SPC Network

Response to TRC Public Consultation Document

"Implementation of a Margin Squeeze Test for local access and broadband access"

Prepared for Zain Jordan

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About SPC Network

SPC Network was founded in 2003 and has worked for over 50 clients worldwide. We undertake Strategic Policy Development in platform and networked industries, by combining the knowledge of our consultants with specific and valuable skills to ensure rigorous analysis and exceptional advice. Our core consultancy team and network of partners have substantial experience in industry and consulting meaning that we understand the practical issues and challenges facing the market. Through advanced academic training, we have developed the key skills and rigorous approach needed to support our clients in the policy debate.

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1 INTRODUCTORY COMMENTS

1. Zain has asked SPC Network (www.spcnetwork.uk), a UK based consultancy specialising in economic regulation of electronic communications markets, to review the TRC's Public Consultation Document "Implementation of a Margin Squeeze Test for local access and broadband access" and to make relevant comments on its behalf. SPC Network has worked with Zain on a number of matters in the past and has thus developed a deep understanding of the Jordanian telecoms market. We have also worked on and developed margin squeeze tests for telecoms operators and regulatory authorities in Europe and elsewhere.
2. As this is the first Margin Squeeze Test (MSQT) to be introduced in the Jordan telecoms sector we have provided particularly detailed answers that we expect will help to ensure that the TRC's MSQT will be fit for purpose. We also note, in paragraph 106 below, that since the last market review in 2020 a new company, Fibretech, has entered the fixed access market and that this company is closely linked with Umniah whislt also selling wholesale access to other retail broadband providers.
3. We are, of course, willing to engage in further discussion with the TRC should this be needed.

2 RESPONSE TO QUESTIONS

2.1 Section 4.1: Efficiency Level

Question 1, Do you agree with TRC's preliminary conclusion that an EEO approach should be considered for estimating downstream costs in the retail MSQT? If not, please indicate your alternative views and provide evidence to substantiate your position.

4. We agree with the TRC that the three main options available to consider are the EEO, Adjusted EEO, and the REO. The first two options will require information from the designated dominant operator(s) as the starting point for accessing the necessary downstream cost information. Adopting the REO option would, however, require the TRC to not only determine which alternative operator(s) would fulfil the role of being "reasonably efficient", but then working with the alternative operator(s) to source the necessary information in order to be able to populate the MSQT model.

5. We also agree with the TRC that the downstream activities are not constrained to just "retail" activities. They could encompass, for example:

- 1 - network costs for the network between VULA and WBA
- 2 - network costs from WBA to retail
- 3 - other necessary wholesale costs for activities purchased from the dominant operator (fixed voice services being one example here)
- 4 - other necessary wholesale costs for activities purchased from other companies (TV content being one example here)
- 5 - retail costs (sales, marketing, customer acquisition, customer care, billing etc)
- 6 - business sustaining costs (corporate management, finance, HR, etc)

6. Providing cost information to the TRC is not a trivial matter for an operator. It will be necessary for the operator to ensure that it fully understands and appreciates the context in which each piece of information has been requested, and indeed how it will then be used to populate the MSQT model (whether directly or indirectly). The operator will then have to carefully source the required information, noting that this might well not be in a form that is straightforward to extract from the operator's own systems. Once the data has been gathered it will need to be checked by the operator both for accuracy and

relevance, again not a trivial task when those tasked with checking the information might be a few steps distant from both those requesting it (typically managers within the operator's wholesale and/or regulatory departments) and those actually gathering it (typically engineers and/or data analysts with little or no appreciation of the intricacies of margin squeeze testing).

7. Clearly, the regulatory burden of data sourcing should fall primarily on the dominant operator that is the subject of the MSQT model. This will therefore tend to preclude the TRC from choosing the REO as the most appropriate option. The choice then reduces to being between a EEO and Adjusted EEO.

8. In the consultation document, the TRC mentions two scenarios where it might be appropriate to deviate from the EEO standards. Both are excellent examples, but we would add a third one which is "Any other scenario that comes to light either during the development and population of the MSQT model, or at some later date." Our reason is evidenced by the phrase used in the consultation document that "… there is no evident reason…" [our emphasis] to depart from an EEO approach. Whilst we do accept that, at this stage, the TRC has not encountered an evident reason, this does not preclude the possibility that it might do so at a later date.

9. All we would ask, therefore, is that the TRC "reserves the right" to later amend necessary aspects of the required efficiency level, should circumstances arise that require adjustments to be made in order that other operators can indeed compete fairly with the dominant operator when using its regulated wholesale inputs. What we are seeking to avoid is the situation where a decision made at this stage is then automatically not able to be modified until a subsequent market review some years later. Should events and/or market dynamics be demonstrated to require it, we firmly believe that the TRC should retain the power to act accordingly by adjusting the necessary aspects of the efficiency level used within the MSQT model.

10. Our suggested new text is:

"An EEO approach should be used as the starting point for the estimation of downstream costs in the retail MSQT. Although at this stage the TRC does not envisage it will be necessary to make adjustments, for the avoidance of doubt it reserves the right to do so at

some future date should circumstances require such adjustments to ensure that other operators can compete fairly with the dominant operator when using its wholesale services as upstream inputs to their own retail offers."

Question 2: Do you agree with TRC's preliminary conclusion to consider an EEO approach for estimating downstream costs in the wholesale MSQT? If not, please indicate your alternative views and provide evidence to substantiate your position.

11. Again, we agree with the TRC that the three main options available to consider are the EEO, Adjusted EEO, and the REO and our reasoning is, therefore, very similar. Again, the first two options will require information from the designated dominant operator(s) as the starting point for accessing the necessary downstream cost information. Adopting the REO option would, however, require the TRC to not only determine which alternative operator(s) would fulfil the role of being "reasonably efficient", but then working with the alternative operator(s) to source the necessary information to to populate the MSQT model.

12. The types of downstream activities are simpler than for the retail MSQT and could encompass, for example:

- 1 - network costs for the network between VULA and WBA
- 2 -wholesale costs ("sales", customer acquisition, customer care, billing etc)
- 3 - business sustaining costs (corporate management, finance, HR, etc)

13. Providing cost information to the TRC is not a trivial matter for an operator. It will be necessary for the operator to ensure that it fully understands and appreciates the context in which each piece of information has been requested, and indeed how it will then be used to populate the MSQT model (whether directly or indirectly). The operator will then have to carefully source the required information, noting that this might well not be in a form that is straightforward to extract from the operator's own systems. Once the data has been gathered it will need to be checked by the operator both for accuracy and relevance, again not a trivial task when those tasked with checking the information might be a few steps distant from both those requesting it (typically managers within the operator's wholesale and/or regulatory departments) and those actually gathering it

(typically engineers and/or data analysts with little or no appreciation of the intricacies of margin squeeze testing).

14. Clearly, the regulatory burden of data sourcing should again fall primarily on the dominant operator that is the subject of the MSQT model. This will therefore tend to preclude the TRC from choosing the REO as the most appropriate option. The choice then reduces to being between a pure EEO and starting with the EEO but then making any necessary adjustments.

15. In the consultation document, the TRC mentions two scenarios where it might be appropriate to deviate from the EEO standards. Both are excellent examples, but we would again add a third one which is "Any other scenario that comes to light either during the development and population of the MSQT model, or at some later date." Our reason is again evidenced by the phrase used in the consultation document that "… there is no evident reason…" [our emphasis] to depart from an EEO approach. Whilst we do accept that, at this stage, the TRC has not encountered an evident reason, this does not preclude the possibility that it might do so at a later date.

16. All we would again ask, therefore, is that the TRC "reserves the right" to later amend necessary aspects of the required efficiency level should circumstances arise that require adjustments to be made in order that other operators can indeed compete fairly with the dominant operator when using its regulated WLA inputs. Should events and/or market dynamics be demonstrated to require it, we firmly believe that the TRC should retain the power to act accordingly by adjusting the necessary aspects of the efficiency level used within the MSQT model.

17. Our suggested new text is as follows:

> *"An EEO approach should be used as the starting point for the estimation of downstream costs in the wholesale MSQT. Although at this stage the TRC does not envisage it will be necessary to make adjustments, for the avoidance of doubt it does reserve the right to do so at some future date should circumstances require such adjustments to ensure that other operators can compete fairly with the dominant operator in providing their own WBA services when using the WLA service of the dominant operator as the upstream input."*

2.2 Section 4.2: Timing

Question 3. Do you agree with TRC's preliminary conclusion that the retail MSQT should be applied on an ex-ante basis, complemented with an ex-post MSQT every six months? If not, please indicate your alternative views and provide evidence to substantiate your position.

18. In section 4.1, the TRC states that the dominant operator "has not yet provided wholesale fibre services to its retail competitors." This would certainly indicate that (as written in section 4.2) "… upstream wholesale products are nascent…", which would, as the TRC argues, favour ex-ante MSQT testing. It is quite possible that the current WLA/WBA offers do not provide a sufficient margin with current retail offers to make them worthwhile for other retail operators to utilise as wholesale inputs. This again would tend to favour ex-ante testing.

19. Nevertheless, we accept that a myriad of rapidly evolving/changing retail offers could create a high burden if all of them were subject to ex-ante testing by the TRC. Therefore, a balance needs to be struck between ex-ante and ex-post testing and we make three specific comments here:

    - Regardless of whether the tests are conducted ex-ante or ex-post, the dominant operator remains under an obligation not to engage in a margin squeeze. In this regard, it is the responsibility of the dominant operator to assess each and every new/revised retail offer so as to satisfy itself that there is indeed no margin squeeze taking place.
    - Once the MSQT model has been developed, and the associated procedures defined and implemented, there is no fundamental reason why ex-ante testing (using the MSQT model developed by the TRC) could not be carried out by the dominant operator itself, with results, and associated evidence, then forwarded on to the TRC as required. This would significantly reduce the burden on the TRC and would not place an undue additional burden on the dominant operator. After all, it has an obligation not to engage in a margin squeeze and thus a responsibility for taking due care that it does not do so.
    - Ex-post testing could take one of two forms. There could be the periodic, ex-post testing according to a structured procedure laid down by the TRC, and we agree that

six months would be a realistic period to adopt. In addition to this though there could be ad hoc short-notice ex-post testing that the TRC could undertake when it has been alerted to potential margin squeeze issues by other operators, or indeed has formed its own views that there is a significant risk that warrants investigation.

20. Our suggestions therefore are the following:

- The TRC requires the dominant operator to undertake ex-ante tests for **all** new/revised retail offers. These would utilise the MSQT Excel model developed by the TRC and follow a formal procedure prepared by the TRC for that purpose. Results, and supporting evidence, would then be retained by the dominant operator and made available to the TRC for review.
- The TRC would in addition undertake its own independent ex-ante tests as an occasional cross-check on the ex ante testing being carried out by the dominant operator.
- Where the TRC becomes concerned that either flagship or non-flagship products might be resulting in a margin squeeze, it reserves the right to undertake short-term ex-post testing of those products. These tests would follow the same procedure as used for ex-ante tests, just undertaken at short notice and not waiting for the next six-monthly review to take place.
- A broader six-monthly review of the various retail products would be undertaken by the TRC on an ex-post basis, following the procedures developed and published by the TRC for this purpose.

Question 4 Do you agree with TRC's preliminary conclusion on the criteria proposed to identify retail fibre flagship offers? If not, please indicate your alternative views and provide evidence to substantiate your position.

21. The selection of the initial set of flagship offers requires careful consideration by the TRC. The consultation document implies that it will be done purely on these products forming a cumulative proportion of the dominant operator's customer base or revenue, with that proportion set at 75%. No indication is provided as to how the TRC will decide whether to base the flagship set on 75% of customers **or** 75% of revenues. We would argue that both

are as important as each other, and thus the flagship set should achieve both targets simultaneously – thus 75% of customers **and** 75% of revenues.

22. It is also unclear to us as to what would constitute an individual "offer", within the context of the set of flagship offers, especially given that there tend to be many variations available for each basic offer – particularly in the case of bundles.

23. Whilst we have no objection to the TRC compiling the initial list of flagship offers primarily on the basis of arriving at a set that constitutes 75% of customers and revenues, we would urge the TRC to involve the other operators too in the decision process. Our reasoning for this request is twofold:

24. The importance of a particular offer in the dynamic landscape might not necessarily reflect the current amount of customers it has and revenues that result from that. For example, a new offer that is priced at a low level and is being marketed aggressively could already be showing signs of having a significant impact on the market even though customer numbers and revenues are still very small.

25. To move the total covered from say 70% to 75% there might be a number of different offers that could be added to the set to take the totals over the threshold. Of those available for selection, some might have a greater potential for market impact than others.

26. In both of the above cases, the other operators would be able to provide guidance to the TRC on the current market dynamics and with which particular offers they are currently most keen to be able to compete fairly. Our request would be that once the TRC has compiled a draft list of the initial set of flagship offers, it then shares that with the operators for comment. Any suggested changes to the list would need to be explained and justified to the TRC.

27. With regards to the maintenance of the set of flagship offers, we suggest a standard periodic review be undertaken by the TRC every six months, perhaps though not necessarily coinciding with the 6-monthly ex-post MSQT analysis. As with the compilation of the initial set of flagship offers, operators should be provided with the opportunity to provide their own input and reflections on the ongoing suitability of the current set of offers.

28. In addition to the standard periodic review suggested above, there might be a need for the TRC to make ad hoc changes to the set of flagship offers. The TRC alludes to this fact by stating that under specified conditions, new offers will automatically be added to the current set. We support the conditions laid down by the TRC in this regard. However, we would also urge the TRC to keep in mind that existing offers not currently included in the set of flagship offers might also need considering if the dominant operator makes a significant change to some aspect of the offer. We accept that the TRC might deem such a significant change to constitute a "new" offer, and thus feel it would already be covered, but if so we would welcome clarity on this point.

29. Finally, we would urge the TRC to be open to ongoing feedback from the other operators should they be of the opinion that specified offers are rising in significance and the operators are struggling to compete fairly with them. This would help to provide the other operators with a very useful check and balance on the applicability and relevance of the set of flagship offers.

30. We would accept that any consultations that the TRC has with the various operators would need to be timely and operators should do their utmost to respond quickly when necessary.

Question 5: Do you agree with TRC's preliminary conclusion that the wholesale MSQT should be applied on an ex-ante basis? If not, please indicate your alternative views and provide evidence to substantiate your position.

31. A dominant operator that is obligated to provide wholesale inputs to competing retail operators will tend to try and "encourage" the competing operators to interconnect at the highest level allowable. It does this so that it can retain as much of the overall value of the retail product for itself. With this in mind, if the dominant operator is required to offer two distinctly different wholesale products, where one is upstream of the other, then there is a strong temptation for the dominant operator to "discourage" use of the upstream variant. In the context of this consultation, the two wholesale products are WLA and WBA, with the former being the upstream variant.

32. The TRC therefore needs to be on the alert for any margin squeeze issues between the two wholesale products, so that it can intervene as soon as is necessary, and ideally *ex-ante*.

We therefore strongly support the view of the TRC that all fibre-based WBA products should be subjected to a permanent *ex-ante* MSQT.

33. It is the nature of wholesale WLA and WBA products that they are much more stable than the retail products. We do not, therefore, consider that a total obligation for the wholesale MSQT to be undertaken *ex-ante* is an undue burden.

2.3 Section 4.3: Level of Aggregation

Question 6. Do you agree with TRC's preliminary conclusion to apply the ex-ante MSQT at the level of individual offers? If not, please indicate your alternative views and provide evidence to substantiate your position.

34. The consultation document briefly describes three distinct levels of aggregation: offer-by-offer, product level, and portfolio level. The reality, we feel, is actually more of a continuum. For example, does an individual offer encapsulate all possible variants, "add-ons" for example, of that offer, or is it limited to a specific permutation of those variants. With regards to products, would a "product" consist of, for example, all single-play broadband access offers, or be divided between the underlying technology used (copper versus fibre), and even the speeds offered (up to 10 Mbps, up to 30 Mbps, up to 100 Mbps, over 100 Mbps etc). Also, as alluded to in the consultation, there is the question of whether a portfolio should encompass every single product offered, or defined subsets of those products, and if the latter then how those subsets should be grouped.

35. With regards to the retail MSQT, the TRC has proposed that:

- Ex-ante tests should be carried out on "individual" fixed broadband offers, though these should be limited to flagship offers for services provided over fibre.
- Ex-post tests should be carried out at a portfolio level, with the portfolio set to "aggregating the offers that have been analysed ex-ante".

36. We agree that ex-ante tests should be carried out on individual offers, as this will enable the tests to be of most use and relevance. However, we would stress that "individual" should be defined very tightly so that the TRC is very specific about the set of offer parameters and/or add-ons that are included in each individual offer.

37. Our reasoning for this is that anti-competitive behaviour can be very focused on specific parameters and/or add-ons. If an "individual" offer is, in reality, a weighted average of a small portfolio of offers (such as a blend of different speeds, or a blend of various add-ons) then the impact of that behaviour could easily be diluted, and the anti-competitive margin squeeze not caught by the test. An extreme example of this would be an offer that included some sort of add-on that could not (or not cost effectively) be replicated by the other operators, with the offer being priced at an aggressive level.

38. We would also urge the TRC to publicise the details of the individual offers, including all of the parameters and/or add-ons associated with each one. This will then better enable the other operators to provide constructive feedback on any changes they might suggest to the precise make-up of each individual offer.

Question 7. Do you agree with TRC's preliminary conclusion that the ex-post MSQT should be applied at the portfolio level? If not, please indicate your alternative views and provide evidence to substantiate your position.

39. As noted in our response to Q6, the TRC has proposed that the ex-post tests should be carried out at a portfolio level, with the portfolio set to "aggregating the offers that have been analysed ex-ante".

40. We have two specific concerns with this proposal, as currently worded. Our first concern was also discussed in our response to Q3, in that we would urge the TRC to retain the right to conduct MSQT tests on individual offers that have already been launched or modified but are not currently included in the set of flagship offers. These tests should be carried out in the same manner as the *ex-ante* tests and be conducted on the individual offers that are causes for concern. We accept that it is possible that this right might be very rarely needed, but we do feel it is important for the industry as a whole to know that the right exists – as this in itself might help to discourage anti-competitive behaviour by the dominant operator.

41. Our second concern is that the portfolio would be automatically limited to a set comprising just those individual offers that were subjected to ex-ante testing. If the portfolio set is limited in this manner, then, almost by definition, around 25% of the customers and/or revenue will be excluded from any testing at all. Whilst we agree that a portfolio set that

encompasses all of the ex-ante individual offers is worthwhile, we would urge the TRC to consider at least two further portfolio sets.

42. A portfolio set that covers all remaining offers over the six-month period. The aim of this set would be to broadly check that the remaining offers, when viewed as a set, do not pose any margin squeeze issues.

43. A portfolio set that comprises all offers over the six-month period. This set would thus be an amalgam of the set currently proposed by the TRC plus the set covered by the first bullet above. This set would act as a final check on the overall relevant business of the dominant operator and would be useful if one of the constituent portfolio sets did fail the MSQT for some reason.

44. As with the ex-ante testing, we would urge the TRC to at least retain the right to examine other, smaller, portfolio sets should either the TRC or other operators have reasonable concerns that are worthy of analysis.

45. Our final suggestion here is that the TRC also undertakes *ex-post* testing on individual offers too, but with the "pass mark" based on the parameters set for *ex-post* tests rather than for *ex-ante* tests. The concern here is that the TRC is considering how best to treat shared/common costs in each of the two types of MSQT and, depending on the final view taken by the TRC, there may be significant differences between a test that excludes most/all of the shared and common costs (at the limit being based on so-called Pure LRIC) and one that includes most/all of those costs. We discuss this point later in our responses to Q12 through Q14.

Question 8. Do you agree with TRC's preliminary conclusion that an offer-by-offer approach is the appropriate level of aggregation to be considered in the wholesale MSQT? If not, please indicate your alternative views and provide evidence to substantiate your position.

46. For the wholesale MSQT, the consultation proposes that the *ex-ante* tests should be conducted on "each individual WBA service", and explicitly states in footnote 13 that each different speed would be treated as a separate individual WBA service. We fully agree with this proposal given the importance of ensuring that there is no margin squeeze at all between the upstream (WLA) and downstream (WBA) wholesale services, coupled with the fact that the number of WBA services that will need to be considered (and thus tests to be

conducted) will be relatively low compared to the retail services. Furthermore, the prices of both WBA and WLA will most likely only change every twelve months or so, again limiting the number of tests that will need to be carried out.

2.4 Section 4.4: Profitability Method and Time Horizon for the Test

Question 9. Do you agree with TRC's preliminary conclusion that an NPV approach should be used in the retail and wholesale MSQT for broadband offers? If not, please indicate your alternative views and provide evidence to substantiate your position.

47. The consultation document identifies two main approaches to assessing the profitability of the offers in order to calculate whether or not a margin squeeze is taking place, these being a period-by-period approach and a Net Present Value analysis.

48. In our opinion, the period-by-period approach is only really suited to steady-state situations. Steady-state, in this regard, would require:

- The number of customers to be constant, with the number of customers added equal to the number of customers leaving.
- The average revenue per customer to be constant, essentially representing a static mix of new customers on introductory rates with older customers on standard rates.
- The average cost per customer to be constant, essentially representing a static mix of new customers incurring initial costs with older customers incurring regular costs.
- Investments in infrastructure are also constant, with assets being retired equal to new assets being put into service, and the average degree of depreciation of assets in service being constant.

49. In the dynamic broadband market that exists in Jordan, we would be surprised if there is a realistic prospect of the above conditions being met. Furthermore, if the tests are to be carried out at the individual offer level, the cost accounting systems of the dominant operator would need to be up to the task. The systems would also need to be subject to regular audit to ensure that both costs and revenues are being allocated correctly and fairly across the multitude of products the operator provides.

50. With the above points in mind, we agree with the TRC that Net Present Value (NPV) analysis is the most appropriate approach for the TRC to adopt for the various margin

squeeze tests, covering both retail and wholesale MSQTs. The NPV also analysis represents best practice, based on testing carried out by regulatory authorities in other countries.

51. We note the time horizon is referred to as “the number of years” in section 4.4.1 of the consultation document. However, in our opinion best practice with such NPV analysis is to have a time horizon measured in months not years. Thus, for example, if the time horizon was 5 years, then there would be 60 individual months considered (and discounted back) as opposed to 5 individual years. It is our view that this is necessary to:

52. Ensure that both costs and revenues are recorded correctly in the month they occur, such that they are discounted back accurately according to the number of months that have elapsed. Clearly, this also requires the use of a monthly, rather than annual, discount rate.

53. Allow for easy analysis of how the cumulative discounted cash flow is progressing from month to month. This in turn allows the TRC to readily identify the month in which break-even occurs.

Question 10. Do you agree with TRC’s preliminary conclusion that the retail and wholesale MSQT should use the average customer lifetime for the time horizon? If not, please indicate your alternative views and provide evidence to substantiate your position.

54. The importance of the time horizon that will be used for the NPV analysis will depend largely on the extent of introductory discounts, promotions, along with the various one-off costs incurred by the retail operator in attracting, acquiring and onboarding the customer. Such reduced revenues (due to discounts etc) and initial costs will result in an initial negative cashflow for the operator, which must then be recovered over the subsequent months for breakeven to take place. This breakeven point must also take into account the time value of money. Thus, future cashflows must be discounted back before they are used to offset the initial negative cashflow that generally arises with customer acquisition.

55. From the standpoint of the MSQT, if the time horizon considered is shorter than the breakeven month then a margin squeeze will have taken place, whereas if it is longer than the breakeven month then the test will have been passed.

56. Within margin squeeze testing, this time horizon used for the NPV analysis is generally referred to as the “average customer lifetime”, as indeed is the case for this consultation document. However, it is not necessarily the case that the “real” average customer

lifetime of the dominant operator is the optimal choice for the regulator to adopt. For example, it is quite possible that the dominant operator will enjoy a longer average customer lifetime than the competing operators. This might have nothing to do with scale and scope efficiencies but be simply due to the dominant operator's market position and a reluctance of its customers to change provider.

57. If a regulator wishes to promote a vibrant market, then there is an argument that can be made to keep the time horizon used for margin squeeze tests less than might otherwise be the case if a strict average customer lifetime was used, especially if such a lifetime was five years or more. At the other end of the scale, the shortest time horizon that should be considered would reflect the average contract period that new customers were expected to sign up to. In most countries, this tends to be between one and two years for residential contracts. There is no formal "best practice" here, but a time horizon of 36 months is not uncommon and represents a reasonable compromise. After all, if an operator is unable to make a customer profitable by the end of three years, then most observers would probably question why it does not increase its prices.

58. One final point we would suggest that the TRC considers is what assumptions should be made in the NPV analysis about "typical" customer behaviour at the end of the minimum contracted period. One option would be to assume that the customer continues to pay the standard price for as long as they remain a customer (or at least until the end of the NPV time horizon). Another option would be to assume that the customer remains with the current operator but signs up to a new deal – and hence starts a new minimum contract period. A third option would be a blend of the two, in that it is assumed a proportion would stay on the standard fee, with the remainder signing up to a new deal. We have no strong opinion either way but does believe that the TRC should consider how to address this in the Excel model.

Question 11. Do you agree with TRC's preliminary conclusion that the reasonable rate of profit should consider the approved WACC rate? If not, please indicate your alternative views and provide evidence to substantiate your position.

59. We agree that an alternative operator should be able to earn a reasonable profit on its downstream operations, and also that a WACC applied to the mean capital employed is the best practice method of accomplishing this within the MSQT.

60. The precise level to be applied to the WACC will always be up for debate, with smaller operators likely to experience a higher WACC than a very large dominant operator. Having said that, the primary competing operators in Jordan (Zain and Umniah) are both large operations in their own right and, as such, utilising the latest approved WACC for the dominant operator seems reasonable. We therefore would have no objection to the use of 11.9%

2.5 Section 4.5: Cost Standard

Question 12. Do you agree with TRC's proposed approach for estimating the costs to be used in the ex-ante retail MSQT? If not, please indicate your alternative views and provide evidence to substantiate your position.

61. The consultation document identifies four different cost standards that were considered, these being: AAC, LRIC, LRIC+, and FAC.

62. AAC (Average Avoidable Costs) is described as a short-term (short-run) standard that excludes any costs that cannot be avoided by the business (thus it excludes all sunk costs due to investments in network infrastructure etc.). We agree with the TRC that such a standard is inappropriate for the MSQT

63. The document mentions that LRIC plus a mark up for joint and common costs (LRIC+) and FAC can produce similar results. This is true to a degree, but really depends on whether the LRIC+ is bottom-up or top-down (only the latter is really similar to FAC), and the approach taken to cost allocations within FAC to ensure that "unnecessary" costs are not allocated to regulated products and services. There is also the degree to which both are adjusted to make them truly "forward-looking". Suffice to say that LRIC+ and FAC both intend that all relevant costs are allocated to the regulated products and services, and are done so in a fair and reasonable manner.

64. LRIC can be a bit of an oddity – at least in terms of how it is interpreted in practice. When it first gained prominence in the early/mid 1990s, it was used as a "catch all" phrase which, in reality, was modelled as LRIC+. Even when regulators talked about (and thus claimed that) inter-increment shared and common costs should be recovered via equi-proportional mark-ups, this was very rarely carried out in practice within the models themselves (except

perhaps for very broad costs such as corporate overheads, where this is generally the most appropriate cost allocation method anyway).

65. With LRIC, "within" an increment, costs are essentially allocated based on LRIC+ (using appropriate cost allocation drivers such as usage). "Between" increments, a decision must be made as to whether inter-increment costs are (a) excluded totally from the results, (b) recovered on the basis of appropriate cost allocation drivers, or (c) recovered via equi-proportionate mark-ups. Whether (a), (b), or (c) are implemented can have serious consequences on the results of the modelling.

66. Choice (a) is what is now generally referred to as "Pure LRIC". The increment itself is tightly defined. Generally, this is the *call termination service provided to third parties*, at least within telecommunications, since this is the only real area it has been used by telecoms regulators. Within fixed networks, the regulated price for call termination to third parties dropped to near zero when costed using the Pure LRIC standard, and many observers (and we suspect operators too) actually started to question whether it was even worth bothering to charge for it at all.

67. Choice (b) means that prices of products within the increment are "based on" LRIC, rather than "set at" LRIC, and the result is essentially the same as LRIC+.

68. With choice (c), the results can vary enormously depending on how the increments are defined, and thus what costs they gather as being "purely incremental". At the extreme, if increment X does not attract any "purely incremental" costs, whereas increments Y and Z do, then by definition increment X will also not be allocated any shared/common costs under the equi-proportionate mark-ups method. Thus the cost-based price of products in increment X will be zero.

69. At the other extreme with choice (c), if the increments are very large, such that nearly all costs are contained "within" the increments, then all that might be left are the residual common overheads. In such a case, choice (c) will end up with very similar, if not identical, results to LRIC+.

70. When determining what costs are "incremental" there is a further complexity that revolves around what "LR" (long run) is taken to mean in practice. A common misconception made is that all costs "shared" between multiple individual increments cannot be deemed

"incremental" to specific increments. However, in the "long run" shared costs can generally be re-sized in the capacity of what is available – they have a cost-volume relationship that is not a simple flat "fixed cost", but perhaps has a lower fixed element plus additional costs that arise as the volume of the capacity increases. These *additional costs* are essentially "variable" costs – costs that vary depending on whether a specific increment is present or not. As such, even under pure LRIC, an appropriate portion of these additional "shared" costs can be allocated to the individual increments.

71. We can illustrate the above with reference to footnote 16 from the consultation document. This provides an example of two increments "voice" and "Internet services", with a shared cost of "IT and billing systems". The footnote states that "the use of incremental costs would **not** include **any** of these costs" [our emphasis]. However, if only Internet services are provided, and the IT and billing systems can, in the long run (LR), be re-sized, then costs can justifiably flow to the individual increments.

72. Section 4.5.1 of the consultation document is unclear to us in how the TRC intends to define the increments, particularly in the case of the ex-ante MSQT. Based on our text above, this could be critical in how the testing works for the retail MSQT. If, for example, an individual offer is deemed to be an increment for the purposes of LRIC, then potentially nearly all network costs would be excluded even when considering that shared costs can have a capacity-variable element to them in the long run (it is unlikely that there will be a need to re-size the fibre network, for example). If non-network costs follow the same fate, then for each individual offer there would essentially be no difference between the cost of the upstream input and the "incremental" cost of the retail output (as all costs will be deemed shared and thus excluded). **This in turn would effectively render the ex-ante MSQT pointless (unless the dominant operator priced below the upstream wholesale input), which we hope is not the intention**.

73. The argument in favour of excluding, at least some, of the shared/common costs from the ex-ante MSQT is that it provides the dominant operator with a degree of pricing freedom. This allows, for example, the operator to apportion/recover shared/common costs in a manner in which the customers are most comfortable with. However, there are inherent risks that need to be kept in mind by the regulator here. In particular:

74. If the upstream wholesale inputs have a defined speed gradient attached to them (where a lower speed profile is charged at a lower rate than a higher speed one), then it may well be hard for the competing operators to justify adopting a different speed gradient with their own versions of the dominant operator's retail offers.

75. The dominant operator could slice-and-dice its retail offers over time with aggressive short term (or as long as necessary) pricing on specific variants of the speeds on offer. Such aggressive offers might well not be sustainable in the long term, but if the dominant operator has strong enough nerves they might be sustainable long enough to force the exit of one or more of the competing operators. Then, once those operators had withdrawn from the market, the dominant operator could remove the aggressive offer.

76. If the inclusion/exclusion of costs ends up based on legally fought definitions of "incremental costing", then the TRC might well end up having to face an all-or-nothing decision between, for example, an incremental cost of zero for each individual offer and a fully LRIC+ version of that cost.

77. One option might be for the TRC to decide that network costs should be allocated on the basis of LRIC+, and only non-network costs on the basis of LRIC. However, this is still likely to cause disputes on how much of the shared/common non-network costs are variable (and thus should be included). It is also still likely to result in issues for multi-play bundles, depending on how content, for example, is purchased by the dominant operator.

78. On balance, we are strongly in favour of the TRC adopting LRIC+ for the ex-ante MSQT and would urge the TRC to reconsider its proposed approach in this regard. This would also represent best practice with margin squeeze testing in other jurisdictions.

Question 13. Do you agree with TRC's proposed approach for estimating the costs to be used in the ex-post retail MSQT? If not, please indicate your alternative views and provide evidence to substantiate your position.

79. Our general argumentation in response to Q12 is also very relevant to the *ex-post* retail MSQT and should thus be considered in our response to Q13.

80. If the increment considered is the "analysed portfolio of offers", as stated in the consultation text, then all other offers will not be included in the assessed increment and any costs shared with the portfolio of offers will thus still be excluded. Advertising is

provided as an example of a cost that would be included, but that would not be the case if there is even a single offer outside of the portfolio considered that benefits from that advertising (as would almost certainly be the case).

81. Therefore, we are again strongly in favour of the TRC adopting LRIC+ for the *ex-post* MSQT and would urge the TRC to reconsider its proposed approach in this regard. This would also again, we believe, represent best practice with margin squeeze testing in other jurisdictions.

Question 14. Do you agree with TRC's proposed approach for estimating the costs to be used in the ex-ante wholesale MSQT? If not, please indicate your alternative views and provide evidence to substantiate your position.

82. Our general argumentation in response to Q12 is also very relevant to the ex-post retail MSQT and should thus be considered in our response to Q14.

83. In section 4.5.2, the TRC is unambiguous that network costs should be calculated using LRIC+, and we fully supports that view.

84. For non-network costs, the text provided is clear on how the cost information will be sought (using information and data "submitted by the regulated operator"). However, the text does not indicate how the TRC proposes to use that cost information. We believe that this should also be calculated using LRIC+ and urges the TRC to be explicit that this will be the case.

2.6 Section 4.6: Relevant Regulated Wholesale Services

Question 15. Do you agree with TRC's preliminary conclusion that the retail MSQT should be implemented separately for VULA, bitstream copper, and bitstream fibre whenever these services are relevant for the provision of the retail broadband service considered? If not, please indicate your alternative views and provide evidence to substantiate your position.

85. We agree that it is best to test for each of the relevant upstream inputs individually. However, it would be acceptable to us to not test with VULA as the input as long as the wholesale MSQT is fully based on the LRIC+ standard, that is with no costs excluded on the basis that they are not "incremental". Our reasoning for this is that in such a case the test

with VULA as the input would automatically pass if the test with Bitstream fibre as the input passes, and so it is not necessary to run the model with VULA.

Question 16. Do you agree with TRC's preliminary conclusion to implement the wholesale MSQT, considering the VULA service as the relevant input? If not, please indicate your alternative views and provide evidence to substantiate your position.

86. Unless/until unbundled fibre is made available to the other operators, VULA is the only realistic wholesale input to bitstream fibre. On that basis, we agree with the TRC that the wholesale MSQT must be based on VULA being the relevant upstream wholesale input.

2.7 Section 4.7: Assessment of Bundles

Question 17. Do you agree with TRC's preliminary conclusion to assess bundles in the retail MSQT adopting an aggregate approach? If not, please indicate your alternative views and provide evidence to substantiate your position.

87. The TRC has considered two broad options with regards to assessing bundles under an MSQT, these being an aggregated approach and an individual approach.

88. With the individual approach, each component part of the bundle is assessed separately. Furthermore, each variant of each component part might need to be assessed separately. This would require allocating both revenues and costs in accordance with the component parts. From the cost side this is relatively straightforward, as that after all is the purpose of cost allocation systems. Having said that, our comments and argumentation in response to Q12 through Q14 also apply here in determining which costs should be included and which excluded. On the revenue side, however, the situation is much less straightforward. If practical, the revenues could be allocated according to the proportions that would apply if the component parts were purchased individually, though this would require that they were in fact all available for individual purchase. Another method would be to make a judgement on the relative value placed on each component part by the end customer and allocate the revenues on that basis.

89. The aggregated approach conceptually seems better as it is the value proposition overall that is being assessed for a margin squeeze. However, the TRC will need to take care on how, for example, economies of scope are handled in the test – especially if the cost

information is being sourced directly from the dominant operator. Examples of where economies of scope might apply are sales and marketing costs, billing costs, and customer support costs. Our arguments about LRIC versus LRIC+ are critical here as otherwise most or all the additional costs might end up being excluded on the basis that they are shared with other offers. Examples here would include a voice component that is offered as an individual service, and TV/streaming content is either also offered as an individual service or is offered by non-flagship bundles.

90. One important consideration with the use of an aggregated approach is whether the other operators can and do compete directly with the bundles offered by the dominant operator. If they can, but choose not to, then the aggregated approach might still be acceptable. However, if technically/economically they are unable to provide equivalent bundles then there is a strong argument that the dominant operator should not be allowed to offer the bundle in the first place. In such a situation, the TRC might choose to either prohibit that type of bundle or, as a compromise, insist that each component part is assessed separately for a potential margin squeeze – though if this is allowed then we would argue strongly that such a separated analysis is done on the basis of LRIC+ as any other standard would allow for significant cross-subsidisation between the component parts of the bundle.

91. One final consideration with bundles is whether the broadband element is also available as an individual offer (with the same parameters), and if so whether that individual offer should then also be assessed for a margin squeeze (regardless of whether it is already deemed a flagship product). We are strongly of the opinion that an equivalent broadband offer should be assessed for margin squeeze as an individual offer and, if necessary, added to the list of flagship products for this purpose. If an exact equivalent is not offered individually by the dominant operator, then a close match should be assessed instead. This will help to provide valuable guidance to the TRC on whether undue cross-subsidisation is taking place with the bundled offer.

2.8 Section 4.8: Consideration of Promotions

Question 18. Do **you agree with TRC's preliminary conclusion that the promotional costs incurred by the regulated operator in the ex-post retail MSQT should be considered? If not, please indicate your alternative views and provide evidence to substantiate your position**.

92. Promotions can take many different forms. Two examples were provided in the consultation document: monthly fee discount for X months, and a temporarily higher speed for Y months. Other examples would be a range of free gifts, which might be related to the broadband service (such as a free wifi router and/or wifi extender), or completely unrelated to the service (such as a voucher to spend in a store or clothes shop).

93. The TRC is right to be concerned about the complexity and rapidly changing nature of promotions, and the impact this might have on the need for the TRC to undertake retail MSQT tests. However, we have strong reservations about only considering the impact of promotions during the six-monthly portfolio ex-post MSQT. Our reasoning is two-fold: first, six months is a long time with a market such as dynamic as broadband provision and the damage could well have been done over that period. Second, depending on how the portfolio test is carried out, the impact of the promotions could get diluted across the range of offers within the portfolio.

94. Once the model has been populated for a given individual offer, taking account of an initial discount for a specified number of months is trivial – five minutes work, at most. Therefore, it should not be considered an undue burden. For promotions consisting of free/discounted gifts, we suspect that some of these might well be regular promotions that are repeatedly applied from time to time. In such cases, once the model has been adapted to take a particular gift/discount into account, it would again be trivial to run the MSQT, as the model operator would simply have to select the individual offer and then select the promotion type and value.

95. Nevertheless, we are conscious that the TRC will have limited resources to attach to running the MSQT and staff that are not that familiar with the topic might well struggle to run tests quickly and/or be prone to not populating the model correctly. We therefore reiterate our earlier suggestion in response to Q3, repeated below:

96. The TRC requires the dominant operator to undertake ex-ante tests for <u>all</u> new/revised retail offers. These would utilise the MSQT Excel model developed by the TRC and follow a formal procedure prepared by the TRC for that purpose. Results, and supporting evidence, would then be retained by the dominant operator and made available to the TRC for review.

97. If the above suggestion is followed, and the dominant operator is "reminded" that it must not introduce new/revised retail offers that fail the MSQT (when run in accordance with the formal procedure prepared by the TRC for that purpose), then the TRC could fall back to more of a monitoring role. This might involve undertaking its own MSQT for a revolving sub-set of the flagship offers on an ex-ante basis (where the results are then compared to those submitted by the dominant operator), and then sampling the results and evidence provided by the dominant operator for other offers within the flagship set.

2.9 Section 4.9: Treatment for Non-Residential Offers

Question 19. Do you agree with TRC's preliminary conclusion to limit the application of the retail MSQT to residential and standardised non-residential broadband offers? If not, please indicate your alternative views and provide evidence to substantiate your position.

98. We accept that non-residential offers fall into one of two types: those based on standardised offers, and those that by virtue of their complexity and importance are bespoke to each customer. We agree that bespoke offers are outside of the scope of the MSQT.

99. We remain of the view that it is very important that standardised non-residential offers are included within the retail MSQT as otherwise the alternative operators would be placed at a significant disadvantage to the dominant operator. One point that we do feel very strongly about though is that "standardised" has to result in the price being published on the website of the dominant operator. If, as seems to be the case at the moment, the dominant operator does not openly publish the prices of its standardised non-residential offers, then that operator could easily be pricing at a level that will fail the MSQT and neither the other operators, nor the TRC, would have any knowledge of it.

100. We therefore urge the TRC to instruct the dominant operator that it must publish these prices on its website. The retail MSQT can then be run in accordance with the published prices. Only in this manner with the other operators have any real confidence that the dominant operator is fulfilling its obligations not to indulge in margin squeeze activities.

3 OTHER COMMENTS

Respondents may comment on any other aspect of the Consultation. In doing so, respondents should indicate the particular section of the Consultation to which their comment refers.

101. We would like to make the following more general comments on the consultation document and the margin squeeze process.

Model Availability

102. We urge the TRC to make the model publicly available and, to the extent possible, populated with realistic data. The dominant operator should be provided with a version of the model that has non-randomised data inputs. Other operators can be provided with a version that has confidential inputs randomised to a certain degree. However, even though some inputs will be randomised, we urge the TRC to take care that overall the model will still produce realistic results with those inputs.

Formalised Procedures

103. We urge the TRC to prepare and formalise various relevant procedures related to MSQT. These need to be specific step-by-step instructions published by the TRC that set out explicitly, and in detail, what will be done by whom and by when. For example:

- How, and how often, will the flagship products be selected/updated
- How will the TRC request data from the dominant operator (and/or other operators if relevant) when conducting the ex-ante and *ex-post* tests.
- When will the dominant operator be expected to populate its own copy of the Excel model, for example as part of its submissions to the TRC. What procedure(s) will the operator need to follow when doing so.
- When will the other operators be expected to populate their own copy of the Excel model, for example as part of submissions to the TRC where a margin squeeze is suspected. What procedure(s) will the operators need to follow when doing so.
- what timescales will be allowable for each step in all of the above, and what will be the impact of, for example, the dominant operator (or indeed the TRC) not adhering to these timescales.

Dominant Operator to run Own Tests

104. The dominant operator should be required by the TRC to run its own tests using the TRC MSQT model and in accordance with a procedure prepared by the TRC for this purpose. All tests performed by the dominant operator should be formally recorded by it, and necessary supporting evidence attached. For flagship offers, the results should be automatically forwarded to the TRC. For all other offers, the results should be retained internally for review by the TRC on request. Only new/revised offers that pass the MSQT (when it is run in accordance with the TRC procedure) are permitted to be launched into the market. Clearly, as and when the model is updated, a revised version will also need to be provided to the dominant operator.

Other Operators to Run Tests when Necessary

105. In return for other operators being provided with a copy of the TRC MSQT model populated with realistic data, Zain has expressed that it will be happy to run that model and forward results and supporting evidence to the TRC if/when it suspects that the dominant operator has new/revised offers in the market that it believes will result in a margin squeeze. Clearly, as and when the model is updated by the TRC, a revised version will also need to be provided to the other operators.

Umniah and Fibertech Shared Ownership

106. We understand that Fibertech is becoming an increasingly powerful company in the fibre broadband access market. This company was not operational at the time of the last market review in 2020 and so is not subject to any regulation. Given the relationship between Fibertech and Umniah, it may be appropriate for the TRC to consider whether Umniah and Fibertech enjoy a position of dominance in the next market review. If it is found to do so then an MSQT should be considererd between the wholesale offers provided by Fibertech and the retail offers of Umniah.