Office of Utility Regulation

Reviewing C&W Guernsey's Wholesale Leased Line Prices

Report on the Consultation & Draft Decision

Document No: OUR 07/09

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1. Introduction

In January 2007 the Director General ("DG") of Utility Regulation ("OUR") initiated an investigation into the appropriateness of C&W Guernsey's ("C&WG") wholesale leased line prices. A key reason for prioritising this review is the importance of leased lines as a building block in the telecommunications industry and therefore the Guernsey economy. Leased lines facilitate access to the basic telecoms infrastructure and provide large business users with a means of linking different geographic locations with voice and data communications. Wholesale leased lines also enable other operators to compete with the incumbent, C&WG, through utilisation of the existing infrastructure in the Bailiwick. This means of promoting competition is particularly important where it is not economic to duplicate infrastructure.

In light of the OUR's own concerns and those raised by Other Licensed Operators ("OLOs") and business customers the OUR, assisted by its advisors Frontier Economics ("FE"), undertook a detailed review of how leased lines are provided and in particular the pricing approach for wholesale leased lines adopted by C&WG.

Document OUR 07/01 presented the issues arising from FE's review and posed a number of specific questions relating to the potential development of the regulatory regime in relation to C&WG's wholesale leased line services. The DG received responses to the consultation from four organisations:

- C&WG;
- Islands Insurance;
- Itex Ltd; and
- Wave Telecom

The DG is grateful to these organisations for their contributions. All non-confidential responses received by the Office are available on the OUR's website (www.regutil.gg) and for inspection at the OUR's office.

C&WG has in the interim announced a 30% reduction to the price of all wholesale leased lines, both on and off island, as from 1st April 2007, a move which the DG welcomes. In compliance with its current price control, C&WG has also announced reductions in its retail leased lines charges.

This Draft Decision paper therefore sets out the DG's position on the issues raised during the consultation exercise having taken account of these interim developments. He invites interested parties to comment on the proposed decision.

This consultative document does not constitute legal, commercial or technical advice. The Director General is not bound by it. The consultation is without prejudice to the legal position of the Director General or his rights and duties to regulate the market generally.

2. Structure of Report & Draft Decision

2.1. Contents

The rest of this paper is structured as follows:

Section 3: presents the legal and regulatory background which empower the DG to price control C&WG's leased line products;

Section 4: sets out key issues from the original consultation paper together with responses from interested parties and the DG's consideration of those responses.

Section 5: assesses additional areas raised by interested parties.

Section 6: sets out the next steps in the process

2.2. Timetable

Interested parties are invited to submit comments in writing on the proposed decision set out in this Draft Decision 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 "*Comments on the Review of C&W Guernsey's Wholesale Leased Line Prices – Draft Decision*" and should arrive before 5pm on **31st July 2007**.

In line with the policy set out in Document OUR 05/28 – "*Regulation in Guernsey; Revised Consultation Procedures*", the DG intends to make any comments received available on the OUR website. Any material that is confidential should be put in a separate annex and clearly marked so that it can be kept confidential. However the DG regrets that he is not in a position to respond individually to the responses to this consultation.

3. Legal Background and Regulatory Framework

3.1. Applicable Licence Conditions

Part IV of C&WG's Fixed Telecoms Licence includes a number of conditions which are applicable to licensees which have a dominant position in a relevant market.

Condition 26 of C&WG's fixed telecoms licence states the following:

26.1 The Licensee shall offer to lease out circuits for any lawful purpose:

> *(a) on publicly advertised conditions and on non-discriminatory terms. This is without prejudice to discounts that are in accordance with Condition 31;*
>
> *(b) within a reasonable and published period of time from any request;*
>
> *(c) so as to meet the quality standards required under the Conditions; and*
>
> *(d) at prices that do not exceed levels determined from time to time by the Director General.*

Condition 26 is included in C&WG's licence under the powers available to the DG under section 5 of the Regulation of Utilities (Bailiwick of Guernsey) Law 2001 which states, inter alia, that the DG shall have the power to determine the conditions to be included in a licence. Under Section 5 of the Telecommunications (Bailiwick of Guernsey) Law 2001, the DG may include licence conditions regulating the prices, premiums and discounts that may be charged or allowed by a licensee which has a dominant position in a relevant market.

C&WG was previously found dominant in the wholesale fixed-line telecommunications market and the retail fixed-line telecommunications market (OUR 05/19). The DG therefore has the power to determine the level of prices for both wholesale and retail leased lines levied by C&WG.

Condition 31.2 states that:

"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;

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

Therefore should the DG determine following the conclusion of a consultation process that amendments are required to the charges levied by C&WG for both wholesale and retail leased lines products and services he may direct that those charges be amended under the powers available to him.

3.2. C&WG's General Comments

C&WG raise three general issues, namely:

- finding of dominance in leased lines;
- relevance of condition 26.1 of its licence; and
- profitability of its leased lines business.

Finding of Dominance

C&WG's view is that a finding of dominance by the DG should be delayed until the completion of his market analysis over 2007 as part of the next price control coming into effect on 1st April 2008. C&WG argue there is the possibility such an analysis may conclude it is not dominant in the provision of leased lines, which would remove the ability of the DG to regulate the charges for these services. In these circumstances, C&WG suggests any draft decision on leased line charges should be delayed until the current price control process is completed.

C&WG was also concerned that the OUR had not proposed to remove off-island circuits from regulatory intervention completely, but rather to apply a different regulatory approach compared to on-island leased line services. C&WG did not consider the DG had the power to adopt a different approach to these two services

Condition 26.2

C&WG consider the relevant licence condition for the price regulation of wholesale leased lines is licence condition 26.2. This licence condition provides that C&WG's wholesale charges are applied in a non-discriminatory way between C&WG's retail arm and OLOs. C&WG argue that compliance with this licence condition satisfies the regulatory obligation of its licence condition regarding leased lines.

Profitability of C&WG's Leased Lines Services

C&WG did not agree with FE's conclusion that the rate of return for the total leased line business in 2005/06 was 66% and believe the figure arises from an inappropriate adjustment to the regulatory accounts. C&WG maintain it is inappropriate to assess its profitability on a different basis to its regulatory accounts since these accounts are prepared in line with Licence Condition 26.2. In accordance with this licence condition it maintains it applies the retail-minus (-9.1%) methodology in a non-discriminatory manner.

3.3. DG's Response to C&WG's General Comments

Finding of Dominance

There is the possibility that during the current price control process[1] the DG may conclude the market has altered to the extent that C&WG is no longer dominant in the provision of wholesale leased line services (on-island or off-island). In these

[1] See OUR 07/08

circumstances, the need to set regulated charges on the basis of a dominance finding would be removed.

However, C&WG's decision to voluntarily reduce wholesale leased line prices by 30% essentially removes the need to make any decision with regard to dominance since the DG is not proposing further reductions to leased line charges in this draft decision. It should be noted that C&WG has been found dominant in the wholesale and retail fixed line telecommunication services market. The DG continues to rely on this finding until there is evidence of material change to alter these findings. If, as an outcome of the current price control review, C&WG is again found dominant in the relevant markets it is proposed the methodology set out in this paper is adopted to achieve any appropriate modifications as part of the ongoing price control process.

Condition 26.2

Part IV of C&WG's Fixed Telecoms Licence includes a number of conditions that apply to licensees that have a dominant position in a relevant market. Among them is Condition 26 of C&WG's fixed telecoms licence which relates to the regulation of leased lines. This licence condition addresses a number of issues, among which are non-discrimination as well as terms and conditions which C&WG refers to in its response. As stated in the consultation, the DG is in this review looking to establish prices in accordance with condition 26. 1 (d) which states that:

"*The Licensee shall offer to lease out circuits for any lawful purpose: (d**) at prices that do not exceed levels determined from time to time by the Director General.*** **[Emphasis added]**

It is apparent that the licensing framework is not limited to issues of discrimination. It is also the case that pricing discrimination is not the only source of potential concern arising from pricing behaviour. The DG believes that condition 26 must be considered in its entirety and this review of leased line charges is consistent with the duties and powers entrusted to the DG in the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 ("the Regulation Law"), and the Telecommunications (Bailiwick of Guernsey) Law 2001. The review of C&WG's leased line prices is also consistent with the DG's role in ensuring compliance with the company's Fixed Telecoms Licence.

Profitability of Leased Lines Services

The DG has noted C&WG's disagreement with the statement by FE that the rate of return for its total leased line business in 2005/06 was 66%. This analysis excluded the transfer charges between the retail and wholesale businesses on the basis that they are not actual costs or revenue by C&WG but an internal transfer. This level of return of 66% supported an initial view that C&WG leased line business, in its entirety, earns profits that contribute a return to C&WG's shareholders that may be excessive and it is appropriate for the regulator to take such a view given the scale of this return. In terms of the appropriate transfer charge methodology that should be taken, C&WG will be aware that at least two alternatives may be appropriate as this was an area the OUR looked at in detail in 2004 as part of the review of C&WG's Regulatory

Accounts[2]. The transfer charge methodology does not however alter the conclusion that C&WG's leased line business earns an overall return of 66%. It should also be apparent that approval by the DG of C&WG's regulated accounts does not preclude the DG from reassessing whether those transfer charges remain appropriate in light of market conditions or concerns that arise over time.

[2] The preparation of the regulatory accounts involves an accounting separation of the costs and revenues associated with the provision of leased lines network services from the retail leased lines business. The leased line network services are provided to the retail business which then sells them to customers. In the regulatory accounts, a transfer charge for these services is reflected as a cost in the retail leased lines business and a revenue in the network business.

4. Responses to Specific Issues in the Consultation

For convenience the DG's proposed approaches to the regulation of C&WG's leased line prices at both the wholesale and retail level which were set out in OUR 07/01 are summarised in Table 4.1 below.

Table 4.1 Summary of Proposed Approaches

	Wholesale Price	**Retail Prices**
On-Island	Cost plus or wholesale price cap	Exclude from new price control with focus on facilitating competition in wholesale market.
Off-island	Retail Minus	Include within new price control.

The issues associated with each of these areas was set out in the consultation paper and summarised below. The response from interested parties and the DG's consideration of these is also provided.

4.1. Retail Minus approach to setting On-Island Leased Lines charges

Consultation Paper

A review of this area[3] concluded C&WG was dominant in the provision of wholesale fixed line telecommunications services, which includes both the on-island and off-island leased line services. FE conducted a more recent review of the leased line market and held interviews with industry. Their conclusion suggested to the DG that while C&WG continues to be dominant in the wholesale provision of both these services it is likely to face less competition in the market for wholesale on-island leased lines than in the off-island market.

On the basis of a dominance finding, the regulator is obliged to ensure that prices for on-island wholesale leased lines reflect efficient economic costs. FE believed this could be achieved either by a cost-plus or wholesale price cap obligation since, in circumstances where retail prices are not cost reflective, setting a wholesale price based on the Retail Minus methodology is inappropriate. The DG was minded to concur with this view and with the proposed remedy namely, either a wholesale price cap or cost plus pricing should be applied to wholesale on-island leased line charges by C&WG. He invited interested parties to comment on the proposal that the Retail Minus approach to setting wholesale prices for on-island leased lines was inappropriate.

Responses from Interested Parties

C&WG's view is that the existing retail price control mechanism imposed on the company's leased lines (RPI-16%) has driven wholesale prices downwards since 2005. In addition C&WG maintain that as the retail minus approach is in line with

[3] OUR 05/19

Licence Condition 26.2 this addresses the manner in which leased lines need to be sold to OLOs.

Itex agreed with the DG's view that using the Retail Minus approach to setting wholesale prices for on-island leased lines was inappropriate in the Guernsey context.

Wave supported the OUR's review of leased lines, however, it has concerns that in the short term, a move to a different pricing model (such as from retail-minus to cost-plus) would disrupt the market. Wave have reservations that this change could result in a significant revision to the entire portfolio in terms of pricing, product definition, service level agreements as well as terms and conditions which will tilt the competitive playing field further to the advantage of the incumbent during the transition period. Wave believed that the pricing changes could result in a drawn out process with C&WG that creates more disadvantages for competitors and argue the OUR should rather concentrate on a few "quick win" issues, which would deliver short-term competitive improvements.

DG's Position

The DG welcomes support for the move away from a Retail Minus approach for the regulation of on-island wholesale leased lines charges and acknowledges the risks highlighted. In terms of timing, relevant to these considerations is that during the consultation period C&WG announced a 30% reduction in all its wholesale prices that came into effect on 1st April 2007. The DG welcomes the fact that OLOs and ultimately end-users will benefit from this reduction in wholesale prices.

Having considered this move by C&WG he does not propose to investigate the level of leased line charges further at this time. He proposes to delay setting any new wholesale charges to on-island leased lines based on FE's recommendations until April 2008, and that will take account of new evidence that might alter the current finding of dominance. In the interim, the DG proposes to maintain the existing Retail Minus regime for on-island leased lines and accept the reductions volunteered by C&WG.

Draft Decision 1

The Director General proposes to cease regulating wholesale on-island leased lines charges through the 'Retail Minus' approach after 31st March 2008.

4.2. C&WG's On-Island Wholesale Leased Lines charges

Consultation Paper

In choosing between a wholesale price cap (with a P_0[4] cut) and a cost-plus obligation, FE recommended that the OUR should have specific regard to a number of factors which were set out in OUR 07/01.

The DG was of the view there was a risk that at current retail prices, on-island leased line charges are too high and simply reflect high wholesale prices. In these circumstances a P_0 adjustment appeared more appropriate than a wholesale price cap with a glide-path to reduce charges over time to an acceptable level. Should the DG

[4] Known as a "P nought cut" with an initial reduction in the price from the start of the period.

introduce either a wholesale price cap or a cost-plus approach to price controlling C&WG's wholesale on-island leased lines on 1st April 2008, he was also of the view it would be appropriate to remove on-island leased lines from any future retail price control of C&WG. The DG specifically invited comments on:

a) Which of the two approaches (i.e. a wholesale price cap - with a P_0 adjustment- or cost plus pricing) would be the appropriate approach to setting C&WG's wholesale on-island leased lines?; and

b) If C&WG's on-island wholesale leased line prices were subject to either a wholesale price cap or a cost plus pricing regime, whether its retail on-island leased lines should be removed from any future retail price control for C&WG?

Responses from Interested Parties

C&WG responded that if wholesale prices for on-island leased lines were to be set on a different basis to prices for off-island leased lines following an appropriate finding of dominance then they should be subject to a wholesale price cap. However if the OUR chose to adopt this approach C&WG argue the regulator would need to further consult on a number of different issues. In particular, C&WG require some indication of:

- The level of the P_0 adjustment;
- The price control period over which the wholesale price cap would apply
- The nature of the wholesale price cap formula
- The end point of the glide path

However, C&WG's view is that cost plus pricing is not the most appropriate approach. Specifically, C&WG state that if wholesale leased lines are only able to be priced at cost plus WACC (of 12.6%) there will be little incentive for C&WG to invest in upgrading the network or introducing new technology because the rate of return on the investment is so low. C&WG supported the proposal that on-island leased lines should be removed from retail price control under these circumstances, arguing that under these proposals the direct relationship between retail and wholesale prices is broken and market forces will be able to operate to reduce retail prices for on-island circuits.

Itex expressed a view that a wholesale price cap associated with a P_0 reduction would be appropriate to ensure wholesale leased line prices were more cost reflective than they currently were. Itex believed that the cap level should be subject to periodic reviews with additional reductions to encourage greater efficiencies within C&WG's operations. Itex did not however agree that C&WG's retail on-island leased line prices should be removed from any future retail price control as the company believed there would be no constraint on C&WG's retail arm from adopting a predatory pricing policy.

Wave agreed that retail prices should be subject to only minimal regulation. In its view, regulation should conform to the over-riding principle that retail prices should only be regulated if wholesale measures to introduce competition are unavailable or cannot be introduced sufficiently quickly. However, Wave consider that the OUR should avoid the mistakes made by other European operators who, in deregulating retail markets have left themselves bereft of ex-ante measures to detect and prevent price squeeze. Wave argue that a minimum requirement on C&WG should be to continue to submit its retail prices to the OUR including all discounts/special offers.

DG's Position

The DG welcomes the support for the wholesale price cap approach to wholesale on-island leased line charges. In view of the recent reductions in all of C&WG's wholesale leased line prices, the DG is of the view that if there was a change to a wholesale price cap or cost-plus approach this should be introduced after 31st March 2008. This would mean that unless there is evidence that alters the current finding of dominance, the appropriate level of a new wholesale control could be addressed at the same time as any new C&WG retail price control. Issues such as the appropriateness of a P_0 adjustment as well as the duration and form of a price control would also be considered during that process. In response to certain concerns raised, the DG's view is that the OUR would continue to have recourse to other licence conditions to detect and rectify any anti-competitive practices which might arise within the market. Given these measures are available, the DG's view is that it would be appropriate to remove on-island retail leased lines from any future retail price control from 31st March 2008.

Draft Decision 2

The Director General will introduce a wholesale control for C&WG's on-island leased lines charges from 1st April 2008 and remove retail on-island leased lines from any future retail price control.

4.3. C&WG's Off-Island Wholesale Leased Lines

Consultation Paper

FE concluded that the emergence of competition in the provision of wholesale off-island leased lines offered some potential for prices to reflect costs for these services. If this potential were fully realised this would alter the DG's basis for regulating these charges since C&WG would no longer be considered dominant. Based on FE's recommendations the DG concluded that if C&WG remained dominant but there was some prospect of competition, a Retail-Minus approach to regulation could offer a safeguard (in combination with the existing retail price cap) for existing customers of C&WG's off-island wholesale leased line services. Such an approach might also improve the likelihood of a high level of competition given this would be more likely to stimulate entry into this area than a cost-plus approach for example.

In light of these findings the DG invited interested parties to give their views on whether:

a) Whether C&WG's off-island wholesale leased line prices should continue to be subject to a "Retail Minus" price control; and
b) Whether C&WG's off-island retail leased line prices should continue to be subject to a safety cap within a Retail price control in the event of a finding of dominance in that relevant market?

Responses from Interested Parties

C&WG acknowledged that if it is found to be dominant in the off-island wholesale leased line market these should be subject to a retail minus price control regime. In addition, C&WG agreed that a 15% wholesale discount is appropriate for all off-island leased lines and it would therefore be appropriate to apply the same discount to HUGO circuits.

Itex agreed with both of the proposals set out in the consultation regarding C&WG's off-island wholesale leased lines.

Wave agreed with the proposal to continue to subject C&WG's off-island wholesale leased line prices to a "Retail Minus" price control. Wave reiterated its view that retail prices should be subject to minimal regulation subject to the OUR having sufficient ex-ante powers to prevent any distortion to competition.

DG's Position
The DG welcomes the support for these proposals. Unless there is evidence that alters the current finding of dominance, the DG will proceed on the basis of regulating wholesale off-island charges using the current retail minus approach and place a price cap on the equivalent retail service when the next price control decision is made.

Draft Decision 3

The Director General proposes to regulate wholesale off-island leased line charges using the Retail Minus approach and to place retail off-island leased lines charges within a safety cap in any future retail price control from 1st April 2008.

4.4. *HUGO Off-Island Leased Line Wholesale charges*

Consultation Paper
FE assessed the reasonableness of the existing Retail minus methodology which requires a -9.1%[5] discount for off-island leased lines. This assessment by FE was based on the cost information provided by C&WG. The "Retail Minus" figures shown in Table 4.2 were derived by dividing the avoidable retail costs by the retail revenues over the period 2005-06 (i.e. the latest period for which data are available). Discount factors were derived for all of C&WG's Leased Lines, On-island leased lines and Off-island leased lines. FE did not verify the accuracy of these new discounts by an audit of the underlying data. However the DG is minded to accept these figures at this time.

Table 4.2 Wholesale Discount Factor Derived from C&WG Data

	Total Retail	On-Island	Off-Island
Discount Factor	16.2%	18.0%	15.0%

On this basis, the DG proposed that the average off-island discount factor should be 15.0% and applied as the appropriate Retail Minus figure to derive the HUGO wholesale prices as shown in Table 4.3 below.

[5] Which was based on an historic estimate of avoidable costs.

Table 4.3 Wholesale HUGO Prices Using Retail Minus Approach

	Applying 15.0% Discount Factor
2 Mb	£5,265
45 Mb	£36,305
155 Mb	£85,992

The DG invited interested parties to comment on the proposed 15.0% discount factor being applied to C&WG's HUGO retail prices to derive the annual wholesale rental charges shown in Table 4.3. The DG also sought views on whether to replace the existing retail minus 9.1% with the 15% to derive C&WG's wholesale price for all off-island leased lines.

Responses from Interested Parties

C&WG maintained that as a one-off commercial decision, the 30% discount on wholesale prices with effect from 1 April 2007 would apply to leased lines on average, with a larger discount applied to the HUGO prices. This reduction also reflected retail price reductions required of C&WG by 1 April 2007. C&WG did not dispute the 15% discount figure, but reserved the right to recalculate the retail specific costs of its Retail Leased Lines Business after submission of the company's 2006/07 Regulatory Accounts.

Table 4.4 HUGO Prices Introduced by C&WG 1st April 2007

	Wholesale Prices	Retail Prices	Discount
2 Mb	£3,941	£6,194	36.4%
45 Mb	£27,178	£42,712	36.4%
155 Mb	£64,373	£101,168	36.4%

Itex agreed with both proposals i.e. the Retail Minus 15% should be applied to C&WG's HUGO retail prices to derive the equivalent wholesale prices and replacing the retail minus 9.1% with 15% to derive C&WG's wholesale price for all-off island leased lines.

Wave did not specifically respond to this issue. It noted however that whilst the pricing issuing should be addressed there were, in its view, other issues relating to the wholesale offering that needed to be addressed more speedily.

DG's Position

Given the retail minus discount C&WG introduced for its HUGO leased line services with effect from 1st April 2007, the DG does not propose to take any further action with respect to C&WG's basic wholesale HUGO prices. In view of the recent reductions in all of C&WG's wholesale leased line prices, the DG is of the view that any move to a wholesale price cap for HUGO off-island leased lines should only be introduced after 31st March 2008.

Draft Decision 4

The Director General proposes to regulate the HUGO wholesale off-island leased lines on the same basis as set out in Draft Decision 3.

5. Additional Issues Raised in the Consultation

5.1. Constraint of C&WG's Wholesale Product Portfolio

C&WG in its response refuted FE's view set out in the annex to the consultation paper that it has deliberately constrained the on-island bandwidth available to OLOs[6]. C&WG argues that when the SDH radio ring was upgraded to STM4 in 2000, the first STM1 was dedicated to voice traffic, and the second and third STM1 circuits were used solely to enable the provision of broadband services. All leased line traffic is consequently provided for over the remaining STM1 circuit. C&WG argues this is the reason leased lines were limited to 45 Mbit and under between the islands of the Bailiwick. C&WG is of the view there is no discrimination as this constraint applies to all operators, including the retail arm of C&WG.

Wave informed the OUR that it requested from C&WG the development of an on-island Guernsey 45Mbit/s private circuit in July 2006 and only received a response on the 5th of September 2006 stating that C&WG was planning to review the wholesale portfolio. However, Wave claim no further information has been forthcoming since that time. Wave's concern is that products available in the on-island wholesale portfolio will not match the off-island portfolio and there will be little incentive for C&WG to create such products in a cost plus environment. As the DG understands the issue:

- Wave currently cannot lease a 45Mbit leased line to serve any retail customer in Guernsey that also requires an off-island leased line of the same capacity to facilitate a complete end-to-end service, without Wave also required to take C&WG's off-island leased line service.
- C&WG does provide a 45Mbit service to on-island retail customers but this is an end-to-end service, i.e. the on-island and off-island service is sold as a single service not as separate services.
- Wave argue discrimination arises because C&WG can and does serve customers requiring leased lines at this capacity. Wave cannot provide the same without an additional obligation to lease the cable for the off-island service. In these circumstances, C&WG retail effectively has access to an on-island service which Wave does not.

Wave therefore seek a direction to C&WG to resolve this issue, arguing it is essential that OLOs have access to equivalent wholesale on-island products as C&WG retail without a requirement to take another C&WG service, namely the off-island service.

DG's Position

The DG intends to investigate this issue further as a standalone investigation. His initial view is that it is a concern if obligations to take off-island services are imposed by C&WG on OLOs who have no need of such services if their access to an

[6] C&WG's wholesale leased line portfolio includes a range of LANs in Guernsey, with bandwidth up to 1Gbit. FE, in their associated report, discuss the services available between Guernsey and Alderney. The total network capacity of the SDH radio ring linking Guernsey, Alderney and Sark is STM4. Before 2000, the ring only had a capacity of STM1 and carried voice and a small number of low capacity leased lines.

alternative provides a viable substitute. The materiality of the issue could increase with the arrival of the Liberty cable installed by Wave. C&WG's current practice appears to require Wave to use the HUGO cable, number 4 or number 7 cable if Wave wishes to provide an end-to-end leased line service requiring 45Mbit on-island leased line.

5.2. Retail Term Discounts

C&WG did not accept the OUR's concerns regarding the issue of the company's term discounts for retail leased lines. C&W Guernsey stated that it offered a 5% and 10% discount for two and three year minimum terms respectively. This is a discount scheme offered by its retail arm and not available at wholesale level. In C&WG's view there was no reason to change this approach as any operator is able to offer similar discounts. C&WG also argue the recently announced reductions in the wholesale price now provide more scope for innovative retail discount schemes.

Itex believed that in order to maintain the 15% retail/wholesale differential for different term pricing, the 15% wholesale discount should be based upon the retail price for the specific period term of the individual purchased circuit i.e. the discounts offered by C&WG's retail arm are in effect discounts offered by C&WG and these term discounts should be reflected in the wholesale discounts.

Wave reiterated its demand for wholesale discounts for wholesale operators as C&WG provide its own retail division and requested the DG to direct C&WG to implement the same term discount structure to its wholesale products as it offers to its retail products for both on and off-island leased lines.

DG's Position

The DG notes C&WG's response to this issue and observes that there is common agreement on the basic facts that:

- C&WG offered discounts of 5% and 10% for 2 year and 3 year term contracts respectively; and
- These were retail discounts offered by C&WG and not discounts offered by C&WG's wholesale business.
- In the case of the 3 year term contract the retail price was below the wholesale price.

Table 5.1 demonstrates the issue.

Table 5.1 Problems with Previous Term Discounts – Hypothetical Example

Product	**Year 1**	**Year 2**	**Year 3**
Hypothetical Product			
C&WG Retail	£1,000	£950	£900
Discount from year 1 retail price	-	5.0%	10.0%
C&WG Wholesale	£909	£909	£909
Wholesale discount	9.1%	4.3%	-1.0%

The DG is however aware that subsequent to the new wholesale discount regime the current retail term discounts allow some margin for OLOs to compete with C&WG at the retail level. Table 5.2 illustrates this.

Table 5.2 Assessment of Current Term Discounts for Pan CI Circuits[7]

Product	**Year 1**	**Year 2**	**Year 3**
Pan CI 2Mbit Gsy/Jsy			
C&WG Retail	£9,950	£9,400	£8,750
Discount from year 1 retail price	-	5.5%	12.1%
C&WG Wholesale	£6,331	£6,331	£6,331
Wholesale discount	36.4%	32.6%	27.6%
Pan CI 45 Mbit Gsy/ Gsy			
C&WG Retail	**£74,400**	**£70,100**	**£67,750**
Discount from year 1 retail price	**-**	**5.8%**	**8.9%**
C&WG Wholesale	**£47,341**	**£47,341**	**£47,341**
Wholesale discount	**36.4%**	**32.5%**	**30.1%**

This does not entirely address the concerns of the OLOs as they argue all retail discounts should also apply to the wholesale offering. However, the fact that C&WG's retail arm offers term discounts does not necessarily imply C&WG's wholesale arm offer such discounts to its retail arm. Neither is it necessarily the case that the selling of some products below wholesale cost constitute anti-competitive behaviour although the DG would wish to consider such cases closely. Questions as to the relevant market and the outcome of such behaviour would need to be addressed before the DG will consider there is basis to proceed with this issue. OLOs have made no arguments that the market is as narrow as the products which are discounted and have not presented any arguments that they could not offer similar discounts within their overall portfolio or, indeed, if they have suffered material harm arising from C&WG's retail term discounts. The materiality of the issue is therefore unclear as the evidence has not been provided by OLOs.

The DG does not propose to consider this matter further at this time.

5.3. Ethernet Circuits

Itex expressed the view that Ethernet Circuits (e.g. Lan Links) are a leased line and should be considered within the scope of the OUR's review. It also believed the prices for Ethernet Circuits should be reviewed as there appeared to be a discrepancy between same specification circuits between Guernsey–Jersey and Guernsey-London.

DG's Position

The Ethernet circuits are indeed leased lines and have been subject to a 30% reduction in price by C&WG. As outlined above all leased lines will be subject to a wholesale

[7] Source: C&WG website

price control from 1st April 2008 and the OUR will look at the costing and pricing of services as part of the work programme in the coming months.

5.4. Retrospective Pricing

Itex also expressed the view that any reductions in wholesale prices should be applied retrospectively to an agreed point in time and C&WG refund the OLOs appropriately. In the event that this is not considered appropriate Itex recommended that any wholesale price changes are applied immediately to any existing leased line provided by C&WG to OLOs.

DG's Position

The DG has welcomed C&WG's voluntary reduction in its wholesale leased line prices which came into effect on 1st April. These changes have been introduced with immediate effect and the DG therefore does not consider it necessary for any retrospective pricing at this stage.

5.5. Pricing Structure

Wave made a number of specific comments on C&WG's pricing structure for leased lines in addition to the term discounts covered in section 5.2 above.

Wave noted that charges only relevant to on-island shifts had the effect of raising C&WG's rivals' costs in the provision of off-island circuits because its competitors' off-island circuits usually require an on-island component supplied by C&WG. Wave sought a requirement on C&WG to abolish wholesale shift charges for on-island circuits arguing this would represent a major improvement to the leased lines pricing framework in Guernsey. Wave also noted that a wholesale on-island circuit is priced on the basis of end-to-end circuit components provided to its own retail arm when OLOs do not require all of these components. The on-island wholesale leased line product is priced as if it involved two local tails. Wave argue that in many instances a second local tail is not required, as the circuit is provided directly into the OLO's Point of Presence ("POP"). Wave argue this costing basis is not efficient since the Point of Connection ("POC") end of the leased line should be delivered using the same bearer circuit as is used for voice. This is the Customer Sited Interconnect (CSI) product purchased under the Reference Offer (RO).

Wave contend that an OLO invests in costly CSI infrastructure to interconnect with C&WG, but has to pay for elements of an interconnect service from C&WG their own CSI infrastructure can support. If OLOs were able to use the CSI infrastructure, Wave believe they only require an on-island tail circuit from C&WG to provide a full end-to-end circuit from a customer's Guernsey premises to an off-island destination. The table below shows a comparison of C&WG wholesale prices for a Guernsey on-island 2 Mbit/s circuit and the charge to connect a 2 Mbit/s port on the CSI Link:-

Service	Connection Charge	Quarterly Rental Charge	Assumed Pricing Methodology
2 Mbit/s on-island Circuit (same exchange)	Nil	£460.00	Retail minus 9.1%

2 Mbit/s on-island Circuit (different exchange)	Nil	£828.00	Retail minus 9.1%
2 Mbit/s CSI Link Port	£2,044.59	£829.96	Cost Plus

Technically, the 2Mbit/s CSI Link Port (or equivalent) involves a subset of the infrastructure used for providing a 2Mbit/s end-to-end leased line yet it is higher than the charge for a 2Mbit/s end-to-end leased line. In fact, the rental charge might be expected to be significantly lower because it does not involve a local tail, the most expensive component of a leased line. Wave notes that reopening the RO costing process to address this problem would be excessively time consuming and requests a direction to C&WG to:

- develop a reasonable charge for the CSI link; and
- deliver the POC end of the leased line using the same infrastructure.

DG's Position
The DG intends to investigate this issue further as a standalone investigation subject. His initial view is that it is a concern if obligations to take a service are imposed by CWG on OLOs who have no need of such services if their access to an alternative provides a viable substitute.

5.6. Quality of Service

Wave commented that on the surface, C&WG's wholesale SLA appears reasonably satisfactory. However Wave maintained that there is nothing in the SLA or the associated regulation to allow C&WG to be adequately monitored to ensure its provisioning performance does not become discriminatory. Wave also believed that penalties for under performance are insufficient, for example the C&WG wholesale SLA requires it to pay £50 per late FOC whilst in the UK this was a matter of much debate. In the end, Oftel concluded that first, the level of compensation should be judged on the basis of the loss suffered by the alternative operator and that compensation should be 7% of the monthly rental payable per day's delay in issuing the FOC.

In addition Wave suggests that C&WG's SLA fails to include a process for expediting wholesale circuits. In many cases a retail customer requiring urgent installation will contact the incumbent requesting this. The incumbent will normally use best endeavours to meet this request and the circuit will be delivered in a substantially shorter timeframe. However, Wave's cites its experience that incumbent operators are much less forthcoming when receiving similar requests from wholesale customers. Wave argue that some regulators (e.g. Ofcom) addressed this problem by introducing an order expedite process into the SLA whereby an expedited circuit can be provisioned in 50% of standard lead time. The process allows a wholesale customer to expedite a small percentage e.g. 10% of all monthly orders.

DG's Position
The DG intends to address these issues within the non-price terms investigation scheduled for later in the year.

6. Next Steps

The OUR invites interested parties to comment on the Draft Decisions and the DG's positions set out in this paper in sections 4 and 5 respectively.

In addition to this project there are a number of inter-related projects that the DG and his staff will continue working on over the coming months:

- A review of the Bailiwick's Wholesale Leased Lines market focusing on the non-price aspects of C&WG's product offerings (e.g. terms and conditions, product range etc); and

- A review of C&WG's Retail Price Control to consider whether any new price control is required from 1st April 2008.

