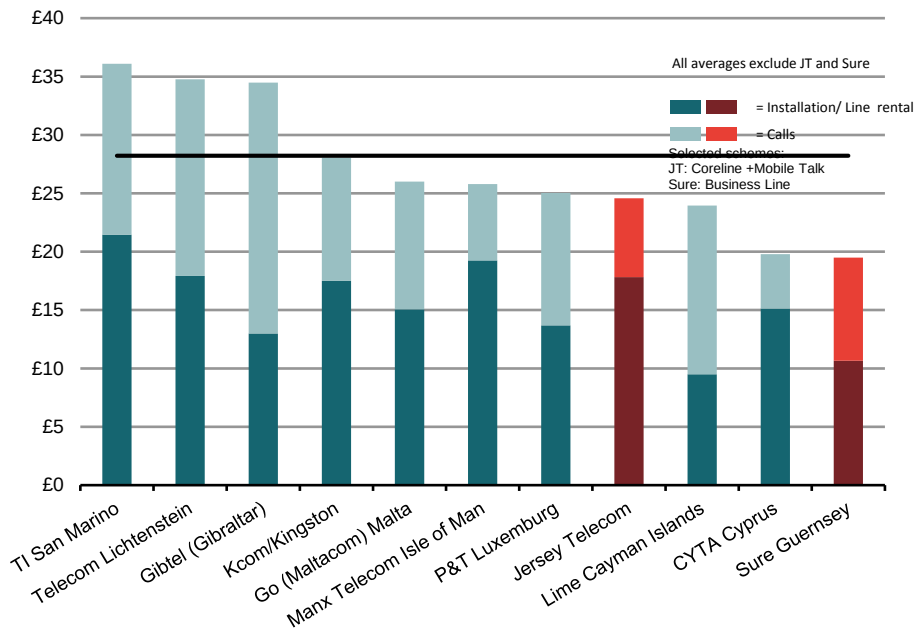
Source: Operator's websites as of August 2014, OECD basket methodology

Figure 14. Basic scheme 140 calls basket residential



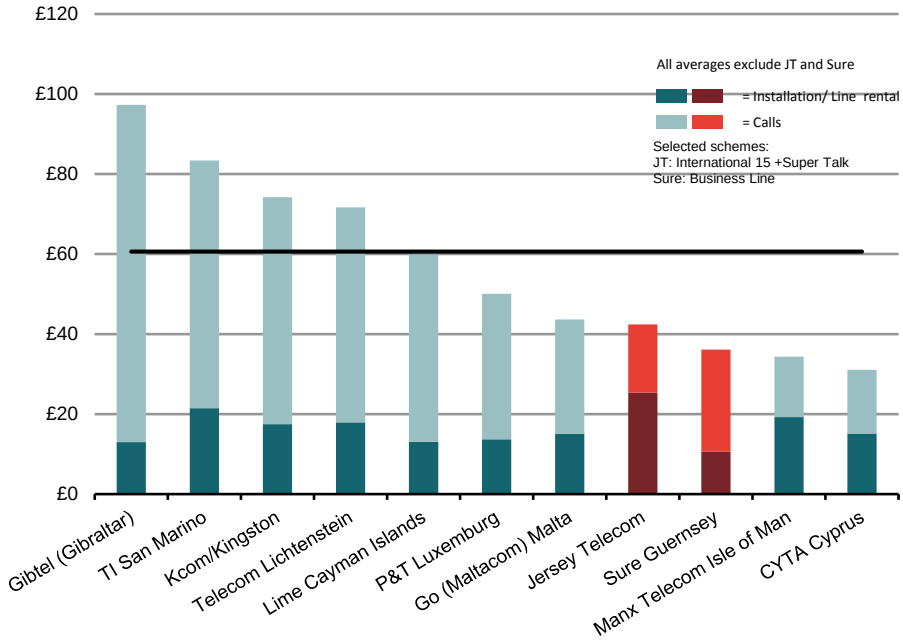
Source: Operator's websites as of August 2014, OECD basket methodology

Figure 15. Basic scheme 100 calls basket business



Source: Operator's websites as of August 2014, OECD basket methodology

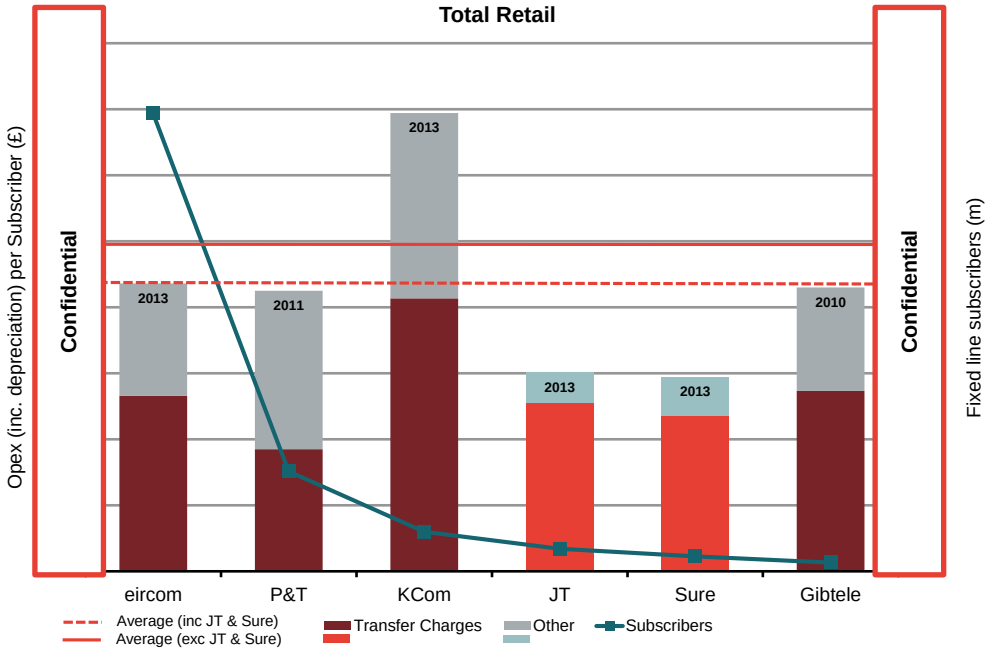
Figure 16. Basic scheme 260 calls basket business



Source: Operator's websites as of August 2014, OECD basket methodology

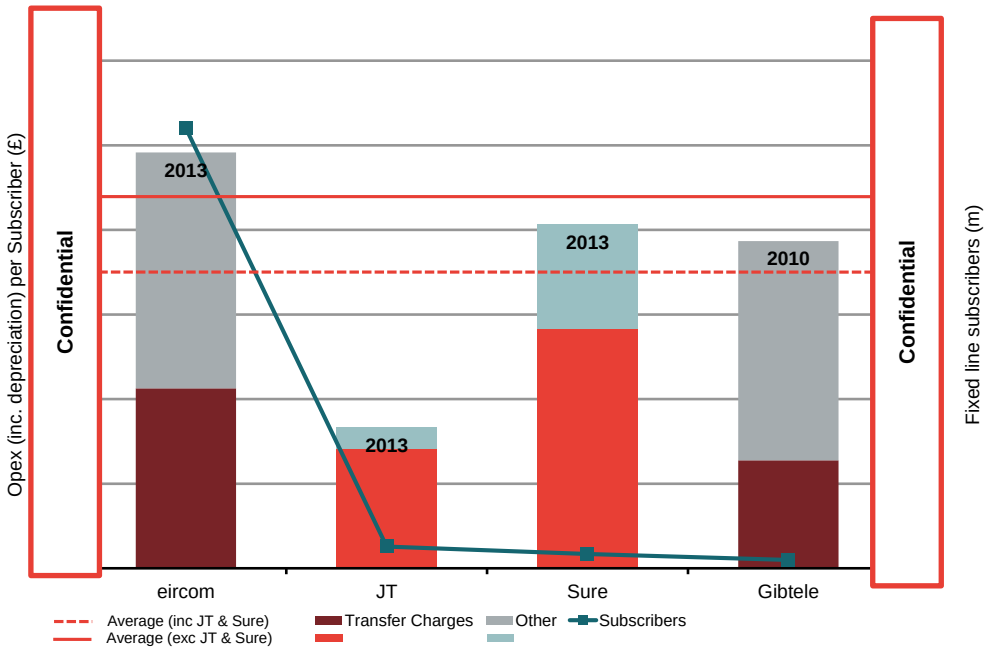
6.1.10 Evidence from cost benchmarking

Figure 17. Benchmarking of total retail OPEX per subscriber – ordered by number of subscribers



Source: Separated accounts

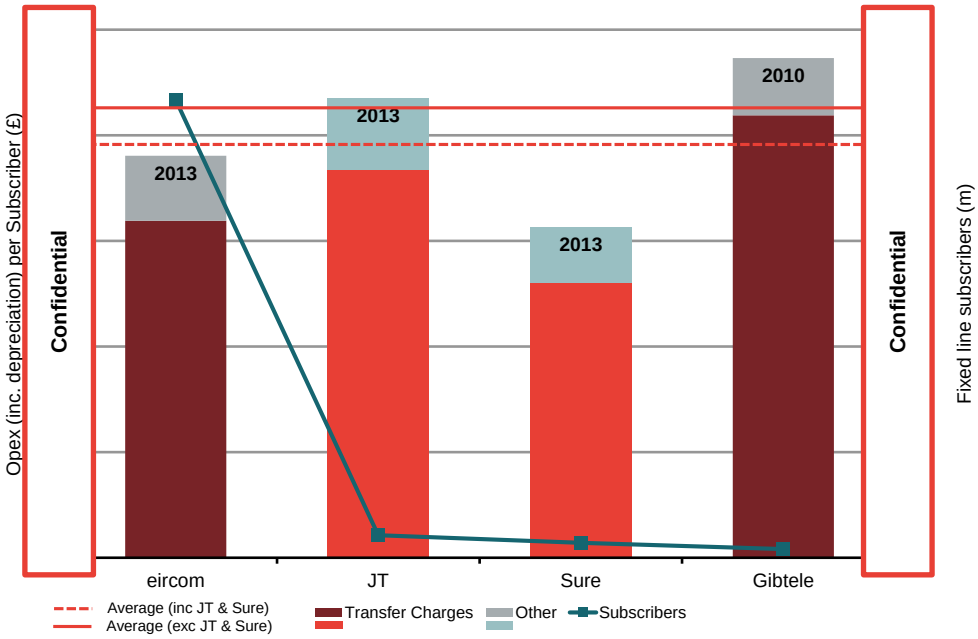
Figure 18. Benchmarking of retail calls OPEX per subscriber - ordered by number of subscribers



Source: Separated accounts

Annexe

Figure 19. Benchmarking of retail line access OPEX per subscriber - ordered by number of subscribers



Source: Separated accounts

6.1.11 Treatment of JT's fibre investments

In total £41.5m was invested into JT's fibre network (States of Jersey: £19m via loans and reduced dividends; JT: £22.5m).[52] [● **confidential**]. As the fibre was installed to support higher speed broadband services, on the basis of cost causality, it would seem reasonable that this investment cost should be recovered from broadband customers, rather than fixed voice services.

The question thus arises how much of the fibre investment cost is included in the OPEX figures reported in the regulatory accounts and which form the basis of our cost benchmarking. To answer this question we analysed the route factors as stated in accounts.

From JT's 2013 separated accounts we know that PSTN line rentals account for the vast majority of connections ([● **confidential**] vs. [● **confidential**] fibre voice connections or [● **confidential**]%). We further understand that for both PSTN and fibre voice line rentals the key network cost is the local loop ([● **confidential**]) of which [● **confidential**]% is allocated to PSTN and [● **confidential**]% to fibre voice.

This means that fibre voice services attract more of the cost of the local loop ([● **confidential**]%) than their connection share ([● **confidential**]%). We don't have further information of the fibre share of local loop cost, but we can say that because the local loop network component contains both copper and fibre cables it follows that some of the access fibre costs are currently recovered from fixed line rental services.

We note that these fibre cost should be excluded from JT's OPEX figures as part of our cost benchmarking, even though with the information we currently have we cannot say with certainty by how much. In order to find out exactly how much of the fibre cost are included in the fixed line rental OPEX, we would require more details from JT.

We conclude that JT's figures shown in our cost benchmarking should be seen as an upper bound to JT's true cost. Given the approach to setting the price control, it has not been necessary to 'strip out' the fibre cost from JT's line rental business costs. However, we propose that CICRA should require JT to do this as part of its future separated accounts.

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52 http://www.ftthcouncil.eu/documents/CaseStudies/JERSEYTELECOM.pdf

Annexe

6.1.12 Return on MCE – Retail SMP business

Table 6. Return on mean capital employed – Retail SMP business

	Sure	JT
Dec-2013	[● **confidential**]%	[● **confidential**]%
Mar-2013	56%	-
Dec-2012	-	[● **confidential**]%

Source: Operator separated accounts

JT reports Retail SMP numbers directly. For Sure this includes all retail services other than the items "Leased Lines" and "Remaining Activities"

6.1.13 Determining the average Channel Islands customers' usage profile and monthly cost

Table 7. 2013 Minutes of use

	Local	National	Fixed to mobile	International	Total
Sure	**Confidential**				
JT					

Source: Data received from operators

We use the call distribution of the 60 calls OECD basket in **Table 8** below, because this corresponds the closest to the actual total minutes of use (**Table 8**)

Table 8. OECD 60 call casket call distribution

Fixed to Fixed			Fixed to Fixed			Fixed to Mobile			International	
D	E	W	D	E	W	D	E	W	P	O
60%	22%	18%	60%	22%	18%	57%	22%	21%	44%	56%

Source: OECD methodology

D = Day, E = Evening, W = Weekend, P = Peak, O = Off peak

Based on the above, we calculate the operator's respective breakdown of their reported minutes of use by time of the day in **Table 9**. The resulting average is the usage profile we use for the purpose of our price comparisons across the 2 islands.

Annexe

Table 9. The usage pattern of the average Channel Islands customer

	Fixed to Fixed			Fixed to Fixed			Fixed to Mobile			International	
	D	E	W	D	E	W	D	E	W	P	O
Sure	Confidential										
JT											
Ø	**49.6**	**18.2**	**14.9**	**26.7**	**9.8**	**8.0**	**13.2**	**5.1**	**4.9**	**3.7**	**4.7**

Source: Frontier Economics based on data received form operators and OECD methodology

D = Day, E = Evening, W = Weekend, P = Peak, O = Off peak, Ø = Average

Based on the operators' current retail prices and the assumed average CI usage pattern, we calculate the average monthly cost of calls (along with the monthly line rental and line connection charges) in **Table 10**.

Table 10. Decomposition of the monthly cost of the average CI basket

Component	Jersey Telecom	Sure Guernsey	% Difference
Monthly line rental	13.24	9.99	32.5%
One-off connection[1)]	0.83	0.67	25.0%
Calls	7.07	5.24	34.9%
Total	**21.14**	**15.90**	**33.0%**

Source: Frontier Economics based on data received from the operators (via CICRA) in February 2015 and OECD basket methodology

1) The underlying line connections charges are £49.99 for JT and £39.99 for Sure and are amortised over a 5 year period

6.1.14 Review of retail price controls in Europe and Australia

Table 11. Review of retail price controls in Europe and Australia

Country	Period	X-factor
UK (2002)	1984-1989	3.0%
	1989-91	4.5%
	1991-93	6.3%
	1993-97	7.5%
	1998-2001	4.5%
	1984-1989	3.0%
AUS (2006)	1989-1992	4.0%
	after 1992	5.5%
	2005/6	7.5%
NL(2006)	1999-2002	5.3%
France	2005-2008	7.0%
Ireland (2004)	1997-1999	6%
	1999-2002	8%
	2003-2007	0%

Year of WLR introduction shown in parenthesis

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