Oaseirys Çhellinsh
Communications Commission

Summary of Commission Decision

30th January 2020

DN/01/2020

1. Introduction

1.1. A complaint was made by Sure (Isle of Man) Ltd. (*Sure*) to the Communications Commission (*the* Commission) that the tender bid submitted by Manx Telecom for the recent ConnectMann tender for IoM Government Technology Services would put Manx Telecom in breach of their regulatory obligations – specifically that its "*bid was based on the use of non-standard wholesale services, prices or service features*".

1.2. During the course of its investigation the Commission determined that the bid submitted by Manx Telecom would[1]:

a. create a margin squeeze in breach of its Price Control Obligation, particularly in the Point to Multi Point Carrier Ethernet (*P2MP CE*) market segment, that would likely have the effect of restricting competition and foreclosing the market for P2MP CE services;

b. be in breach of its Non-Discrimination obligations as it was ostensibly providing one of its retail customers with terms that were outside of a normal market offering; and,

c. be in breach of the *Fair Trading Condition* of its licence as it was abusing its dominant position in the marketplace.

1.3. The Commission required Manx Telecom to furnish the Commission with the full details of its bid for the contract and any financial projections or other supporting documents used to support the same. Manx Telecom was also afforded the opportunity to provide any other information it believed to be relevant to the investigation.

1.4. Having assessed the information received, the Commission has formed the view that Manx Telecom has breached its regulatory obligations and in accordance with the procedure set out by the Telecommunications Act 1984 (*the Act*) has issued a Proposed Order to prohibit Manx Telecom from fulfilling Lot 1 of the ConnectMann contract on the terms it set out in its tender submission.

1.5. Interested parties have the opportunity to make representations or objections to the Commission in relation to its Proposed Order; full details are set out in the Proposed Order (OR/01/2020), as published on the Commission's website.

2. Regulatory Obligations

2.1. As the incumbent operator, Manx Telecom is subject to a number of Regulatory Obligations and Licence Conditions in markets in which it has Significant Market Power. The purpose of these Obligations and Conditions is to ensure that Manx Telecom does not engage in anti-competitive behaviour or otherwise attempt to prevent or stifle competition in the telecoms sector.

2.2. Specifically the Obligations preventing Manx Telecom from creating a Margin Squeeze are intended to prevent it from leveraging its dominant position to set prices at the retail level that would render it unprofitable for others to enter a market, or continue in that market. The *Fair Trading Condition* in its licence also intends to prevent Manx Telecom from carrying on any concerted practice with any undertaking which is, or is intended to be implemented in the Island that may affect trade within the Island, or has the effect preventing, restricting, or distorting competition within the Island.

2.3. There is an additional Obligation on Manx Telecom not to unduly discriminate between its retail customers; to that end Manx Telecom cannot offer

[1] The Obligations referenced are set out in the 2012 Market Review and Decision Notices.

substantially different pricing or terms and conditions in relation to the ConnectMann tender than would be offered on the open market.

2.4. The Commission has put in place the Obligations in consultation with industry and other stakeholders, and has been clear in terms of its regulatory objectives. In particular, the Commission has identified the potential harm that could occur should the incumbent be allowed to abuse its position of dominance. Should Manx Telecom be permitted to engage in anti-competitive practices it would have a detrimental effect on competition in the long-run, ultimately restricting consumer choice and resulting in higher prices.

2.5. It should be noted that while there have been new Obligations and market definitions put in place that took effect on 1st January 2020, the Commission is assessing this complaint in line with the Obligations that were in place for the submission of the tender in October 2019.

3. Assessment

3.1. During its investigation the Commission analysed all information provided by Manx Telecom which included, but was not limited to, three Economic Replicability Tests (*ERTs*) to assess for Margin Squeeze, and data underlying some of the assumptions made by Manx Telecom in its bid, and the bid that Manx Telecom submitted. Manx Telecom was afforded ample opportunity to provide any other information that may be of interest to the Commission in considering the matter, and was given the opportunity to present its case for compliance with its Obligations.

3.2. The various versions of ERTs submitted failed to demonstrate that Manx Telecom would generate a sufficient margin, currently set at 8.9% on one or more of the product lines comprising its ConnectMann tender bid. Additionally, there were assumptions made in relation to the treatment of costs that are not in keeping with the Commission's stated position on margin squeeze assessments[2]. Specifically Manx Telecom employed a Discounted Cash Flow approach when dealing with costs whereas the Commission expects to see a static cost base.

3.3. Having had due regard to the tender submission the Commission held that it was not in a position to accept any of the ERTs that have been provided as evidence of Manx Telecom's compliance with its regulatory objectives.

3.4. In addition to the abovementioned ERTs the Commission conducted an ex-post margin squeeze assessment of the tender submission and concluded that there was evidence that products in the Retail Dedicated Capacity Market – specifically the Point-to-Multi-Point Carrier Ethernet market segment did not demonstrate a sufficient margin being generated.

4. Findings

4.1. The Commission determined that it is appropriate to take the tender submission as its starting point when conducting any regulatory tests as it was on the basis of this submission that Manx Telecom won the competitive tender process and it was clear as to what would be provided to deliver the ConnectMann Lot 1 contract. It would not be reasonable for the Commission to conduct its regulatory tests using information that was not consistent with the tender bid.

4.2. In its later submissions to the Commission, Manx Telecom attempted to demonstrate compliance with its obligations by retrospectively varying the numbers and types of circuits that would be used to deliver the contract for Lot 1. Manx Telecom argued that it was not bound to provide any particular blend of circuits and that it was at its discretion to vary them over the course of the contract.

4.3. The Commission is of the view that while the tender did not explicitly request a breakdown of the circuits that would be used to provide the service, one was nevertheless provided as part of Manx Telecom's submission. Furthermore, the tender submission and the first ERT received by the Commission are largely consistent with regard to the dedicated capacity circuits that would be used to deliver the service.

4.4. It is apparent that on the basis of the bid that was submitted to the ConnectMann tender Manx Telecom would create a margin squeeze and this would constitute anti-competitive behaviour on the part of Manx Telecom. In making this determination the Commission must consider whether a competitor would be able to replicate the offering and remain profitable; it is clear that on the basis of the

[2] https://www.iomcc.im/media/1218/guidelines-on-assessment-of-margin-squeeze.pdf

information submitted by Manx Telecom that this would, on the balance of probability, not be case.

4.5. Based on its own analysis the Commission has also identified that there would be substantial cross-subsidisation between the products in the Retail Dedicated Capacity Market and other product lines. The Commission could not allow such cross-subsidisation to occur as it would have the effect of distorting competition in the P2MP CE market and would in effect require rivals to exactly match Manx Telecom's offering(s) to effectively compete; this would also likely stifle innovation at the retail level.

4.6. The Commission's primary concern is that competition in the dedicated capacity markets would be stifled to such a degree as to effectively allow Manx Telecom to foreclose the market. The net effect of foreclosure, should a margin squeeze be allowed to occur, would be that competitors would be constrained in their ability to exert competitive pressure on the incumbent. Ultimately, competitors would not be able to continue to compete in the P2MP CE market and remain profitable, and new competitors would face significant barriers to entry. This is turn would likely result in increasing prices and decreasing choice for consumers over time. The market segment (P2MP CE) where the margin squeeze would occur is likely to be lucrative in the long term (relative to other markets) and the contract in question is likely to represent a significant part of that market.

4.7. Absent the distorting effect of the margin squeeze it is likely that competitors would see an increase in their ability to compete and make inroads into Manx Telecom's overall dominance in relevant markets which would ultimately benefit consumers in the long run. As competitors' market shares grow they can make better use of economies of scale and invest more in their core networks which would help to ensure that increased competition would be sustainable in the long run.

4.8. With the foregoing in mind the Commission has decided that, based on analysis of the information received from Manx Telecom, and its own analysis of the tender bid, that Manx Telecom:

a. would create a margin squeeze in breach of its Price Control Obligation, particularly in the P2MP CE market segment, that would likely have the effect of restricting competition and foreclosing the market for P2MP CE services;

b. would be in breach of its Non-Discrimination obligations as it was ostensibly providing one of its retail customers with terms that were outside of a normal market offering; and,

c. would be in in breach of the *Fair Trading Condition* of its licence as it was abusing its dominant position in the marketplace.

ENDS