



Office of Utility Regulation

Review of Cable & Wireless Guernsey's Proposed Charges for Interconnection and Access

Report on the Consultation and Decision Notice

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1 Introduction

Cable & Wireless Guernsey's ("C&WG") as a dominant operator in the fixed and mobile telecommunications markets in Guernsey is required to produce and publish a Reference Offer ("RO") for Interconnection and Access services. The RO is a catalogue of the services that C&WG makes available to Other Licensed Operators ("OLO") and the prices for those services. ROs are a standard feature of telecommunications regulatory regimes worldwide. Among the obligations on C&WG is a requirement to ensure that its charges for the services in the RO are cost-oriented and non-discriminatory.

In November 2003, C&WG submitted proposed charges for the provision of interconnection and access services. In addition to the proposed charges, it also submitted its justification for its proposed charges.

Upon receipt of the submission the Director General ("DG") undertook an initial review of the proposed rates and their justification. It became apparent that there were significant concerns with regard to the manner in which the rates had been calculated and the level of justification provided to support those rates, in particular the reliance upon outputs from the Regulatory Accounts. Therefore the OUR concluded that it could not accept the proposed charges as being compliant with the Telecommunications (Bailiwick of Guernsey) Law, 2001.

However in view of the fact that rates that were in the market at that time had been in place from July 2002, and that those rates were based on benchmarking, the DG believed it appropriate to review the rates based upon up-dated benchmarking data. In December 2003, the DG set out her findings in OUR 03/38. This report directed C&WG to reduce its interconnection and access charges by between 15% and 20%.

In addition the DG in document OUR 03/38 set out briefly certain of the concerns that the OUR had with the manner in which the C&WG's proposed rates had been calculated. The DG indicated that a more detailed review of both C&WG's proposed rates and their calculation in the context of a review of C&WG's Regulatory Accounts would be undertaken.

In its submission of proposed interconnection and access charges on 14 November 2003, C&WG proposed two categories of changes. With regard to the structure of the interconnection "switching" services, C&WG submitted an entirely new set of services and products that did not correspond to those in the existing RO.

Essentially the company proposed to change the product set in Schedule 3 of the RO, including making structural changes to some services, withdrawing others and introducing new services.

The OUR appointed Europe Economics to assist it in reviewing both C&WG's Regulatory Accounts and also the proposed interconnection and access charges. The findings of the review of the Regulatory Accounts was published in July 2004 (OUR 04/12R). This report and decision notice summarises the main findings from Europe Economics' review and the resulting directions to C&WG in order to address the issues identified in regard to the way in which C&WG calculates its interconnection and access charges.

2 Structure of the Paper

This paper is structured as follows:

Section 3 provides background information on the development of interconnection and access charges since the market was liberalised, the submission of proposed rates by C&WG and the independent review of C&WG's proposed rates;

Section 4 contains a review of the proposed structural changes proposed by C&WG and reviews the comments received to the OUR consultation on those proposed changes;

Section 5 contains a review of C&WG's proposals to introduce new services to and withdraw existing services from the RO and reviews the comments received to the OUR consultation on those proposed changes;

Section 6 contains the principal findings and conclusions arising from Europe Economics' review of C&WG's proposed interconnection and access charges;

Section 7 sets out the DG's directions to C&WG in relation to the proposed changes to the RO and to future submission of interconnection and access charges; and

Section 8 provides outlines for the next steps in the development of revised interconnection and access charges.

Two responses to the consultation paper (OUR 04/03) were received from:

- C&W Guernsey; and
- Wave Telecom; and

The DG wishes to thank respondents for their contributions. In line with OUR standard practice, with the exception of any responses marked as confidential, written comments are available for inspection at the OUR's office and are also published on the OUR's website www.regutil.gg.

This document reports on the consultation on the proposed structural changes and the review of C&WG's justification for its proposed interconnection and access charges. This Report sets out the DG's Directions to C&WG with regard to these matters.

3 Background

3.1 Legislative Background

Section 10 of the Telecommunications (Bailiwick of Guernsey) Law, 2001 (“the Telecoms Law”) sets out the DG’s powers with regard to interconnection and access and describes the requirements that the DG may impose on *inter alia* any licensee whom he determines has a dominant position in a relevant market.

The DG has determined (Document OUR 01/14), that C&WG has a dominant position both in the fixed telecommunications network and services market and in the mobile telecommunications network and services market. OUR further informed C&WG that the provision of section 10(2) of the Telecoms Law would apply to it thus requiring it in due course to;

- (a) make its procedures for the provision of interconnection and access publicly available on a non-discriminatory basis in a manner that is to the reasonable satisfaction of the DG;
- (b) offer a standard interconnection and access agreement (referred to as the “Reference Offer”) which is available under non-discriminatory terms, conditions and charges, and on a non-discriminatory basis, no less favourable than that offered to -
 - (i) any of C&WG’s own services; or
 - (ii) any associated company of C&WG’s or services of such a company;
- (c) provide interconnection or access on terms, conditions and charges that are transparent and cost-oriented having regard to the need to promote efficiency and sustainable competition and maximise consumer benefits;
- (d) provide interconnection or access at any technically feasible point in its telecommunications network; and
- (e) provide interconnection or access in a manner that is sufficiently unbundled so that the person requesting interconnection or access does not pay for telecommunications network components or telecommunications services that he does not require.

In addition, the Telecoms Law makes provision for the DG to direct changes to the standard interconnection and access offering and to require C&WG to justify its costs or charges for the provision of interconnection and access services.

3.2 C&WG Reference Offer

In July 2002, following a number of directions from OUR, C&WG published a RO for the Guernsey market. The RO is available from the C&WG website¹ and includes a range of core services that the OUR consider are essential for new operators to plan for and enter the Guernsey telecommunications market. The services included in the RO are based on network elements or components and form a “building block” structure whereby individual services can be combined in various different ways to make up the end products and services sold to telecoms users. This structure is simple

¹ http://www.cw.com/guernsey/products_services/wholesale/reference/index.html

and logical, and minimises complexity and administrative and processing overheads for all parties in the market, thus easing market entry and keeping costs low.

In common with ROs in telecommunications markets worldwide, the Guernsey RO is considered a living document which will evolve to meet market needs. In November 2003, the OUR concluded a review of the existing scope and range of interconnection and access services offered by C&WG to new entrants (see Document OUR 03/32 for details). This report concentrated on the actual legal framework for the provision of interconnection and access services and on the scope of services offered in the RO; the review of the appropriate charges for those services was considered separately.

Following the conclusion of this review C&WG published its revised RO in January 2004.

3.3 Rates for Services

In order to determine rates for interconnection and access services that are related to C&WG's costs, the DG requires full and accurate justification of the costs to C&WG of providing the interconnection and access services. At the time of opening up the market, C&WG was unable to provide such information and this prompted a range of additional workstreams by OUR, including independent benchmarking and additional research to inform the DG's decisions in relation to interconnection and access service prices.

In the event, a set of charges that the DG considered appropriate for presentation to the market was included by C&WG in the RO published in July 2002. In an information note published at the same time (Document OUR 02/20) the DG stated that these should be considered interim rates appropriate at that time and would be subject to further review and revision when more detailed costing information became available.

In July 2003 the OUR required C&WG to submit formally its proposals for interconnection and access rates and to confirm that these were in compliance with its licence obligations with regard to transparency, cost-orientation and non-discrimination. On 14th November 2003, C&WG made a submission detailing its proposed new rates for interconnection and access services including certain structural changes to the services to be included in the RO and its justification for the rates being proposed.

The OUR reviewed the proposals from C&WG and set out its position on the proposal in OUR 03/38. The DG did not accept the proposals from C&WG as being in compliance with the Telecoms Law on a number of grounds. In particular, the DG had concerns about the proposed rates as they included an Access Deficit Charge ("ADC") and a proposal to include a charge for 'Product Management, Policy and Planning' ("PPP") which did not appear to be based on elements one would normally expect to see covered by such a charge. Together these two elements make up between 23% and 86% of each of the C&WG proposed charges. Further the 'switching' costs were based on outputs from the Regulatory Accounts which needed to be verified.

The DG was of the view that C&WG had not justified the proposed rates as core elements - including the switching costs, ADC and PPP were not justified. In conclusion the DG believed that C&WG had not adequately, or at all, explained and justified these key cost allocations in order for them to be considered for inclusion in the rates at that time.

3.4 Revised Interconnection Rates

As a consequence, the OUR carried out a review of the key conveyance or 'switching' services that form the building blocks of all switched services in the RO, with a concentration on the call termination rate as this comprises the basic component from which all other rates are built. In carrying out this review, the OUR examined, *inter alia*,

- the justification provided by C&WG on 14th November 2003 for its proposed rates for interconnection and access services;
- published EU Commission recommendations on best practice interconnection tariffs and trends in those tariffs immediately after liberalisation;
- other internationally available information on trends in key interconnection rates following liberalisation; and
- information provided by C&WG in the context of its compliance with a direction to submit its Regulatory Accounts.

The conclusion of this review was a Direction to C&WG in December 2003 (OUR 03/38) to reduce the existing charges for key interconnection and access by between 15 and 20%.

4 Structural Changes to RO services

In addition to submitting proposed rates for interconnection and access services in November 2003, C&WG also proposed a restructuring of certain key interconnection services.

Essentially the company proposed changing the product set in Schedule 3 of the RO, including making structural changes to some services, withdrawing others and introducing new services. Among the proposals submitted by C&WG were:

- The introduction of new “single tandem” and “double tandem” origination and termination charges, compared to the existing single averaged charge for each of origination and termination;
- To change the current Time of Day definition applied to interconnection and access charges in the RO; and
- To de-average the current Off-Island Transit call service into several services, depending on the destination of the calls.

At the time the DG believed that the proposed changes had the potential to significantly impact on the market. It was considered appropriate that other interested parties be consulted on the proposed structural changes, including the detailed service descriptions, before any decision could be made on whether the proposed changes should be accepted as being appropriate. Further the DG was concerned that C&WG had not provided adequate explanation or supporting justification for its proposals.

As a result the DG published a consultation on C&WG’s proposals in OUR 04/03 in April 2004. In the annex to that paper, the DG published in full C&WG’s supporting position for its proposals. Two companies responded to the consultation – C&WG and Wave Telecom. Those comments are published in full on the OUR website. This report sets out the DG’s position on the review of these proposals.

4.1 Single & Double Tandem Charging

In OUR 02/20 published in July 2002 the DG set out her position on a number of issues relating to the interconnection and access regime and more particularly the structure and content of the first RO. One of the matters dealt with in that document was the structure of the charges that would apply for conveyance services.

The DG at that time took the view, having considered charging structures elsewhere, and taking account of the early stage of development of the market in Guernsey, that a simple charging structure, based on a single geographically averaged rate, was most appropriate for Guernsey. C&WG proposed moving from the current situation where there is no distance differentiation in conveyance charges to a distance de-averaged charging system. Under this proposal OLOs would pay different rates depending on the specific network elements used. The new charges would comprise single and double tandem charges for the conveyance of calls on the C&WG network.

Position of Respondents

C&WG's rationale for their proposal is set out in full in OUR 04/03. In addition it has commented in response to that consultation that it would be willing to continue to charge OLOs on the basis of the averaged rates. It also noted however that its model used to produce regulatory accounts would continue to charge C&WG's own business on the basis of calculated cost plus WACC single and double tandem rates.

Wave Telecom, in summary, believed that the proposal severely over complicated the interconnection regime and in a market the size of Guernsey this is not justified. It also believed C&WG had not provided sufficient justification for its proposed changes.

Position of the DG

As the DG noted in OUR 04/03, the proposed structure is common and available in many other markets, particularly those in Europe. The structure brings a number of advantages as it reflects the principle that OLOs should only pay for those network elements that they require to provide services and it recognises that OLOs can interconnect at various 'layers' of an incumbent's network.

However these markets are of a larger size than the Guernsey market with more complex networks offering interconnect at several 'layers' in the incumbent's network. Typically, there are also distance-related retail rates in place. The C&WG network does not have this structure and thus cannot offer the benefits that might otherwise be gained from disaggregated rates.

The DG remains unconvinced that C&WG's proposed approach is correct for Guernsey at this time. He believes that the proposal introduces an unnecessary degree of complexity to the charging structure (as also acknowledged by C&WG) and to the costing of the services. There may also be increased complexity in the interconnection billing between the parties.

Decision 4.1

The DG therefore requires C&WG to retain its current averaged call origination and call termination charging structure. C&WG is also required to ensure that it charges its own retail arm the same interconnection and access charges for RO services as are approved by the DG for inclusion in its RO.

4.2 Time of Day Definition

The conveyance charges in the RO are differentiated by time of day, i.e. there are different charges at peak times compared to off peak times. This reflects many retail charges and also reflects the principle that the network is typically most congested at busy peak times. The RO defines what those periods are. C&WG proposed amending the Time of Day structure by removing the 'Day, Evening, Weekend' element of the definition of the time of day charge entirely and adjusting the peak and off-peak definitions.

Comments of Respondents

The full details of the proposed change and C&WG's reasons for it was set out in the original consultation document. Wave Telecom believed that the proposal was not

appropriate for Guernsey and doubted whether it would be possible to cover the costs associated with the change from any additional traffic that might be generated or whether there would be any shift in traffic as a result of the proposed changes. It also had concerns relating to the fact that C&WG's retail rates would continue to follow the existing structure while interconnection rates would not.

Position of the DG

The DG has previously set out the OUR's concerns (OUR 03/38) with the justification provided by C&WG on its proposals for the changes to the 'Time of Day' charging structure. These include:

- the manner in which the Time of Day gradient had been calculated, in particular the fact that only outgoing traffic has been used in the calculation and then only to UK fixed and mobile destinations;
- the fact that the difference between Saturday and Sunday traffic was significantly less than the difference between Sunday and Weekday traffic, calling into question the reason for having a Sunday rate rather than a weekend rate (this is dealt with later in this report); and
- the time period over which the measurement of the traffic occurred was only one month and as such it is questionable whether it can be said to accurately reflect – even for the narrow call type used – an accurate assessment of the Time of Day gradient.

This is discussed further in Section 6.6.

The DG remains concerned that this proposal would affect the market and the ability of new entrants to compete having regard, *inter alia*, to retail price structures. He does not believe a sufficient case has been made by C&WG for the proposed changes. He does not believe it is in the interest of the market as a whole for the proposed changes to be introduced at this time.

Decision 4.2

The DG requires that C&WG retains the current Time of Day definitions for calculation of interconnection and access charges in the future.

4.3 De-averaging of Off-Island Transit Call Charge

C&WG proposed to develop separate cost-based charges for transiting calls off-island to Jersey, the UK and France, depending on the specific costs of each link and the volume of traffic using the link. C&WG also proposed that calls to international destinations be constructed from two components: an Off-Island Transit Call to the UK and an additional charge for specific back-up routing and dedicated submarine capacity.

Comments of Respondents

The full details of the proposed change and C&WG's reasons for it are set out in the consultation document. Wave Telecom responded that resilience costs should be the same for all routes and, as it has seen no justifiable evidence for the reasoning behind

the proposals, it concludes that the changes would cause further unnecessary complexity. Wave Telecom therefore did not support C&WG's proposed changes.

Position of the DG

As stated when reviewing the issue of de-averaging call origination and call termination charges, the DG acknowledges that there are benefits in developing specific cost-based charges for each separate service included in the RO. However, each layer of disaggregation of charges introduces an additional layer of complexity in the management of the RO and the resulting inter-operator relationships. It is therefore important that decisions on the level of averaging of charges into aggregated product definitions (such as Off-Island Transit Calls as currently defined in the RO) are weighed up against the benefits of simplicity and ease of management.

At the present time, C&WG is due to submit its first full set of Current Cost Accounting ("CCA") based Regulatory Accounts to the OUR in the near future. The DG believes that it would be premature to decide on the benefits of the proposed de-averaging until the costs are fully understood. The DG therefore requires C&WG to continue the provision of the single averaged Off-Island Transit Call service for the present.

With regards to the specific incremental charge proposed by C&WG for specific back-up routing and dedicated submarine capacity for the routing of international calls, the OUR has not received any documentation to support this proposition and therefore cannot accept the proposal.

Decision 4.3

The DG requires C&WG to continue offering the Off-Island Transit Call service as currently specified in the RO.

5 Withdrawal, Introduction and Amendments of RO Services

In its submission of interconnection and access rates in November 2003, CWG also proposed that a number of current RO services be amended, or deleted, as well as proposing the introduction of a new service.

C&WG's proposals were set out in the consultation document and below the responses received to these points are set out, as well as the DG's considered decisions.

5.1 Amendments to Schedule 3.04 of the RO – Off-Island Transit Calls

In addition to the changes discussed in section 4 above, C&WG proposed to amend the Service Description for this particular RO service to:

- restrict the calls which C&WG would accept for termination outside Guernsey to calls originated on numbers allocated to the OLO; and
- introduce the word 'Outgoing' into the title of the service.

Furthermore, to accommodate the proposed de-averaging of the Off-Island Transit Calls Service as explained in 4.3 above, C&WG proposed certain changes to the service description wording.

Comments of Respondents

The full details of the proposed change and C&WG's reasons for it are set out in the consultation document OUR 04/03. Additionally, C&WG responded to the consultation that it had not been its intention to exclude calls originating from C&WG customers, but only calls originating outside Guernsey.

Wave Telecom responded that it saw no reason for the proposed changes and that C&WG could use tools such as call-gapping to prevent being flooded with calls, in the unlikely event that this should become necessary.

Position of the DG

The DG accepts C&WG's comment that it had not been its intention to exclude calls from its own customers (using CS or CPS) or calls from customers of other licensed operators in Guernsey. He remains unconvinced, however, regarding the need to limit the calls which can use this service at all. He acknowledges that C&WG could deploy measures to deflect the impact of large numbers of calls 'swamping' its network, should this situation arise.

With regards to the addition of the word 'Outgoing' into the title of the service, the DG considers that this would neither add nor detract value as it would not impact upon the meaning of the service. C&WG is therefore free to introduce this additional wording to the title of the service if it still wishes to do so.

As the DG has not accepted C&WG's proposal to de-average the Off-Island Transit Call charges, the associated proposed textual changes to Schedule 3.04 are also not accepted.

Decision 5.1

The DG requires C&WG to retain the current service description for RO service 3.04. However C&WG can add the word 'Outgoing' into the title of the service if it wishes to do so.

5.2 Introduction of New RO Service: Incoming Off-Island Transit

C&WG proposed to introduce this new service which covers the termination of calls originated outside Guernsey to an OLO's numbers. Again the full details of the proposed change and C&WG's reasons for it are set out in the consultation document OUR 04/03.

Comments of Respondents

C&WG responded to the consultation that it had not intended to exclude the possibility of an OLO transiting the calls destined for another OLO licensed in Guernsey, but only to exclude calls to number groups allocated outside Guernsey. C&WG also pointed out that as, in their view, the current RO does not specifically oblige C&WG to transit calls originated outside Guernsey to OLOs, this service is necessary. Wave Telecom commented that it considers the proposed new service unnecessary.

Position of the DG

As noted in the consultation document, the DG does not understand the need for the service in relation to the local interconnection between C&WG and OLOs as the interconnection agreements between C&WG and OLOs will already cover a local call termination service on the OLOs network, which appears to be identical to what C&WG is proposing the new service will do. The DG similarly does not accept the need to limit the ability of OLOs to transit calls to other OLOs or to operators licensed outside Guernsey.

Decision 5.2

The DG does not accept the proposed introduction of a new RO service – Incoming Off-Island Transit.

5.3 Amendment of RO Service 3.02 – On-Island Call Origination

C&WG suggested the removal of certain elements of this service which includes access to C&WG's Operator Services.

Comments of Respondents

The full details of the proposed change and C&WG's reasons for it are set out in the consultation document. Wave Telecom responded, and has since clarified its response, that it believes the service should remain as its indirect access customers do have

access to C&WG's Operator Services and Wave Telecom does not offer an alternative Operator Services facility in Guernsey.

Position of the DG

The DG agrees that this service is still required in Guernsey, but notes that maybe the relevant Service Description is not sufficiently clear for all parties in the market to fully understand the difference between the two versions of the service.

The DG requires C&WG to retain both versions of RO Service 3.02 and encourages C&WG to work with OLOs to improve the wording of the Service Description to avoid any confusion that may exist in the market about the service.

Decision 5.3

The DG requires C&WG to retain both versions of RO Service 3.02 in the RO. The DG encourages C&WG to work with OLOs to improve the wording of the Service Description to avoid any confusion that may exist in the market about the service

6 Review of C&WG's Proposed Interconnection and Access Charges and Justification

The OUR appointed Europe Economics to carry out a detailed review of C&WG's submission in support of its proposed charges for interconnection and access which the company submitted in November 2003. In addition Europe Economics has reviewed in detail C&WG's Regulatory Accounts and has sought specific information with regards to the manner in which the interconnection and access charges have been calculated by C&WG. The objectives of Europe Economics review were to:

- Consider the cost justification provided by C&WG;
- Assess the degree to which the justification is adequate to satisfy the DG that the rates are in compliance with the legislation; and
- If necessary, identify any shortcomings in the justification or methodology used to determine the rates;

Europe Economics was also required to propose alternative charges should the rates proposed by C&WG be found to be un-justified. This will be commented on later in this report.

The OUR wishes to thank C&WG for co-operating fully with this project and for the help C&WG staff gave in answering detailed questions and responding to information requests.

The findings of this review and the conclusions are set out below.

6.1 Principal Findings of the Review

This section presents the findings of Europe Economics' review of C&WG's proposed Interconnection and Access charges and the justification provided by C&WG. In summary, the review found that C&WG had not sufficiently justified its proposed charges for interconnection and access in its submission of November 2003. The reasons for this may be grouped under a number of headings as follows:

- the issues identified in the review of the Regulatory Accounts – detailed in OUR 04/12R – which provide a core input into the calculation of the interconnection and access charges, undermines the justification for the proposed rates;
- the charges proposed were based on historic costs;
- The PPP charge was not reflective of current best practice;
- The ADC element of the proposed rates was not justified; and
- Concerns with the calculation and use of tariff gradients by C&WG for calculating interconnection and access rates.

These are considered in further detail below.

6.2 Regulatory Accounts

The OUR undertook a detailed examination of C&WG's Regulatory Accounts and published its report and directions to the company (OUR 04/12R) in July 2004. Significant concerns were expressed in that Report on C&WG's regulatory accounts relating primarily to:

- Transparency;
- Cost causality;
- Objectivity;
- Transfer charges; and
- Preparation under Current Cost Accounting basis.

Full details on these matters are set out in the report OUR 04/12R and will not be repeated here.

The report also sets out a number of actions that C&WG was required to undertake to improve the Regulatory Accounts so that they can fulfil the purpose for which they are required and the timeframe for this further work. It is clear from the analysis undertaken by Europe Economics that the proposed interconnection and access charges can not be considered to be properly cost-oriented or justified when significant concerns exist with regard to a core input into their calculation by C&WG.

The DG however does want to point out that since the publication of OUR 04/12R significant work has been undertaken with regard to manner in which C&WG's Regulatory Accounts are prepared and wishes to express his appreciation to C&WG for their co-operation in addressing the matters raised in that report.

The Regulatory Accounts for the period 2003/04 will be published shortly.

6.3 Current Costs

It is widely accepted that interconnection charges should be based on current rather than historic costs as current costs are more likely to reflect the economic costs of the resources used to provide interconnection services.

The interconnection charges proposed by C&WG were based on historic costs and can be traced back to the HCA-based regulatory accounts submitted by C&WG in 2003.

Since the publication of OUR 04/12R, C&WG have started preparing Regulatory Accounts based on Current Costs and their first full submission of CCA-based Regulatory accounts is due shortly. The CCA-based Regulatory Accounts should form the basis for the calculation of interconnection and access charges in the future.

Decision 6.1

C&WG is required to submit future interconnection and access tariffs based on current costs.

6.4 Product Management, Planning and Policy (PPP)

The main concern Europe Economics found with C&WG's PPP estimate was that it attributes too many regulatory costs and costs associated with competition to the PPP category. C&WG argued that any costs associated with competition and with compliance with regulatory decisions associated with competition, can be passed on to interconnecting operators through PPP charges. It states that:

"C&WG considers that all costs relating to interconnect (including new billing system), OROS (the tool used to provide separated accounts for Reference Offer calculation), specific RO consultancy and certain other minor charges....should be included within this charge".

This is not consistent with the approach taken in other countries and the OUR and its advisers do not consider it correct. Additionally, C&WG had not provided transparency in the elements that go into making up the PPP. However, it was clear that C&WG had included costs that are not strictly caused by the provision of interconnection and access services.

The OUR's review of PPP has benefited from work undertaken in 2004 by Ofcom in its review of BT's PPP charge and the OUR is aware that C&WG has indicated that it will be taking on board the findings of that review in its current work on the Regulatory Accounts.

While the OUR accepts in principle the inclusion of a PPP charge as an appropriate element in the make-up of interconnection charges, the PPP charge proposed by C&WG in its November 2003 submission is not accepted.

For future interconnection charges proposed by C&WG, the company will be required to only include costs that are consistent with those identified in the Ofcom review of BT's PPP charge, namely:

- The development and management of interconnect products;
- The cost of managing the relationship with operators which purchase interconnect services;
- The administrative costs of dealing with orders for interconnect services; and
- The billing of interconnect services.

Further, C&WG must document, explain, and justify what costs it proposes should be included in the PPP charge. Its submission in November 2003 did not provide sufficient justification for its proposed charge. Furthermore, C&WG must ensure that its own retail arm is treated in the same manner as new entrants and that it is subject

to the PPP charge also. This should be achieved through transparent transfer-charging by C&WG from its wholesale business to its retail business – using the same wholesale charges as it uses for interconnection with OLOs. Further PPP costs should be recovered across all traffic that is conveyed across or transits the C&WG network.

To aid transparency on this element of the charge, C&WG will be required to publish details of the elements that make up the PPP element of its interconnection charge. This will allow OLOs to have greater transparency of C&WG's interconnection charges and to understand the manner in which this element is calculated.

Decision 6.2

C&WG is required to review its proposed interconnection and access tariff and resubmit those with a revised PPP charge which reflect recovery of costs associated only with:

- the development and management of interconnect products;
- the cost of managing the relationship with operators which purchase interconnect services;
- the administrative costs of dealing with orders for interconnect services; and
- the billing of interconnect services.

C&WG must also demonstrate that the costs associated with the provision of the PPP services reflect those that would be incurred by an efficient operator.

C&WG is required to publish details of the elements that make up its PPP charge at the same time as it submits its proposed new rates.

C&WG is required to recover its PPP costs across all traffic that is conveyed across or transit the C&WG network.

C&WG is required to implement transparent transfer-charging between its wholesale and retail businesses.

6.5 Access Deficit Charge (ADC)

It is important to make it clear that ADCs are not part of cost-based interconnection charges. The review of C&WG's submission of November 2003 focused on determining the appropriate level of interconnection charges rather than the appropriateness of any surcharges on interconnection charges.

C&WG argues that the 'last mile' is deemed to be part of the network from the customer premises to the concentrator. This definition is at odds with the way networks are defined in most, if not all, other countries. The European Commission in Annex 1 to its Part 1 Recommendation on Interconnection Pricing stated that:

"The local loop refers to the final links between the customer and the local exchange. In a fixed network using wired or wireless local loops, the cost of an un-switched local loop is largely a one-off cost, with periodic maintenance"

costs. Where call termination is being purchased the “lowest” place in the network where this can occur is on the main network side of the local switch.² Interconnection at this point may impose additional switch capacity costs, but there is no additional capacity cost of investment requirement relating to those components of the local loop which are dedicated to a particular customer (i.e. the pair of copper wires in a traditional network).

The European Commission further stated that:

It follows from the principle of cost orientation that since the provision of interconnection does not lead to any increase of costs in the dedicated components of the local loop of the terminating network, the calculation of interconnection charges should not include any component relating to the direct cost of the subscriber-dedicated components of the local loop. The cost of those components in the un-switched local loop that are dedicated to a particular customer should therefore be recovered from that customer through a subscriber line charge, or as a combination of this and revenues from other services, to the extent that competition permits.”

This suggests that the any access deficit contribution be addressed separately from interconnection charges. If it were found that an access deficit did exist and that it was appropriate that this be recovered by C&WG, then a decision could be made on how best to recover that deficit. It is possible that other avenues could be found to recover those deficits. The DG believes this to be the most appropriate approach to be taken in Guernsey should an access deficit be found to exist.

The DG does not therefore accept that the ADC element of C&WG’s proposed interconnection and access charges is justified as being appropriate for inclusion in the calculation of interconnection and access charges. Any future interconnection charges proposed by C&WG should not contain any component that represents an ADC.

Decision 6.3

C&WG shall review its proposed interconnection and access tariff and re-submit those excluding any component which relates to an Access Deficit Charge (ADC).

6.6 Charge Bands and Gradients

C&WG proposed new charge bands for its tariffs and has proposed a certain calculation for the gradients it proposed to use.

With regard to the charge bands, C&WG has stated that “a weekend rate was considered but a study has revealed that C&WG’s fixed network traffic on a Sunday is considerably less than that on a Saturday.” However, the data provided by C&WG suggests that Saturday traffic shares more characteristics with Sunday traffic than with

² The provision of “unbundled” local loop, whereby a new entrant takes over and has exclusive use of a local loop installed by an incumbent, for an appropriate fee, is not strictly “interconnection” in EU terms.

weekday traffic. In addition, international experience supports a weekend rather than a Sunday rate.

Further, C&WG uses outgoing traffic only and furthermore only outgoing traffic to a small sample of call destinations, namely UK fixed and mobile destinations, to calculate its gradient. The OUR considers this sample to be too limited. The tariff gradient calculation in the UK is derived by considering both local and national calls, including non-geographic calls. ComReg, in its Consultation and Draft Direction (04/69) also refers to an earlier consultation (00/31), which noted that respondents requested that the largest possible sample size be used for data collection.

While the DG is satisfied that the formula used by C&WG to calculate the gradients is appropriate, given that it uses minutes and revenues, the application of this formula to the case in question raises certain concerns.

Firstly only two services are considered when aggregating minutes, revenues and prices of the formula above. These are “Fixed Line Calls to National Geographic to the UK” and “Fixed Line Calls to National Mobiles to the UK”. Secondly, the gradient is calculated with reference to minutes, prices and revenues of C&WG Retail Services. This could be an issue if the traffic profile of the wholesale traffic (and ultimately of the retail traffic offered by OLOs) is significantly different from the traffic profile of C&WG Retail traffic.

The first concern can be overcome by expanding the number of Retail Services included in the formula. Therefore in any new submission on interconnection and access rates C&WG will be required to include all appropriate call types, including both incoming and outgoing calls.

With regard to the second limitation, the OUR’s advisers made the following points.

- In the absence of significant wholesale traffic in the earlier stages of liberalisation in Guernsey, the use of retail minutes to set wholesale gradients may be necessary subject to the following two points;
 - Where interconnection charges include time of day and day of week variations they should be applied in a non-discriminatory manner to new entrants and to the incumbents own traffic.
 - Given the early stage of liberalisation in Guernsey there should be no de-coupling of the network tariff gradient and the retail tariff gradient.

The point about de-coupling the network tariff gradient and the retail tariff gradient was explored by Oftel.³ Oftel recognised that although there may be some potential efficiency gains if the Network Tariff Gradient and the Retail Tariff Gradient are de-coupled, there may also be scope for anti-competitive behaviour.

The DG therefore believes that the same gradients should apply to wholesale minutes bought by C&WG retail from C&WG wholesale as the gradient used for wholesale

³ Oftel, Network Charges from 1997 — Consultative Document, page 7.

minutes to OLOs. Further, C&WG should if it wishes to pursue further its interest in charging a ‘Sunday’ rate provide appropriate justification when it submits revised interconnection and access tariffs.

Decision 6.4

C&WG’s proposed ‘Sunday’ tariff is not accepted at this time and C&WG should continue to use the existing charge bands. C&WG is required to submit revised interconnection and access tariffs and in doing so should ensure that the calculation of any gradients uses the widest possible sample in line with international practice.

C&WG is directed to apply the same gradients to wholesale minutes bought by C&WG retail from C&WG wholesale as the gradient used for wholesale minutes to OLOs

6.7 Proposed Rates

Among the objectives of the review that Europe Economics was required to undertake was, in the event that the proposed charges from C&WG were found not to be justified, that it should consider proposing alternative rates.

However this has not been possible due to the issues identified in this section of the report. Therefore the DG has decided that the rates determined in OUR 03/38 shall remain in the market until such time as any new determination on interconnection and access charges is made. The DG will consider at that time the issue of retrospection.

6.8 Future Submission of Proposed Charges

The DG notes that a significant failing in the November 2003 submission by C&WG on its proposed interconnection and access tariffs related to the level and quality of justification provided to support the proposed charges. Any future submission in support of proposed rates will need to provide such relevant information as to properly explain and justify any proposed interconnection and access charges.

The DG is currently considering what guidance should be provided to C&WG on the level of justification the DG will require when reviewing C&WG’s new proposed interconnection and access charges. The DG believes it may assist C&WG in presenting any future submission on proposed charges. The DG proposes to address this matter directly with the company and will publish, for the information of interested parties, the details of the level of justification required.

7 Directions to C&WG

7.1 Changes to the RO

In section 4 of this Report, the DG has discussed the responses received on C&WG's proposed changes to the RO and has set out his decisions on each of these.

In accordance with his decisions in Section 4 of this Report the DG hereby directs C&WG under section 10(3) of the Telecommunications (Bailiwick of Guernsey) Law 2001 to comply with the following decisions:

C&W Guernsey Ltd shall:

- (i) Retain the single averaged charge for the call origination and call termination services in the RO;
- (ii) Retain the current Time of Day definitions in the RO;
- (iii) Retain a single averaged Off-Island Transit charge;
- (iv) Retain the current service description for Off-Island Transit calls, with the exception that C&WG can add the word 'Outgoing' into the title of the service if it wishes to do so;
- (v) Not introduce a new service for Incoming Off-Island Transit calls;
- (vi) Retain the two versions of service 3.02 – On-Island Call Origination, although the DG would encourage C&WG and the OLOs to review the wording of this service description.

7.2 Submission of revised interconnection and access charges

It is noted that considerable work has been undertaken by C&WG since the submission of its interconnection and access tariffs in November 2003. This both reflects the work currently in progress resulting from OUR 04/12R and C&WG's own work on issues such as PPP (arising from the Ofcom report) and on its own model.

In OUR 04/12R C&W Guernsey was directed to submit revised CCA Regulatory Accounts and it is expected that these will be submitted shortly. Given the linkages between the work on regulatory accounts and on interconnection and access tariffs it is important that these two work streams are linked.

7.2.1 Direction to C&W Guernsey

C&W Guernsey Ltd are hereby directed under Section 10(2) of the Telecommunications (Bailiwick of Guernsey) Law 2001, to submit interconnection and access charges for its interconnection and access services which are in compliance with its regulatory obligations by **27th May 2005**. Any rates proposed must be fully cost-oriented, justified and transparent.

In submitting its proposed rates for interconnection and access charges, C&W Guernsey Ltd is directed to:

- submit future interconnection and access tariffs based on current costs;

- ensure that its PPP charges are in line with best practice and which reflect recovery of costs associated only with:
 - the development and management of interconnect products;
 - the cost of managing the relationship with operators which purchase interconnect services;
 - the administrative costs of dealing with orders for interconnect services; and
 - the billing of interconnect services.

C&W Guernsey Ltd must also demonstrate that the costs associated with the provision of the PPP services reflect those that would be incurred by an efficient operator. C&W Guernsey is required to recover its PPP costs across all traffic that is conveyed across or transit the C&W Guernsey network. C&W Guernsey is also required to publish an explanation of its PPP charge at the same time as it submits its proposed new rates.

- Exclude from its interconnection and access charges any component which relates to an Access Deficit Charge (ADC);
- Use the existing time of day charge bands and ensure that the calculation of any gradients uses the widest possible sample in line with international practice; and
- C&W Guernsey is directed to apply the same gradients to wholesale minutes bought by C&W Guernsey retail from C&W Guernsey wholesale as the gradient used for wholesale minutes to OLOs.

8 Next steps

The DG is grateful to C&WG for its co-operation on both the development of appropriate interconnection and access services and charges and on the continued work on its Regulatory Accounts. The DG is aware that significant progress has been made by C&WG in implementing the recommendations from OUR 04/12R.

Currently a significant amount of work is being undertaken on the development of a price control mechanism to come into effect on 1st October 2005. It is important that any new interconnection tariffs are available to the market at the same time.

The DG requires C&WG to submit proposed interconnection and access tariffs by 27th May 2005. Upon receipt of the new proposed interconnection and access tariffs the DG will review those and will publish his findings on the review of those tariffs and the degree to which they are in compliance with the Telecoms Law and the directions set out in this document in Quarter 3 2005.

/ENDs