



Office of Utility Regulation

# **Price Control Compliance Guidelines for C&W Guernsey Ltd**

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## **Information Notice**

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## **1. Introduction**

This document provides guidelines on how the Office of Utility Regulation (“OUR”) will monitor Cable & Wireless Guernsey Ltd’s (“C&WG”) compliance with the price control which will come into effect from 1<sup>st</sup> October 2005.

After that date C&WG’s ongoing charges for the services contained in the four baskets of services will be constrained by the efficiency factors set by the OUR for each basket. Section 2 defines the baskets and specifies the X factors applicable to each basket.

During the price control regime the Actual Price Index (“API”) for a basket, (which is the prices that are actually charged by C&WG for that basket of services calculated in accordance with the formulae set out in this document), cannot exceed the Price Control Index (“PCI”) for that particular basket, where the PCI is derived from the Retail Price Index (“RPI”) and an “X” set by the OUR.

Section 3 describes key components of the price control mechanism (time periods, inflation rates and prior year revenue weights).

Section 4 explains the requirements for C&WG to demonstrate compliance with the price control and how the Director General will address any over or under achievement of the control.

## 2. Baskets and Price Controls

The four baskets applicable for the price control are defined as follows:

**Basket 1: Main basket: RPI + 2%**

- Exchange line connection and takeover
- ISDN line rental, connection and takeover
- Jersey dialled calls
- National dialled calls
- International dialled calls
- Local dialled calls to ISPs
- Fixed Line calls at national call rate
- Fixed Line calls charged at Local Rate
- Public payphone calls
- Fixed calls to Guernsey Mobiles;
- Fixed calls to other mobiles.

Changes in prices of this basket shall not exceed RPI +2%.

**Basket 2: Leased Lines: RPI-16%**

- Leased line connection and takeover
- Leased line rental.

Changes in prices of this basket are subject to a reduction in each relevant period which shall be at least equal to RPI - 16%.

**Basket 3: Exchange Line Rental: RPI+10%**

- Exchange line rental

Changes in the price of this basket shall not exceed RPI + 10%

**Basket 4: Local Calls: RPI-14%**

- Local calls

Changes in the price of this basket are subject to a reduction in each relevant period which shall be at least equal to RPI -14%

### 3. Price Control Mechanism

#### 3.1 Duration of Controls

C&WG's price controls cover a number of "relevant periods". These periods will commence on 1 October 2005 and run until 31 March 2008. The first relevant period will run for six months through to 31 March 2006. The remaining two relevant periods will each run for 12 months from 1<sup>st</sup> of April in subsequent years. These arrangements are summarised in the table below.

**Table 3.1: Relevant Periods**

Period	Start	End
1 <sup>st</sup> Relevant Period	1 October 2005	31 March 2006
2 <sup>nd</sup> Relevant Period	1 April 2006	31 March 2007
3 <sup>rd</sup> Relevant Period	1 April 2007	31 March 2008

#### 3.2 Inflation

The price control formula includes an inflation factor to account for exogenous changes in C&WG's input costs. The OUR will use Guernsey's Retail Price Index ("RPI") as published by Treasury and Resources' Economics and Statistics Unit<sup>1</sup> as the basis for the inflation factor in the price control regime. The relevant measure of inflation will reflect the most up to date RPI figures for the appropriate time period as shown in the table below.

**Table 3.2: RPI Figures for Relevant Periods**

Period	RPI Figure
1 <sup>st</sup> Relevant Period	Most recent six month RPI figure prior to 1 October 2005.
2 <sup>nd</sup> Relevant Period	Most recent 12 month RPI figure prior to 1 April 2006.
3 <sup>rd</sup> Relevant Period	Most recent 12 month RPI figure prior to 1 April 2007.

#### 3.3 Price Indices and Weights

The baskets specified by the OUR include a number of C&WG's individual services, each offered at different prices. Consequently the OUR will index each of these prices and C&WG will be required to keep its actual prices below a Price Cap Index ("PCI").

Prices for all services in each of the baskets will be indexed at their respective levels at the date the relevant period commences. The price index for individual services at the end of each relevant period is calculated to reflect any price changes that have been introduced during that period (i.e. it may be necessary to weight the prices themselves by time). These price indices are then weighted by revenue for the prior

<sup>1</sup> Available on the Government website: [www.gov.gg](http://www.gov.gg)

relevant period to reflect the relative importance of each individual service within the basket. C&WG should use **retail**<sup>2</sup> revenues received in the previous period to derive the weights which need to be applied to the price changes introduced during the relevant period.

As the first relevant period covers the six months from 1<sup>st</sup> October 2005 to 31<sup>st</sup> March 2006 the annual basket price controls stated in Section 2.2 will be adjusted to reflect that C&WG will only have half a year to realise the required efficiency gains. Consequently the X factors for the 1<sup>st</sup> relevant control period have been adjusted as follows:

**Basket 1: Main basket: RPI +1%**

**Basket 2: Leased Lines: RPI -8%**

**Basket 3: Exchange Line Rental: RPI +5%**

**Basket 4: Local Calls: RPI -7%**

As noted earlier the inflation measure for the first relevant period will also cover six months rather than twelve.

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<sup>2</sup> Retail revenues comprise all revenues for the price controlled services excluding revenue from wholesale and interconnect services and C&WG's own use of these services.

## 4. Monitoring Compliance

### 4.1 Monitoring Timetable

The OUR's assessment of C&WG's compliance with its price controls will be undertaken retrospectively on an annual basis. The timetable for the annual assessment is shown in Table 4.1 and will require submission of timely information by C&WG in accordance with these guidelines. The OUR would seek to review the data within three months of receipt of C&WG's submission.

**Table 4.1 Timetable for Reviewing Compliance**

Period	Covering	C&WG Submission
1 <sup>st</sup> Relevant Period	1/10/05 to 31/3/06	30/04/06
2 <sup>nd</sup> Relevant Period	1/04/06 to 31/03/07	30/04/07
3 <sup>rd</sup> Relevant Period	1/04/07 to 31/03/08	30/04/08

Ideally the basket weights for each relevant period would be based on the retail expenditure for the given services in the 12 months preceding the actual relevant period. However as this information will not be available until after the beginning of the relevant period, C&WG must supply information from the financial accounts before the beginning of each relevant period giving the revenues for each service within the four baskets **for the latest available 12 month period**<sup>3</sup>. In demonstrating compliance C&WG must provide the following statement signed by a Director:

*“The Directors are responsible for keeping proper accounting records and for ensuring that C&W Guernsey complies with the requirements of its fixed and mobile telecommunications licences issued by the OUR. On behalf of each of the Directors of C&W Guernsey I confirm that the accounting records have been properly kept and the appropriate retail revenues for price controlled services have been extracted from those records for the period xxx to xxx.”*

*Signed [ ] on behalf of*

*[ ]*

*[ ]*

*[ ]”*

The DG may require, in accordance with conditions 4.3, 4.4 and 4.5 of C&WG's fixed telecommunications licence, an inspection of C&WG's financial records to

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<sup>3</sup> For 12 month relevant periods (commencing on 1 April) the most recent financial figures should cover the previous calendar year. For the 1<sup>st</sup> Relevant Period, starting 1 October 2005, the revenue weights should be derived from the equivalent six-month prior period i.e. 1 October 2004 to 31 March 2005.

verify the accuracy of C&WG's submission in demonstrating its compliance with the price control regime.

In addition, when C&WG wishes to introduce a price change, it will need to submit an assessment to the OUR demonstrating its compliance with the price control by completing the five steps described in section 4.2 below. Whilst C&WG will not need the OUR's approval of individual price changes, these submissions will assist the OUR in assessing compliance at the end of the relevant period. The DG may intervene however if he considers C&WG's proposals are likely to be non-compliant. In complying with the price control, C&WG are also required to comply with other relevant licence conditions.

## **4.2 Compliance Procedures**

In order to demonstrate annual compliance<sup>4</sup> with the price controls for the services included in the baskets specified in Section 2 C&WG will need to undertake a number of tasks comprising:

- Quantifying the price change for each service;
- Indexing the price changes;
- Weighting the services on the basis of revenue earned in the 12 months prior to the relevant period;
- Deriving the weighted average basket price index; and
- Comparing this with the Price Cap Index incorporating RPI.

### **4.2.1 Quantify the price change for each service**

This information is derived by comparing the historical (i.e. nominal) prices for each service in the price control periods.

Simply, this is the differential between the old and new price, represented by:

$$\delta P = \frac{P_t - P_{t-1}}{P_{t-1}}$$

Where:

$P_t$  = The weighted average price for service during the relevant price control period;

$P_{t-1}$  = The average price for the previous relevant period.

Note that  $P_t$  should be weighted to take into account the phasing of any price changes during the relevant period. If the price change were introduced at the start of a relevant period then the new price could be used as  $P_t$  for the purposes of the calculation. If however the price change were introduced midway through the year, then  $P_t$  would need to reflect 0.5 of  $P_{t-1}$  and 0.5 of the new price to reflect the average price for the service over the period<sup>5</sup>.

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<sup>4</sup> C&WG should also follow these steps when notifying the OUR of changes in the prices of price controlled products for the duration of the price control.

<sup>5</sup> In calculating average prices over a price control period, C&WG should use a weight of  $n/365$  for a price that was offered for  $n$  days.

#### 4.2.2 Index the price change for each service

Once the price change has been quantified, the next step is to index the price changes. The indexed price (IP) for each service is derived from the following formula:

$$IP_i = 100 * (1 + \delta P)$$

Where:

$IP_i$  = Indexed priced for service one within a basket.

#### 4.2.3 Weight services based on revenue in the relevant period

Weights for each service in the basket are derived from each service's percentage share of total revenue in that basket. Thus the sum of the weights of all the services within the basket equals 1.

Thus:

$$W_i = \frac{R_i}{R_B} \text{ subject to } 1 = \sum_i^n W_n \text{ and } R_B = \sum_i^n R$$

Where:

$W_i$  = weight for a given service in the basket;

$R_i$  = the amount of actual revenue for the previous relevant period that is derived from that individual service;

$R_B$  = the amount of total revenue in the previous relevant period that is derived from a combination of all services in the basket.

#### 4.2.4 Derive the weighted average basket price index (Actual Price Index)

The Actual Price Index (API) is calculated by combining the weights for each individual service with the indexed price changes and summing the products.

$$API = (IP_1 * W_1) + (IP_2 * W_2) + \dots + (IP_n * W_n)$$

#### 4.2.5 Compare with Price Cap Index incorporating RPI

The final step involves:

- calculating the Price Control Index (PCI) for the basket; and
- comparing the PCI with the API to assess compliance.

The PCI is:

$$PCI = 100 * (1 + RPI - X)$$

Where:

RPI = the measure of inflation for the relevant price control period. This figure is obtained from the Economics and Statistics Unit within Treasury and Resources.

X = the efficiency factor applied to the basket. This figure is specified in Section 2 of these guidelines.

### **4.3 The Compliance Decision**

The Basic Price Control Rule is that the API over the relevant period must be equal to or less than the PCI.

$$i.e. API \leq PCI$$

If the API is greater than the PCI then C&WG would have failed to comply with the price control regime.

However, if C&WG's API for a basket at the end of the relevant period is lower than required by the PCI, it *may* be able to carryover the difference into the next charge control year subject to the DG's approval. Pursuant to Decision 16 set out OUR 05/19, the DG reserves the right to decide whether any over-achievement in one price control period may be carried over into later periods on the merits of the case presented by the regulated firm. However, the DG would be minded to permit carry over where early reductions benefit consumers.

Conversely, if C&WG's average charge is higher than the required level, it will be obliged to remedy the situation as the DG may reasonably require. The DG may also impose sanctions on C&WG for failing to comply with the price control regime imposed by the OUR.

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