



Interim Price Control for C&W Guernsey Ltd

Report on the Consultation & Decision Notice

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Contents

1. Introduction.....	2
2. Background	3
2.1. Legislative and Licensing Background	3
2.2. The setting of the First Price Control	3
3. Interim Options.....	5
3.1. The Four Interim Options.....	5
3.1.1. Option 1 - Continuation of Existing Price Control.....	5
3.1.2. Option 2 - Price Freeze on Any Increases in Charges	6
3.1.3. Option 3 – Continue Current Control with a Price Freeze on Any Increases in Charges	6
3.1.4. Option 4 – Continue Current Control on Targeted Services.....	6
3.2. Respondents’ Views	6
3.2.1. General Comments	6
3.2.2. Comments on Options	8
3.3. Director General’s Position.....	8
3.3.1. General Comments	8
3.3.2. Responses to the Options.....	11
3.4. Director General’s Decision	11
4. Next Steps	12
ANNEX I.....	13

1. Introduction

In January 2005 the Director General (“DG”) of the Office of Utility Regulation (“OUR”) published a consultation document – OUR 05/02¹ - on a proposed interim price control on C&W Guernsey (“C&WG”). It was proposed that this interim price control would cover the period from 1st April 2005 to 30th September 2005. This interim control is necessitated arising from the fact that it was not going to be possible to complete the review of C&WG’s business plan and consider the responses to the three consultation papers issued in the summer of 2004 and have a new price control in place for C&WG before the end of March 2005.

Instead the DG indicated that this work would now conclude in the summer of 2005 with any new price control coming into effect from 1st October 2005. The January consultation paper therefore set out for public consultation a number of possible interim arrangements for C&WG’s retail price control for the period to 30th September 2005.

The OUR received responses from C&WG and Newtel Solutions. 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.

The rest of this paper is structured as follows:

- Section 2 :** describes the legal and licensing background in the telecommunications sector whilst summarising the OUR’s activities in this area in the second half of 2004;
- Section 3:** sets out the responses to the issues raised in the consultation paper and the DG’s view on the issues raised before presenting the DG’s decision on the arrangements for the interim price control; and
- Section 4:** sets out the next steps in the process.

¹ Our 05/02 - Interim Price Control for C&W Guernsey Ltd; Consultation Document

2. Background

2.1. Legislative and Licensing Background

Section 5(1) of the Telecommunications (Bailiwick of Guernsey) Law, 2001 (“the Telecoms Law”), provides that the DG may include in licences such conditions as he considers necessary to carry out his functions. The Law specifically provides that such conditions can include (but are not limited to):

- conditions intended to prevent and control anti-competitive behaviour²; and
- conditions relating to the price premiums and discounts that may be charged or (as the case may be) allowed by a licensee which has a dominant position in a relevant market³.

In accordance with these provisions, both the “Fixed Telecommunications Licence” and the “Mobile Telecommunications Licence” include the following condition⁴:

“The DG may determine the maximum level of charges the Licensee may apply for Licensed Telecommunications Services within a Relevant Market in which the Licensee has been found to be dominant. A determination may;

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

This condition allows the DG to regulate the prices that a licensee charges for its telecommunications services in a way and for a time that he deems appropriate, where the licensee has a dominant position in the relevant market. C&WG has been found to be dominant in the fixed network and services markets and in the mobile network and services market.

2.2. The setting of the First Price Control

In November 2001, the OUR consulted on the need for, and the format of price control in the telecoms market⁵, and published a report on that consultation in March

² Condition 5(1)(c) of the Telecommunications (Bailiwick of Guernsey) Law, 2001.

³ Condition 5(1)(f) of the Telecommunications (Bailiwick of Guernsey) Law, 2001.

⁴ Condition 31.2 of C&WG’s Fixed Telecommunications Licence and 27.2 of the company’s Mobile Telecommunications Licence.

⁵ Document OUR 01/22: Proposals for the Price Regulation of Fixed Telecommunications Services; Consultation Paper

2002⁶, along with a decision to impose price control on a range of fixed telecommunications services using the internationally recognised mechanism of incentive regulation.

The price control set an upper limit for the prices of a number of baskets of services provided by C&WG, allowing individual prices for services within those baskets to change upward or downward, within the overall constraint of the control. The control was initially set for the period from 1st April 2002 to 31st December 2004. This was later amended to be aligned with a change in the year-end of C&WG so as to facilitate reporting and compliance monitoring. The price control was therefore extended to 31st March 2005.

⁶ Document OUR 02/11: Price Regulation of Fixed Telecommunications Services: Report on the Consultation and Decision Notice

3. Interim Options

In OUR 05/02, the DG set out a number of possible options that exist for the structure of the proposed interim price control on C&WG for the period 1st April to 30th September 2005 and invited comments from interested parties. The four proposed options are summarised below.

3.1. The Four Interim Options

3.1.1. Option 1 - Continuation of Existing Price Control

One option for the interim price control would be to extend the existing price control for another six months through to 30th September 2005 pending the conclusion of the OUR's price control work programme. The DG noted that there was a precedent for this option in that the original price control was extended from 31st December 2004 to 31st March 2005, following the sale of Guernsey Telecoms to C&WG in May 2002 to align the price control with the resulting change in C&WG's financial year end.

C&WG's current price control comprises four "baskets" of services that are subject to a cap. These are as follows:

Basket 1: Leased lines: No change

- private circuit connection and takeover
- private circuit rental

There shall be no upward change in the price of this basket or in the price for any individual service within the basket

Basket 2: ShortCall Basket: RPI - 3%

- Shortcall line connection and takeover,
- Shortcall line rental
- Shortcall local calls

Changes in the price of this basket shall not exceed RPI – 3%.

Basket 3: Main basket: RPI-5%

- Exchange line connection and takeover
- ISDN line rental, connection and takeover
- Local dialled calls
- Jersey dialled calls
- National dialled calls
- International dialled calls
- Local dialled calls to ISPs
- National dialled calls to ISPs
- Operator calls
- DQ calls (including call charges and facility charge)
- Payphone calls

Changes in prices of this basket shall not exceed RPI - 5%.

Basket 4: Exchange Line Rental: RPI+7%

- Exchange line rental

Changes in the price of this basket shall not exceed RPI + 7%

The extension of the existing price control would need to be applied on a pro-rata basis i.e. adjusted to take into account the six month period. The RPI figure would be for the six month period and the X factor would be halved to reflect the half year period covered by the interim price control.

Any new price control from October 2005 would likewise be applied pro-rata for the 6 months to the end of March 2006.

3.1.2. Option 2 - Price Freeze on Any Increases in Charges

The second option comprised a price freeze on any upward movement in C&WG's services across the four baskets described in 3.1.1.

3.1.3. Option 3 – Continue Current Control with a Price Freeze on Any Increases in Charges

The third option would be to continue with the existing price controls for baskets 1 and 3 but freeze prices in baskets 2 and 4. This would freeze prices for exchange line rentals and all products in the shortcall basket. This interim control would control any increases in prices for vulnerable users.

3.1.4. Option 4 – Continue Current Control on Targeted Services

A fourth option would be to allow the existing price control to continue on all but baskets 2 and 4 and remove local calls (ppm and per call charges) from basket 3. The prices for the products in baskets 2 and 4 and the local calls would be frozen. The continuation of the existing price control would be applied on a pro rata basis as explained in section 3.1.1.

3.2. Respondents' Views

C&WG's and Newtel Solutions' responses to the consultation paper offer a number of general comments (summarized in section 3.2.1) and specific comments (see section **Error! Reference source not found.**) relating to the four options presented by the OUR.

3.2.1. General Comments

C&WG expresses concern regarding the order in which the OUR proposes to conduct the price control review and suggests that with the extra time now available the OUR should follow due process in reaching conclusions on the price control.

In addition C&WG expresses concern that delays to some critical decisions, such as the application of the Market to Asset Ratio (MAR) adjustment and the Weighted Average Cost of Capital (WACC) to be applied to future investments, may impact on C&W Guernsey's ability to invest in the network of Guernsey in the near future.

Furthermore C&WG suggests that the delay in the conclusion of the price control review may be due to recent personnel changes at the OUR and that therefore C&W Guernsey should not be disadvantaged as a result of the delay.

Comments on Principles for the interim price control mechanism

C&WG offered the following principles for designing the interim price control:

- **It should minimise additional compliance requirements**

C&WG favours adding a six month period to the year 04/05 as an ‘extension’ resulting in an 18 month period. The rationale for favouring this approach is that this would avoid the need for multiple price control compliance models, and would reflect the approach taken when the original price control was extended to align with C&W Guernsey’s year-end. C&WG noted that was taken by Ofel in October 2000.

C&WG also requests that the OUR revise its policy of requiring current year weighting.

- **It should not penalise C&WG for the delay in revising the price control mechanism should it be found following the consultation that current controls are too harsh;**

C&WG argues that the company should not be penalised for any delay in establishing a new price control, and thus should be able to benefit from any relaxation of controls in the new regime, as if the regime had been implemented from the expiration of the previous price control. The justification provided for this argument is that the new price control should allow pricing flexibility for the company. A delay would thus effectively ‘penalise’ the company, although this delay is not of its own making.

However, C&WG does not accept that any harsher “X” factor should be applied retrospectively, since this could undermine confidence through creating considerable uncertainty over the regulatory environment. C&WG again bases this argument on the premise that the delay to the process is not of its making. C&WG also argues that the retroactive imposition of a harsher “X” factor could adversely affect the willingness of other operators in Guernsey to make investments.

- **It should not provide any additional restrictions on C&WG’s ability to rebalance tariffs;**

C&WG argues that it should not be prevented from operating on a commercial basis or denied the level of pricing flexibility to which it is currently entitled because of the OUR’s requirement for extra time to complete its assessments. C&WG argues that options 2, 3 and 4 as presented by the OUR would impose additional restrictions on the company’s ability to act commercially.

Although C&WG respects that the OUR is keen to protect customer interests whilst completing the price control review, it believes that preventing ongoing rebalancing would thwart the development of local competition and thus not necessarily benefit the majority of standard customers and business users. In any event C&WG believes that the interests of vulnerable customers will continue to be protected through the TAS scheme.

- **It should continue to provide incentives for C&WG to make efficiency savings**

C&WG argues that the introduction of a short 'interim' mechanism would mean that incentives would be less than would otherwise have been the case for both 2004/05 and the first half of 2005/06. Based on this argument, C&WG requested that it be given some latitude to carry-over into the new regime any efficiency savings made in the first half of 05/06 in excess of what might have been expected.

Newtel stated that although retail price controls can assist in protecting consumers, it is important that these are also structured such as to not prevent viable competitive market entry. It also reiterated the importance of allowing rebalancing of tariffs, within a framework which will protect vulnerable users. Furthermore, Newtel states that the current level of accounting information in the public domain does not make it possible for operators like Newtel to make informed comments on OUR's retail price control proposals.

3.2.2. Comments on Options

C&WG considers the continuation of the existing price control (i.e. Option 1) to be the only reasonable option of those presented by the OUR. C&WG does not support options 2, 3 and 4.

C&WG believes that the most workable solution would be to handle the Option 1 extension in the same way as when C&WG amended its financial year-end i.e. RPI would be taken for an 18 month period and X would be adjusted by 18 / 12.

C&WG supports this approach as it believes it would be the simplest for both C&WG and the OUR to implement and would not entail multiple price control compliance models and compliance filings.

Newtel expressed a preference for Option 1 in order to minimise uncertainty going forward.

3.3. Director General's Position

3.3.1. General Comments

OUR Price Control Review Process

The OUR is continuing to review the responses to the three consultation papers published in the summer of 2004 as well as reviewing C&WG's business plan. At the same time the OUR is developing its own economic model to assist in the development of any future price control. This model will be informed by, inter alia, C&WG's business plan (see below for further comments on C&WG's own excel model). This economic model will enable the OUR to model the specific impact in those areas where any price control will be applied (i.e. the model allows for products to be either included or excluded from any future price control).

The OUR does not accept C&WG's argument that delays in decisions relating to for example, the application of MAR and to the company's cost of capital will have an impact on C&WG's investment plans in the near future. MAR would apply to

historical investment only and as such has no effect on future investment. Similarly whilst the OUR set a cost of capital for Guernsey Telecoms in March 2002, C&WG have used a different cost of capital for new services, such as broadband in October 2002. The OUR therefore does not accept C&WG's view that any delay in determining the company's WACC will be affecting the company's future investment programme for new services.

The OUR indicated in Document OUR 05/02 a proposed timetable that it intends to follow which stated that the DG is aiming to publish a draft position paper in Q2 2005 for public consultation. This will set out his position on the issues in the three consultation papers issued in 2004 which will include consideration of the use of the MAR and the company's WACC having completed its review of C&WG's business plan.

The delay to the price control review process has in fact been caused by two factors:

- The substantial delay by C&WG in submitting its business plan; and
- The need for the OUR to spend considerable efforts and resources on restructuring the model which accompanied C&WG's business plan.

These two points are discussed further below.

Delays in submission of Business Plan

C&WG were originally required to submit its business plan and tariff application by 30th July 2004. However the company sought a number of extensions to this original deadline all of which were granted by the OUR. This office was aware of the amount of work that the review required and forewarned C&WG that the impact of its continued requests for extension would most likely result in slippage of the overall timetable.

Incremental work on C&WG's Business Plan Model

Despite the delay in submission by C&WG to the 29th October 2004, the OUR nonetheless wished to complete the review within the original timeframe. This was however severely impacted when it became apparent that the OUR would have to restructure the business plan supplied by C&WG so that the OUR could make it fit for purpose for its own work. This has required significant effort which was not allowed for in the original timetable. The restructured model is now being returned to C&WG to allow it to understand the changes that have been made to the model structure.

The DG rejects C&WG's claims that OUR staffing issues are a contributing factor.

C&WG's proposed principles for the interim price control mechanism

Turning to the substantive issues raised in the responses to the consultation the DG does agree with a number of the points made by the respondents. These are addressed below:

- **Minimise additional compliance requirements**

The OUR agrees that one of the principles for the interim price control should be to minimise additional compliance requirements. From a mechanistic

perspective the OUR will consider a review the use of current year weighting of revenues within baskets and the use of current year RPI in the main price control review. Any change will be considered from 1st October 2005.

- **Not to penalise C&WG for the delay in revising the price control mechanism should it be found following the consultation that current controls are too harsh;**

Any new price control which comes into effect from 1st October 2005 will be based on the OUR's own modelling informed by, inter alia, C&WG's business plan. The reasons for the need for an interim model have been explained earlier in this paper.

The OUR does not believe that any retrospective adjustment of an interim control (in either direction) following the DG's final decision due in the late summer of this year would be in the interests of any party.

- **Not to provide any additional restrictions on C&WG's ability to rebalance tariffs;**

The DG concurs that any interim control should continue to allow the company to operate on a commercial basis and be able to assume a degree of pricing flexibility, although it should be noted that the additional time required by the OUR is due to C&WG's own actions.

- **To continue to provide incentives for C&WG to make efficiency savings**

The DG agrees that any interim price control should continue to provide incentives for C&WG to make efficiency savings. The DG notes that in earlier correspondence C&WG stated that:

*"In the event of delays to the implementation of any potential new price control mechanism, C&WG considers that the fairest way to proceed would be to allow the current price control mechanism to continue on a pro-rata basis."*⁷

The DG acknowledged and agrees with Newtel's comments on the need to consider the potential impact of any retail price control on competitive operators as well as on consumers. Although the DG understands Newtel's points relating to the rebalancing of tariffs, such rebalancing must only be allowed if and when any access deficit has been fully documented and then it must happen within a framework which will protect users.

The DG also acknowledges Newtel's points on the public availability of C&WG's regulatory accounts. In 2004 the OUR did consult and revise C&WG's Regulatory Accounting Guidelines and the company's 2003/04 Regulatory Accounts will be published shortly with a further set for the year ending March 2005 being published in September 2005.

⁷ Letter from C&WG to OUR 24 August 2004

3.3.2. Responses to the Options

The DG concurs with the respondents' preference for implementing Option 1 over the interim period from 1st April 2005 to 30th September 2005. This option represents the simplest approach of the four set out in the consultation paper whilst reducing uncertainty, minimizing additional compliance requirements and protecting consumer interests whilst also providing an incentive to C&WG to introduce efficiency saving measures.

3.4. Director General's Decision

The Director General has decided to extend the price control for an additional six months with a new relevant period for 1st April 2005 to 30th September 2005. This necessitates a pro-rata adjustment to the relevant X factors to reflect that the duration of the interim price control is only for a six month period. The DG's Determination is set out fully in Annex 1 to this Report and Decision Notice.

4. Next Steps

The OUR is continuing its review of C&WG's business plan which will inform any new price control which would come into effect from 1st October 2005. The OUR has restructured C&WG's excel model which supports its business plan and C&WG will be required to review and make necessary corrections to some data inputs where there appear to be errors in the model.

C&WG's continued co-operation and assistance and the provision of timely information will critically affect the OUR's future timetable. At the current time the DG intends to publish for public consultation a draft position paper in Q2 2005, having completed its review of C&WG's business plan, setting out the OUR's position on the three consultation papers issued in 2004. However this is dependent on C&WG being able to provide inputs to the process in a timely manner.

As outlined in Document OUR 05/02 C&WG will also shortly be submitting and publishing its 2003/04 Regulatory Accounts which for the first time will have been prepared on a Current Cost Accounting (CCA) basis. These accounts will form the basis for the company's proposed interconnection and access rates which the OUR anticipates receiving from the company in May 2005. The OUR will review the company's proposals immediately upon receipt of the information and is aiming to publish the DG's final price control decision and a decision on interconnection and access rates during Q3 2005.

/ENDS

ANNEX I

Determination of the Maximum Levels of Charges which may be applied by C&W Guernsey Limited in respect of Licensed Telecommunications Services

1. The Director General of Utility Regulation in accordance with:
 - condition 31.2 of the Fixed Telecommunications Licence acquired by C&W Guernsey Limited on 30th May 2002; and
 - his duties, powers and functions, under the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001 and in particular sections 2(a), 5(a), 5(e) and 5(g) thereof; and
 - his duties, powers and functions, under the Telecommunications (Bailiwick of Guernsey) Law, 2001 and in particular section 5(1)(f) thereof; and
 - the existant finding that C&W Guernsey Limited (Guernsey Telecoms Limited at the time) has a dominant position in the market for fixed telecommunications services and networks in the Bailiwick of Guernsey⁸ in accordance with section 5(3) of the Telecommunications (Bailiwick of Guernsey) Law 2001

hereby determines that the maximum levels of charges that C&W Guernsey Limited may apply to the provision of the Licensed Telecommunications Services, as defined in the Licence of C&W Guernsey Limited of the 1st of October 2001 are those specified in paragraphs 4, 5, 6 and 7 below.

2. The maximum levels of charges which may be applied by C&W Guernsey Limited, as set out in this Determination shall come into effect on 1st April 2005 and shall apply until 30th September 2005 subject to the provisions of paragraph 3 hereof.
3. This Determination is subject to review, either in whole or in part, by the Director General, where the Director General considers this necessary and/or appropriate having regard to his duties and functions under Law, including the Regulation of Utilities (Bailiwick of Guernsey) Law, 2001, and the Telecommunications (Bailiwick of Guernsey) Law, 2001 and any such review will be carried out in accordance with

⁸ Document OUR 01/14: Decisions Under the Telecommunications (Bailiwick of Guernsey) Law, 2001, Decision Notice and Report on the Consultation; Decisions no. 1.1 and 3.1

the provisions of sections 5(2) and 5(3) of the Telecommunications (Bailiwick of Guernsey) Law, 2001.

4. **Maximum Levels of Charges which may be applied by C&W Guernsey Limited in respect of a Basket of Leased Lines**

The following services shall be included in the basket of leased lines:

- All analogue private circuit connections
- All digital private circuit connections
- All analogue private circuit rental
- All digital private circuit rental

C&W Guernsey Limited shall ensure that for the period of this Determination the charges which it applies to this basket of services shall not exceed the charges for this basket of services in place on 1st April 2005.

In addition C&W Guernsey Limited shall ensure that for the period of this Determination the charges which it applies to each individual service within this basket shall not exceed the charges it applies for each of these individual services in place on 1st April 2005.

5. **Maximum Levels of Charges which may be applied by C&W Guernsey Limited in respect of a Shortcall Basket**

The following services shall be included in this basket:

- Shortcall line connection
- Shortcall line rental
- Shortcalls

C&W Guernsey Limited shall ensure that the charges which it applies to this basket of services are subject to a reduction in each relevant period which reduction shall, be at least equal to the annual percentage change in the Retail Price Index less 1.5% ($\Delta RPI - 1.5$).

6. **Maximum Levels of Charges which may be applied by C&W Guernsey Limited in respect of an Exchange Line Rental basket**

The following services shall be included in this basket:

- Exchange Line rental

C&W Guernsey Limited shall ensure that the charges which it applies to this basket of services shall not increase in each relevant period more than the annual percentage change in the Retail Price Index plus 3.5% ($\Delta RPI+3.5$).

In addition C&W Guernsey Limited shall ensure that the maximum charge for the services in this basket at any time during the relevant period shall be no greater than the charge at the end of the previous period plus the annual percentage change in the Retail Price Index plus 3.5% ($\Delta RPI+3.5$).

7. **Maximum Levels of Charges which may be applied by C&W Guernsey Limited in respect of a Main basket**

The following services shall be included in this basket:

- Exchange Line connection
- All ISDN2 Service Connections
- All ISDN30 service connections
- All ISDN8 service connections
- All ISDN22 service connections
- All Additional ISDN service connections
- All ISDN2 Service rental
- All ISDN30 service rental
- All ISDN8 service rental
- All ISDN22 service rental
- All additional ISDN channel service rental
- Local calls
- Jersey calls
- National Calls
- International Calls
- Local calls to ISPs
- National calls to ISPs
- Calls from public payphones
- Calls to the Operator

- Calls to Directory Enquiries (including call charges and facility charge)

C&W Guernsey Limited shall ensure that the charges that it applies for this basket of services are subject to a reduction in each relevant period which reduction shall be at least equal to the annual percentage change in the Retail Price Index less 2.5% ($\Delta RPI - 2.5$).

8. This Determination shall come into effect on 1st April 2005 and shall continue in force until 30th September 2005 unless changed, amended, replaced or revoked, by the Director General. For the duration of this Determination, the relevant period in which the maximum levels of charges shall apply and be monitored shall be 1st April 2005 to 30th September 2005 and the term “relevant period” shall be construed accordingly.
9. To the extent that C&W Guernsey Limited has made, during the relevant period, a reduction in charges that is greater than the reduction required by this Determination or an increase in charges that is less than any increase permitted by this Determination, the under-recovery may be taken into account by the Director General in monitoring compliance with the maximum levels of charges which may be applied in the relevant periods subsequent to the relevant period in which the under recovery occurred.