SMP Obligations in relevant Retail Fixed Markets – Application of Rebalancing and a Price Cap control on Gibtelecom

Decision Notice No. 03/09

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Executive Summary

The communications regulatory framework[1] requires the Gibraltar Regulatory Authority ("the Authority") to define relevant markets appropriate to national circumstances and to analyse these markets to ensure that regulation remains appropriate in the light of changing market conditions, otherwise known as market reviews.

On 10th April 2007, the Authority issued a national consultation on its market analysis for retail fixed markets (Public Consultation No. 01/07).

Having considered the views of all respondents to the Public Consultation ("the Consultation"), the Authority set out in a Statement (Document No. 13/07) its conclusions regarding the market analysis process including its Significant Market Power (SMP) obligations.

The Authority designated Gibtelecom as having SMP in the following retail fixed markets:

1. Access to the public telephone network at a fixed location for residential and non-residential customers in Gibraltar;

2. National publicly available telephony services from a fixed location market; and

3. International publicly available telephony services from a fixed location market (including managed VoIP services).

The Authority has applied SMP obligations on Gibtelecom in the relevant markets in which it has been designated as having SMP. The SMP obligations included retail price controls and the Authority issued a public consultation on 11th August 2008: "Retail Price Controls – Application of Rebalancing and a Price Cap control on Gibtelecom"[2] ("Retail Price Controls Consultation" or "RPCC").

The RPCC proposed and detailed the application of the retail price controls to apply to the SMP designated operator Gibtelecom as part of the SMP obligations described in Decision Notice 05/08 issued 11th August 2008.

The Authority proposed to apply a retail price control on the SMP operator Gibtelecom in the following markets:

1. Retail access to the public telephone network at a fixed location

2. Retail national publicly available telephony services from a fixed location

3. Retail international publicly available telephony services from a fixed location

1 Communications Act 2006, Act No. 15, 2006 ("the Act").

2 Public Consultation 06/08, Gibraltar Regulatory Authority.

The form of the retail price cap preferred by the Authority was framed according to the following main parameters:

1. Services subject to the price cap will face a price cap such that each year the (weighted) average of price changes shall not exceed inflation less 3 percentage points.

2. The price cap shall start on 1 January 2009 or as soon as possible thereafter and will last for three years.

3. The starting prices in the price cap will enable Gibtelecom to rebalance its tariff structure.

Two sub caps were proposed to apply on monthly exchange line rental charges, one for residential and one for business. These sub caps were proposed to constrain price increases in each year not to exceed inflation plus 2 percentage points for residential and inflation plus 5 percentage points for business.

Taking into account all the comments received during the RPCC and in particular comments in letters sent to the Authority by Gibtelecom dated 6 November 2008, 30 December 2008, 17 January 2009 and 26 February 2009, the Authority shall apply on Gibtelecom in accordance with the existing SMP obligations the following retail price control obligations.

1. A requirement that retail price changes for telephony services in the relevant markets shall not exceed inflation less 3 in each applicable 'Price Control Year' for three years. The retail price control shall apply on 1st May 2009 and end 30th April 2012.

2. Gibtelecom shall be allowed to set cost orientated retail tariffs (known as rebalancing) in accordance with SMP transparency obligations applicable in the relevant markets. The Authority therefore permits Gibtelecom to increase monthly line rental charges as stipulated in Table 1.

Table 1 Rebalanced monthly line rental charges

Line type	Rebalanced monthly line rental charges (£)	Current monthly line rental charges (£)
Residential	8.00	6.00
Business	12.00	10.00
Centrex	14.50	12.50

Gibtelecom shall be permitted to increase line rental charges, subject to the ceilings stipulated in Table 1 and the requirement that it shall publish changes to the terms and conditions at least 30 days in advance of implementation, and shall publish information on increases to tariffs at least 30 days in advance.

3. Two sub-caps shall apply to the monthly line rental charges, one for residential and one for business. These sub-caps will constrain price increases each applicable year not to exceed inflation plus 2 percentage points for residential line rental and inflation plus 5 percentage points for business line rental.

4. A price control on retail fixed to mobile services in the form of a cost orientation requirement.

Gibtelecom shall be permitted to remove the free call allowance of £1.25 per month available to all residential customers subject to the requirement that it shall publish the changes to the terms and conditions at least 30 days in advance of implementation, and shall publish information regarding the (implied) increase in the line rental at least 30 days in advance.

The Authority has been notified by Gibtelecom that the rebalancing allowed as part of the retail price control obligations is to be introduced contemporaneously with per second billing for local telephony calls. Per second billing for local calls is a requirement under the SMP obligations stipulated in Decision 05/08.

The Authority has been provided with estimates by Gibtelecom that show tariff rebalancing, the removal of free call allowance and the introduction of per second billing for local calls will provide a net benefit to almost all residential and business subscribers.

1. Decision

1.1 Introduction

The European regulatory framework for electronic communications networks and services entered into force on 25th July 2003 in the European Union. The framework is designed to create harmonised regulation across Europe and is aimed at reducing entry barriers and fostering prospects for effective competition to the benefit of consumers. The legal basis for the regulatory framework is set out in five key Directives:

1. Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services (the Framework Directive)[3]
2. Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities (the Access Directive)[4]
3. Directive 2002/20/EC on the authorisation of electronic communications networks and services (the Authorisation Directive)[5]
4. Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services (the Universal Service Directive)[6]
5. Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector (the Privacy Directive)[7].

The above Directives were implemented as part of the Communications Act 2006, Act No. 15, 2006 ("the Act") and accompanying Regulations. The legislation enables the Authority to carry out reviews of competition in relevant electronic communications markets to ensure that regulation remains appropriate in the light of changing market conditions, otherwise known as market reviews.

3 See footnote 2 above.

4 DIRECTIVE 2002/19/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive) OJ [2002] L 108/7.

5 DIRECTIVE 2002/20/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 7 March 2002 on the authorisation of electronic communications networks and services (Authorisation Directive) OJ [2002] L 108/21.

6 DIRECTIVE 2002/22/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive) OJ [2002] L 108/51.

7 DIRECTIVE 2002/58/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications) OJ [2002] L 201/37.

1.2 SMP Obligations and Price Controls of retail fixed telephony services

On 11th August the Authority published a Decision ("Retail Fixed Markets Review or RFMR") and outlined the SMP Obligations that would be applied to the SMP designated operator Gibtelecom in the following relevant markets:[8]

1. Retail access to the public telephone network at a fixed location
2. Retail national publicly available telephony services from a fixed location
3. Retail international publicly available telephony services from a fixed location

In the RFMR the Authority stated that Gibtelecom's retail charges for:

1. Monthly charges for its line access products facilitating publicly available telephone services on the fixed network shall be included in a basket of services to be subject to a retail price control commencing on 1 January 2009 or later if a public consultation is not concluded by this date;
2. National publicly available telephone calling services on the fixed network may be included in a basket of services to be subject to a retail price control commencing on 1 January 2009 or later if a public consultation is not concluded by this date; and
3. International publicly available telephone calling services on the fixed network may be included in a basket of services to be subject to a retail price control commencing on 1 January 2009 or later if the public consultation is not concluded by this date.

In addition the Authority also stated in the RFMR that Gibtelecom comply with a SMP transparency obligation requiring the company notify the Authority with regard to the above services:

4. At least 60 days in advance of changes to terms and conditions (excluding price decreases).

The RFMR also placed the SMP obligation on Gibtelecom requiring it to:

5. Charge its retail customers using a per-second billing format from 1 January 2009 and that this shall apply to all calls lasting more than one minute (calls less than one minute are not subject to this obligation).

1.3 Retail Price Controls Consultation

On 11th August 2008 the Authority published a public consultation: "Retail Price Controls – Application of Rebalancing and a Price Cap control on Gibtelecom"[9] ("Retail Price Controls Consultation" or "RPCC").

8 Decision and SMP Obligations – Retail Fixed Markets, Decision Notice No. 05/08, 11th August 2008, Gibraltar Regulatory Authority.

9 Public Consultation 06/08, Gibraltar Regulatory Authority.

The RPCC proposed and detailed the application of the retail price controls to apply to the SMP designated operator Gibtelecom as part of the SMP obligations described in Decision Notice 05/08 issued 11th August 2008.

The Authority proposed to apply a retail price control on the SMP operator Gibtelecom in the following markets:

1. Retail access to the public telephone network at a fixed location

2. Retail national publicly available telephony services from a fixed location

3. Retail international publicly available telephony services from a fixed location

The form of the retail price cap preferred by the Authority was framed according to the following main parameters:

1. Services subject to the price cap will face a price cap such that each year the (weighted) average of price changes shall not exceed inflation less 3 percentage points.

2. The price cap shall start on 1 January 2009 or as soon as possible thereafter and will last for three years.

3. The starting prices in the price cap will enable Gibtelecom to rebalance its tariff structure.

4. Two sub caps will apply to monthly exchange line charges, one for residential and one for business. These sub caps will constrain price increases each year not to exceed inflation plus 2 percentage points for residential and inflation plus 5 percentage points for business.

The public consultation closed at 4pm on Friday 19th September 2008. Under Regulation 15 of the Communications (Access) Regulations 2006 and in order to promote further openness and transparency, the Authority is publishing the names of all respondents and has made available for inspection non-confidential versions of the responses at its offices.

Only one formal response to the RPCC was received by the Authority. This response was submitted by Gibtelecom Limited. The Authority is grateful to Gibtelecom for submitting its views on the important issues raised in the RPCC.

1.4 Stakeholder Consultation

As part of the ongoing assessment of the form of retail price controls, the Authority held a stakeholder workshop on 6 August 2008 and held a meeting with Gibtelecom on 24th October 2008. At this meeting the Authority's consultant Dr. Chris Doyle made a presentation outlining the position on the retail price controls. It was agreed at the meeting that the Authority would provide a further opportunity for the SMP affected operator Gibtelecom to comment on the draft Decision Notice relevant to the RPCC. The draft Decision Notice was submitted to Gibtelecom on 10th February 2009.

1.5 Gibtelecom proposals

The Authority was notified of proposals for tariff rebalancing and the introduction of per second billing for local calls in a letter received from Gibtelecom dated 30th December 2008. The Authority has considered these proposals as part of the RPCC process.

In a letter submitted to the Authority dated 17th January 2009 Gibtelecom proposed to remove the free call allowance of £1.25 per month available to all residential customers. The Authority has considered this proposal as part of the RPCC process.

1.6 Retail Price Controls - Decision

Taking into account all the comments received during the RPCC and in particular comments in letters sent to the Authority by Gibtelecom dated 6 November 2008, 30 December 2008, 17 January 2009 and 26 February 2009, the Authority shall apply on Gibtelecom in accordance with the existing SMP obligations the following retail price control obligations.

1. A requirement that retail price changes for telephony services in the relevant markets shall not exceed inflation less 3 in each applicable year for three years. The retail price control shall apply on 1st May 2009 and end 30th April 2012.

2. Gibtelecom shall be allowed to rebalance retail tariffs in accordance with SMP transparency obligations applicable in the relevant markets. The Authority therefore permits Gibtelecom to increase monthly line rental charges as stipulated in Table 2.

   Table 2 Rebalanced monthly line rental charges

Line type	Rebalanced monthly line rental charges (£)	Current monthly line rental charges (£)
Residential	8.00	6.00
Business	12.00	10.00
Centrex	14.50	12.50

   Gibtelecom shall be permitted to increase line rental charges, subject to the ceilings stipulated in Table 1 and the requirement that it shall publish changes to the terms and conditions at least 30 days in advance of implementation, and shall publish information on increases to tariffs at least 30 days in advance. **The above rebalancing shall not count as price changes (increases) for the purposes of compliance with the retail price cap starting 1st May 2009.**

3. Post rebalancing two sub-caps shall apply to the monthly line rental charges, one for residential and one for business. These sub-caps will constrain price increases each applicable year not to exceed inflation plus 2 percentage

points for residential line rental and inflation plus 5 percentage points for business line rental.

4. Gibtelecom shall be permitted to remove the free call allowance of £1.25 per month available to all residential customers subject to the requirement that it shall publish the changes to the terms and conditions at least 30 days in advance of implementation, and shall publish information on the implied increase in the line rental at least 30 days in advance.

5. A price control shall apply to retail fixed to mobile services in the form of a cost orientation obligation.

1.7 Gibtelecom notifications

The Authority has been notified by Gibtelecom that the rebalancing allowed as part of the retail price control obligations is to be introduced contemporaneously with per second billing for local telephony calls. Per second billing for local calls is a requirement under the SMP obligations stipulated in Decision 05/08.

The Authority has been provided with estimates by Gibtelecom that show the tariff rebalancing, the removal of free call allowance and the introduction of per second billing for local calls will provide a net benefit to almost all residential and business subscribers.

The Authority intends to monitor closely the effect of the application of the retail price controls and associated tariff changes, and in particular monitor the effect on low volume, low income users.

The Authority has also been notified by Gibtelecom that the call credit allowance of £4.50 per month granted to old age pensioners in receipt of Government rent relief will continue.

1.8 Structure of this document

The rest of the decision is structured as follows:

Chapter 2 summarises the responses to consultation and presents the Authority's position.

Chapter 3 describes the nature of the retail price cap and outlines the key parameters.

Annex A describes in detail the form of the retail price controls, the nature of compliance and provides a revised version of the illustrated example shown in the in the RPCC document.

Annex B reproduces a slightly modified version of a note sent by the Authority to Gibtelecom on 18th November 2008 regarding the regulatory treatment of fixed to mobile calls. The modifications made take account of consultation developments subsequent to 18 November 2008.

Annex C provides further explanation on the price control applied to mobile voice call termination services supplied by Gibtelecom, in response to comments made in Gibtelecom's letter of 26 February 2009. Although the SMP price control lies outside the remit of this Decision, the matter discussed by Gibtelecom has had a bearing on the Authority's approach to retail fixed to mobile voice call services in this Decision.

2. Responses to the Public Consultation

In this section the Authority summarises the response to the public consultation on the application of price controls on the applicable retail services in the relevant markets.

Q1: Do you agree that line rental charges are relatively low in Gibraltar? Do you agree that Gibtelecom's monthly line rental charges are unbalanced?

Please give reasons for your answer. If you believe Gibtelecom's monthly line rental charges are unbalanced, please provide analysis indicating to what extent the tariffs are unbalanced.

Views of Respondents

Gibtelecom agreed that the line rental charge is relatively low when to compared to other jurisdictions and is well below the EU27 weighted average rental charge for residential subscribers of £10.15 (including VAT) cited in the Public Consultation. Gibtelecom pointed out that the figure of £10.15 was dependent on the Euro exchange rate and that any fluctuation would affect the EU average. The recent trend of a falling Euro rate from €1.47 to €1.25 per pound sterling meant that the EU average was increasing therefore bridging a wider gap between Gibtelecom's line rental charge and that of the rest of Europe.

Gibtelecom concluded that only five out of the twenty seven other EU countries have lower line rental charges than Gibraltar. Furthermore, when taking into account the discounts which the line rental charge includes, such as the £1.25 calling credit for all subscribers and the £4.50 call credit for pensioners falling under the rent relief scheme, only two or three other jurisdictions have lower line rental charges than Gibraltar.

Gibtelecom also affirmed that its monthly line rental charges are unbalanced and therefore below cost. They asserted that they were below cost when first set as part of the partial first stage rebalancing approved by the Authority for December 2001 and that the loss had been recorded in the access deficit charge (ADC) included in Gibtelecom's Accounting Separation Reports submitted to, and approved by the Authority.

Moreover, they stated that tariff rebalancing was not just a general goal of EU telecommunications frameworks but was a legal obligation in which its implementation was long overdue. In the context of the Public Consultation, Gibtelecom argued that a retail price cap cannot be imposed until the rebalancing of tariffs is fully completed. It is Gibtelecom's view that to do otherwise, the Authority would be raising the possibility of acting in *ultra vires* as the rebalancing process should have been completed under the previous 1998 EU framework as implemented in Gibraltar under the Telecommunications Ordinance 2000.

Authority's Position

The Authority welcomes confirmation from the respondents that tariffs are unbalanced and the monthly line rental charges in Gibraltar are relatively low. The Authority disputes the fact that there is in place a legal obligation to implement rebalancing of tariffs prior to the application of a retail price cap in the relevant market. Indeed, the Authority notes that rebalancing has occurred in a number of EU member states contemporaneously with the implementation of retail price controls. Furthermore, the Authority notes that the EU framework of 1998 has been superseded by what has been termed the New Regulatory Framework which came into effect in 2003.

In the response to the RPCC submitted by Gibtelecom, information was not provided indicating the scale of tariff unbalancing. Gibtelecom has supplied the Authority with detailed regulatory accounting data in the form of Access Deficit Charges in relation to accounting separation requirements. However, while this information provided some insights it was regarded as not sufficiently up to date. In subsequent correspondence submitted to the Authority by Gibtelecom dated 6 November 2008, 30 December 2008 and 17 January 2009, additional detailed information has been provided indicating the scale of the unbalanced tariffs. Notwithstanding, the Authority has not been provided with up to date detailed regulatory accounting data to determine the scale of tariff unbalancing.

The Authority wishes to allow for rebalanced retail tariffs and accepts that the current tariff is unbalanced. The Authority shall incorporate the rebalanced tariffs as proposed by Gibtelecom in response to the RPCC and in subsequent correspondence.

Q2: Do you agree that retail charges for Gibtelecom's broadband services are relatively high and appear excessive?

Please give reasons for your answer. If you agree or disagree with the Authority's view on broadband prices, provide supporting evidence to substantiate your position.

Views of Respondents

With regard to section 2.3 on call charges and section 2.4 on Internet access and service charges, Gibtelecom commented on the GBP-Euro exchange rate of €1.47 applied. It was highlighted the British Pound had weakened significantly and the exchange rate was at €1.24 (as at 10th September 2008). Consequently, as illustrated in Table 2.3 in the RPCC, the price of a ten minute local call during the peak period was 30 pence and so, was quoted as being €44.16. Using the lower exchange rate of €1.24, this call cost came out to €37.06. Similarly, the lowest charge for the Internet access line (standard service) of £12 (see Table 2.10) was now equivalent to a value of €14.96 instead of €17.66 as quoted at the time of the Public Consultation.

Gibtelecom also raised a procedural objection. It questioned in principle the Authority's use of the RPCC procedure to impose retail remedies on Gibtelecom's activities in the broadband market. They stated that the RPCC is a follow-up to the Authority's main Decision Notice on Retail Fixed Markets and that this decision did not conclude that Gibtelecom has SMP status in the retail fixed broadband access market.

In relation to the charges for broadband in Gibraltar, Gibtelecom agreed that a comparison with the UK market would not be fair given the difference in size and greater number of broadband providers in the UK. However, it did not accept that its retail charges for broadband services are excessive and did not agree with the selection of Liechtenstein as a benchmark and the comparator of its Gibtelecom, Tele 2. It was added that the comparison of the entry level broadband product of Gibtelecom's was flawed in relation to the speed of connection. Although Tele2's most basic ADSL product is cheaper and offers a higher download speed than that of Gibtelecom's it was argued that Tele2's download speed of 768Kbps is a nominal speed and is dependent on the capacity of the infrastructure used and customer demand. Therefore this speed could in fact be much lower than Gibtelecom's 512kbps which is actually guaranteed in Gibraltar as they do not offer any contended bandwidth.

Authority's Position

In further consultations with Gibtelecom and stakeholders the Authority has decided to withdraw retail broadband services from the retail price controls applied as part of the SMP obligations in the retail fixed markets. The Authority has proposed that the retail broadband market will be subject to a separate review.

Q3: Do you agree that Gibtelecom's retail tariffs need rebalancing and that this would enable lower broadband charges?

Please give reasons for your answer.

Views of Respondents

Gibtelecom did not accept its pricing structure for broadband services is linked to the rebalancing problem and that unbalanced tariffs are not causing high Internet prices. It stated that it has not been recouping losses on line rentals through high broadband prices, as this would be a cross subsidy between product offerings which is not allowed under EU and Gibraltar legislation. Gibtelecom explained that the potential subsidy to cover line rental losses takes the form of Access Deficit Charges (ADC's) which are included as part of the interconnection charges and are derived from the Accounting Separation Report. This was said to be in line with the Authority's position to allocate the ADC's to the Local Access Network business rather than the Core Network.

The respondent also explained that its increased efficiencies and larger volumes of traffic would drive prices lower and highlighted that changes in the wholesale price structure would also allow reductions in retail prices. As an example, Gibtelecom stated that the wholesale price for a fully unbundled local loop at £8.89 per month, as quoted in its draft Reference Unbundling Offer, would, once approved by the Authority allow a reduction in the retail price of an ADSL Standard access line.

Authority's Position

As noted in the Authority's position in response to question 2 above, the Authority has removed retail broadband charges from the SMP obligations in this review.

Q4: Do you agree that a retail price control in the form of IRP-x is the best form of price control to apply to some or all of the services offered by Gibtelecom in the relevant retail market?

Please give reasons for your answer.

Views of Respondents

Before commenting on the retail price control mechanism, Gibtelecom reiterated its response in relation to Question 1 on rebalancing. It affirmed that the Authority cannot implement a retail price control mechanism in any form unless and until it fully completes retail tariff rebalancing to fulfil a legal obligation that is long overdue.

With regards to the IRP-x mechanism, it was agreed that the proposal is a standard formula applied by many EU regulatory authorities and that it had no objection in principle to a formula applied to a basket of regulated retail services, provided each service falls within a relevant market in which Gibtelecom has been designated as having SMP. Gibtelecom however, reserved its position on the value of 'x' pending being allowed to complete rebalancing.

Authority's Position

The Authority disputes the claim that it is under a legal obligation to complete retail tariff rebalancing before the application of retail price controls. Notwithstanding, the Authority accepts the rebalancing proposals presented by Gibtelecom in a letter dated 30th December 2008 and has incorporated the proposed rebalanced rates into the retail price control in this decision.

Q5: Do you agree that resources in a small market like Gibraltar do not merit the application of a detailed financial model to compute x in an IRP-x price control?

If you disagree, please give detailed reasons for your answer and provide calculations demonstrating that there would be an expected net benefit from applying a detailed financial model to compute x as opposed to choosing a value for x a shown below.

Views of Respondents

Gibtelecom agreed that an unusual set of factors place Gibraltar in a unique situation, particularly the need to minimise regulatory compliance costs given the limited resources available in a very small market. The respondent stated that while not being completely dispositive of the issue, they noted the Authority's proposal not to proceed with a full scale financial model.

Gibtelecom explained that there are a series of alternative approaches for calculating the value of x and that the main methods are the historical productivity method, the regulatory benchmark method and different empirical approaches within both methods. They added that the Authority has chosen to follow the regulatory benchmark method but had not specified their choice of following the differential approach or the direct approach.

When carrying out a benchmarking exercise to determine the x factor, Gibtelecom cautioned that great care must be taken when choosing comparator companies or countries and the weighting of the comparative data.

Authority's Position

The Authority acknowledges that its proposal to apply a value for x was the result of a benchmarking exercise and that care is needed when performing such analysis. However, it should also be noted that regulatory resources are limited in Gibraltar and the exercise necessarily involves compromise. Nevertheless, the Authority has not been persuaded by the response to consultation that there is merit in applying a detailed financial model to determine the value of x. In particular, no calculations were presented to the Authority to suggest the selection of x should be by way of a detailed financial model.

Q6: Do you agree with the choice of x=3 in the IRP price cap? Do you agree that the horizon should be three years?

Please give reasons for your answer, present calculations where helpful and any supporting evidence.

Views of Respondents

Gibtelecom noted that the approach taken by Malta and Jersey in applying retail price controls was to choose a value of x=2. It argued that such a value is likely to be closer in applicability to a smaller market such as Gibraltar. It also noted the broader calculations used by the Authority to arrive at an international average of x=3 as the productivity factor appeared to be in line with the practice of European NRA's.

Gibtelecom did not accept that full rebalancing would take place in stages over the three year period and possibly not even be completed by the end of that period. It insisted that rebalancing should be completed before the commencement of the retail price controls as the price cap could only function based on a fully rebalanced starting price for the line rental service.

Notwithstanding Gibtelecom's objection to an incremental implementation of full rebalancing over the three year period, it queried how the three year term would comport with the legal requirement for the Authority to initiate market reviews every two years (Article 40(9) of the Communications Act 2006). Having said this, under Article 40(9), they noted that the Authority can use its discretion to postpone initiating a new round of market reviews if it feels that no circumstances have changed.

Gibtelecom added that the first round was initiated in April 2007 and the proposed retail price cap remedy would only enter into effect at the earliest, on 1st January 2009 and last until 31st December 2011 i.e. the price cap would expire more than four and a half years later.

Gibtelecom reserves its rights on the proposed three year period and on the timing of the next market reviews to be undertaken by the Authority.

Authority's Position

Gibtelecom has indicated that in two small European markets (Jersey and Malta) the value of x was set at 2. However, the Authority is of the view that both these markets are at a more advanced stage of development in terms of competition and therefore it is perhaps understandable that the NRAs applied a value of x=2. The Authority was not, however, provided with any evidence to suggest that x=3 would cause undue financial distress to Gibtelecom or act to the detriment of Gibtelecom's competitors. Further, no evidence was presented to suggest why x=2 would be a value more likely than x=3 to be closer in applicability to a smaller market such as Gibraltar. Without such evidence, the Authority feels that x=3 is appropriate given the status of competition and the relatively high prices in the relevant market in Gibraltar at this time.

Article 40(9) of the Communications Act 2006 states "The Authority shall carry out a further analysis of a relevant market referred to in subsection (2) two years after that analysis and every two years thereafter unless the Authority, at its sole discretion, considers that further analyses are not necessary." The Authority may therefore analyse a relevant market two years after the completion of the market analysis in a previous review. For the avoidance of doubt, the Authority shall analyse a relevant market two years after the publication of a Decision Notice associated with the relevant market as referred to in subsection (2).

The Authority may therefore start the analysis of the relevant fixed retail markets on 12 August 2010 – if at that time or thereafter it is determined that such markets remain suitable for the application of ex ante regulation. However, Article 40(9) allows the Authority discretion to postpone such analysis. As the price cap is proposed to extend over three years, the Authority believes there are good grounds to postpone a review of retail fixed markets until the beginning of the second year of the application of the retail price controls. Therefore, the review of the relevant fixed retail markets shall not commence before 16th March 2011. Nevertheless, the Authority reserves the right to commence a review sooner than 16th March 2011, but not before 12 August 2010, in the event of substantially changed competitive conditions in the relevant markets.

The Authority notes that the Article 40(7)(b)(ii)-(b)(iii) of the Communications Act 2006 state that the Authority may: "maintain or amend, as the Authority considers appropriate, the SMP obligations imposed on that person or combination of persons under the previous [SMP] designation in so far as such SMP obligations are authorised by this Act; and impose on that person or combination of persons such further SMP obligations authorised by this Act as the Authority considers appropriate to impose on that person or combination of persons in relation to that market."

In the interest of regulatory certainty the Authority wishes to make clear that it shall not amend or withdraw the current retail price control in the relevant market before 30th April 2012 – that is, three years after the date on which retail price cap controls are applied. However, if market conditions were to change appreciably the Authority may make changes sooner – but not before the conclusion of the next review.

Q7: Do you agree with the choice of services to be included in the price cap?

Please give reasons for your answer.

Views of Respondents

Gibtelecom did not accept the inclusion of fixed broadband access and services in the basket of regulated services subject to the retail price cap. It argued that the Authority had not defined the broadband access and services markets as relevant markets in which Gibtelecom has been designated as having SMP status.

Gibtelecom quoted from various documents which the Authority had published throughout the year. By referring to the Retail Fixed Markets Public Consultation, the Response to Consultation, Decision Notice and the European Commission's Article 7 letter, they emphasised the fact that narrowband access and broadband access were established as being in different markets and that Gibtelecom had only been designated as having SMP in the market for retail fixed narrowband access. Therefore, it was clearly stated that the Authority could not include the broadband services in the basket as the broadband markets had not been given SMP status.

Authority's Position

The Authority accepts that broadband services should not be included in the basket of services subject to the retail price controls within this market review.

Q8: Do you agree with the application of sub-caps on monthly line rental charges? Do you agree that changes to the residential line rental charge shall not exceed inflation plus 2 percentage points in each calendar year over the duration of the price cap? Do you agree that changes to the business line rental charge shall not exceed inflation plus 5 percentage points in each calendar year over the duration of the price cap?

Please give reasons for your answer, present calculations where helpful and any supporting evidence.

Views of Respondents

Gibtelecom did not accept the application of sub-caps on line rentals as long as the starting price (price in Year 0) is not set at a level to eliminate the line rental loss and therefore complete the rebalancing partially accomplished in December 2001, legally required by the telecommunications framework and which is long overdue. Neither, did it accept the application of the broader retail price cap covering the full basket of services which affects line rental prices until the rebalancing precondition is met.

Once full rebalancing is achieved, Gibtelecom advocated that line rental services form a separate basket for retail price control purposes. Residential and business line access would no longer need to be included in the basket for other retail services as the rebalancing losses would have been eliminated and there would no longer be a need for cross-subsidies. As part of a separate basket, the Gibtelecom agreed that it would be prepared to consider the proposed price cap formulae for residential lines (IRP+2) and business lines (IRP+5).

Authority's Position

The Authority has accepted the tariffs proposed by Gibtelecom that provide for full rebalancing. This was made clear in the Authority's response to the matters addressed in question 1 above. Consequently the Authority shall proceed to apply a retail price cap and will apply separate sub-caps on residential and non-residential (business) lines, at values IRP+2 and IRP+5 respectively.

Q9: Do you agree with the starting prices proposed by the Authority?

Please give reasons for your answer, present calculations where helpful and any supporting evidence.

Views of Respondents

Gibtelecom expressed a concern that the starting prices had been set without any real explanation or justification for the calculation. The starting prices must reflect the extra costs incurred due to the market's very small size and low volumes.

As stated in the response to Question 8, Gibtelecom insisted that the starting prices for line rentals reflect full rebalancing. They mentioned the fact the Authority proposed to allow a more generous increase between the current year and next year for line rentals than will be allowed under the IRP – 3 formula to help along the rebalancing effort. This would allow Gibtelecom to charge a retail price of £10.22 for residential line rental if a 15% increase is applied to the price of £8.89, a fully unbundled loop under the draft RUO.

Gibtelecom also added that it was not 100% clear that the Authority had allowed them to carry out some kind of rebalancing as part of the starting prices. Due to the wider political connotations rebalancing brings with it, Gibtelecom stated that the danger of agreeing with the Authority's statement was that they would be limiting themselves to IRP+2 and +5 regardless of whether problems are experienced in completing full rebalancing in year 0. Gibtelecom therefore maintains its stance that rebalancing must be completed before any application of price caps can be considered.

Gibtelecom also insisted, for reasons stated in its response to Question 7, that the Internet services be eliminated from the basket of regulated services as there was no proper procedural basis for the Authority to extend the retail price cap to fixed broadband access and services in light of the scope of the Retail Fixed Market Decision of 11 August 2008.

Authority's Position

The Authority has accepted proposals submitted by Gibtelecom to allow for starting prices compatible with full rebalancing. Furthermore, as noted above, retail broadband services are excluded from the retail price cap.

Q10: Do you agree with the compliance procedure proposed?

Please give reasons for your answer.

Views of Respondents

The respondent replied that the compliance procedure is premised on, inter alia, a limited credit carryover privilege of one year and that the one year limit was too burdensome a restriction given the magnitude of the price cap regime and the limited resources at hand. Gibtelecom added that it requires more than a one year carryover credit period, preferably a three year period, to balance out the highs and lows of any inflationary pressures in the future.

Authority's Position

The Authority is not persuaded by the assertions made in this regard and a one year carry over period was chosen to reflect both the interests of shareholders and customers. The Authority does not believe carryover should exceed more than a year, as this would likely work against the interest of consumers. Furthermore, the nature of the retail price cap to be applied by the Authority provides Gibtelecom a considerable degree of protection against unforeseen changes in inflation. It is also noted that in most jurisdictions where retail price caps are applied in telecommunications, the carry over period is typically specified to be no more than one year.

Q11: Do you agree with the method of implementing the proposed price cap?

Please give reasons for your answer, present calculations where helpful and any supporting evidence.

Views of Respondents

Gibtelecom did not agree with the proposed method of implementing the proposed price cap. It was critical of the mechanism to price cap fixed to mobile calls, suggesting the procedure outlined was flawed. It explained that the mobile retention rate to which the Authority referred is calculated as a weighted average of a selection of calls, fixed to mobile calls being one of them and that capping the price of a fixed to mobile call using the Authority's mechanism will affect the calculations of Table 4.1, which could lead to a further reduction of the mobile termination rate. This would lead to circularity, as it then would mean that a further reduction in fixed to mobile calls would be needed and so on. Furthermore, Gibtelecom emphasised that to maintain the current prices it would then be forced to increase the prices of other mobile-related calls included in the mobile termination rate weighted average calculation.

In order to find a way to apply a price cap measure, Gibtelecom stated that it should be done in a manner which does not affect the weighted average mobile termination charge.

Authority's Position

The Authority has withdrawn the fixed to mobile calling charges from the retail price cap. In a note submitted to Gibtelecom on 18th November 2008, the Authority outlined the rationale behind the exclusion of fixed to mobile call charges from the retail price cap in the relevant market. It was explained that SMP obligations in other relevant markets provide for the necessary measures to deal with the competition problems. The note is reproduced as annex B to this Decision.

Q12: Do you agree with calculations in the illustrative example?

Please give reasons for your answer.

Views of Respondents

Gibtelecom explained that it was not clear how the formula given in Table 4.1 would take into account changes in volume [quantity changes year on year]. For example, by selling more of one product in one year, the revenue for that year would be different from the revenue of the preceding year.

Gibtelecom explained that the table simply demonstrates how much regulated revenue Gibtelecom should make in a following year (also by showing the differences in absolute revenue between one year and the next) without taking into account that a higher revenue the following year could be caused by an increase in volumes even if the unit prices had been lowered in accordance with any price cap.

Gibtelecom asked for greater clarity in the table itself as it was not clear what the carryover for the following year would be.

Authority's Position

The Authority is grateful to Gibtelecom for raising this issue and for noting the (typographical) error in the IRP index value in Table 4.1. This Decision makes clear that sales volumes in the current price control year do not impinge on the ability of the firm to generate additional revenues above the target required to comply with the retail price control. The Authority explains its position in much greater detail in Annex A and provides reasoning to allay fears that the price cap somehow restricts current year volumes.

Q13: Do stakeholders have any other comments or observations that are relevant to this consultation?

Views of Respondents

In Gibtelecom's view there is a legal and financial precondition – full rebalancing – that must be satisfied before the proposed retail price control regime can be implemented. Retail price caps for all services, particularly for line rentals, cannot be imposed unless and until rebalancing is fully completed.

Gibtelecom reiterated that it had presented the Authority on two occasions, in its letters of 30th November 2004 and 24th August 2006, requests for full rebalancing, to which it claims the Authority did not provide substantive responses. It also asserted that the correspondence included information needed to implement rebalancing.

Authority's Position

This Decision has been framed to accommodate the proposed full rebalancing.

3. Retail Price Controls

3.1 Structure of Retail Price Controls

Taking into account all the comments received during the RPCC and in particular comments in letters sent to the Authority by Gibtelecom dated 6 November 2008, 30 December 2008 and 17 January 2009, the Authority shall apply on Gibtelecom in accordance with the existing SMP obligations the following retail price control obligations.[10]

1. A requirement that retail price changes for telephony services in the relevant markets shall not exceed inflation measured according to the IRP published by the Government of Gibraltar less 3 in each applicable Price Control Year for three years. The retail price control shall apply on 1st May 2009 and end 30th April 2012.

2. Gibtelecom shall be allowed to rebalance retail tariffs in accordance with SMP transparency obligations applicable in the relevant markets. The Authority therefore permits Gibtelecom to increase monthly line rental charges on the first day of the first Price Control Year in accordance with the values in Table 3.

Table 3 Rebalanced line rental charges

Line type	Rebalanced monthly line rental charges (£)	Current monthly line rental charges (£)
Residential	8.00	6.00
Business	12.00	10.00
Centrex	14.50	12.50

Gibtelecom shall be permitted to increase line rental charges, subject to the ceilings stipulated in Table 3 and the requirement that it shall publish changes to the terms and conditions at least 30 days in advance of implementation, and shall publish information on increases to tariffs at least 30 days in advance. **The above rebalancing shall not count as price changes (increases) for the purposes of compliance with the retail price cap starting 1st May 2009.**

3. Two sub-caps shall apply to the monthly line rental charges, one for residential and one for business. These sub-caps will constrain price increases each applicable year not to exceed inflation plus 2 percentage points for residential line rental and inflation plus 5 percentage points for business line rental.

10 Additional details determining the precise format of the retail price control are provided in Annex A.

4. Gibtelecom shall be permitted to remove the free call allowance of £1.25 per month available to all residential customers subject to the requirement that it shall publish the changes to the terms and conditions at least 30 days in advance of implementation, and shall publish information on the implied increase in the line rental at least 30 days in advance.

5. Table 4 below summarises the services within the retail price cap, the associated starting prices and information about the application of sub-caps.

Table 4 Services in the retail price cap, starting prices and sub-caps

Specific Set of services	*Starting Price*	*Included in sub-cap?*
Connection Fee	£60	No
Residential monthly rental fee	£8.00	Yes, x=Inflation + 2%
Business monthly rental fee	£12.00	Yes, x=Inflation + 5%
Centrex Line	£14.50	No
Unit price national fixed to fixed calls	6p	No
Local DQ	25p per call	No
International DQ	50p per call	No
International Direct Dial charges	Tariff as at August 2008	No

6. There shall be three Price Control Years over the periods: 2009-10, 2010-11 and 2011-12.

7. A price control on retail fixed to mobile services in the form of a cost orientation obligation shall apply. Gibtelecom shall demonstrate compliance by reference to the three main cost components of the services:

   (i) Wholesale fixed call origination which is subject to a SMP price control obligation;

   (ii) Wholesale mobile termination which is also subject to a SMP price control obligation; and

   (iii) Other costs (such as a proportion of overheads).

3.2 Gibtelecom notifications

The Authority has been notified by Gibtelecom that the rebalancing allowed as part of the retail price control obligations is to be introduced contemporaneously with per second billing for local telephony calls. Per second billing for local calls is a requirement under the SMP obligations stipulated in Decision 05/08.

The Authority has been provided with estimates by Gibtelecom that show tariff rebalancing, the removal of free call allowance and the introduction of per second billing for local calls which will provide a net benefit to almost all residential and business subscribers.

The Authority intends to monitor closely the effect of the application of the retail price controls and associated tariff changes, and in particular monitor the effect on low volume, low income users.

The Authority has also been notified by Gibtelecom that the call credit allowance of £4.50 per month granted to old age pensioners in receipt of Government rent relief will continue.

3.3 The Authority's commitment to regulatory certainty

The Authority shall not commence a review of the relevant markets in this Decision before 16th March 2011. It is unlikely that the Authority shall amend or withdraw the retail price controls in this decision before 30th April 2012 – that is, three years after the date on which retail price cap controls are applied. However, if market conditions vary considerably before 30th April 2012, the Authority may amend or withdraw the retail price controls in accordance with procedures laid out in the Act.

Annex A. Retail Price Controls

This annex describes in detail the way the retail price control shall apply and be implemented in the relevant market. The annex also provides an illustrative example and explains why volume changes year-on-year do not enter the implementation of the price cap.

A.1 Specific Set of Retail Price Controls

The Authority shall apply a retail price control in the form of IRP-x to a *Specific Set* of services offered by Gibtelecom in the relevant retail markets. The retail price control constrains the weighted average change in prices for the services in the specific set, where the weight of a service in the specific set is its revenue share in the preceding year.

IRP will measure inflation according to data published by the Government of Gibraltar in compiling the Index of Retail Prices. The value of x will be set at 3. The retail price control will apply for three years starting 1st May 2009 and ending 30th April 2012.

The Specific Set of services is shown in Table 5, along with the starting price and information about sub-caps.

Table 5 Services in the retail price cap, starting prices and sub-caps

Specific Set of services	*Starting Price*	*Included in sub-cap?*
Connection Fee	£60	No
Residential monthly rental fee	£8.00	Yes, x=Inflation + 2%
Business monthly rental fee	£12.00	Yes, x=Inflation + 5%
Centrex Line	£14.50	No
Unit price national fixed to fixed calls	6p	No
Local DQ	25p per call	No
International DQ	50p per call	No
International Direct Dial charges	Tariff as at August 2008	No

A.2 Structure of Retail Price Controls

The retail price control in A.1 above is described formally in this annex using algebra. The annex provides guidance to Gibtelecom and the public on how the cap will be implemented and how compliance will operate in practice.

In each current price control year *t* the weighted average (arithmetic average) of percentage changes in tariffs of services in the specific set shall not exceed something known as the controlling percentage $CP_{(t)}$ in year *t*.

Note 1: The controlling percentage may be inflation less 3. Hence if annual inflation is measured at 4, the controlling percentage would be 1. Thus the weighted average change in retail prices for services in the specific set is required not to exceed 1%, or alternatively must decline by at least 3% in real terms.

The weights applied to arrive at this average shall be based on revenues from the year preceding the current price control year. In the current price control year *t* the percentage change in price of service *i* in the specific set is defined as:

$$\Delta P_{(i,\, t)} = ((p_{(i,t)} - p_{(i,t-1)}) / p_{(i,t-1)}) \times 100 \qquad \text{(A.1)}$$

where

(t): is the current Price Control Year

(t-1): is the year preceding the current price control year

$p_{(i,t-1)}$ is the published tariff of Gibtelecom for service *i* in the specific set at the <u>beginning</u> of the Price Control Year excluding any discounts offered; and

$p_{(i,t)}$ is the published tariff of Gibtelecom for service *i* at time t during the Price Control Year excluding any discounts offered.[11]

The revenue weight for service *i* is defined as the revenue associated with service *i* in the previous price control year divided by the total revenue for all services *i=1 … n* in the specific set of services:

$$(p_{(i,t-1)} \times q_{(i,t-1)}) / \Sigma_{\,i = 1 \text{ to } n}\, p_{(i,t-1)} \times q_{(i,t-1)} \qquad \text{(A.2)}$$

11 See section A.6 below for issues arising from within current price control year price changes.

The denominator in (A.2) represents the total revenue associated with all the services *n* in the specific set from the year preceding the current price control year. It shall be written more simply as follows:

$$\mathbf{p}_{t-1}\mathbf{q}_{t-1} = \Sigma_{\ i = 1 \text{ to } n}\ p_{(i,t-1)} \times q_{(i,t-1)} \qquad \text{(A.3)}$$

The sum of the revenue weights is one, that is:

$$\Sigma_{\ i = 1 \text{ to } n}\ \{(p_{(i,t-1)} \times q_{(i,t-1)}) /\ \mathbf{p}_{t-1}\mathbf{q}_{t-1}\} = 1 \qquad \text{(A.4)}$$

Compliance with the retail price control requires that in each price control year the weighted average of percentage price changes of services in the specific set shall not exceed the controlling percentage:

$$\Sigma_{\ i = 1 \text{ to } n}\ [(((p_{(i,t)} - p_{(i,t-1)}) /\ p_{(i,t-1)}) \times 100) \times \{(p_{(i,t-1)} \times q_{(i,t-1)}) /\ (\mathbf{p}_{t-1}\mathbf{q}_{t-1})\}] \ \leq\ CP_{(t)}$$

$$\text{(A.5)}$$

Note 2: The expression in (A.5) states that the weighted average of the price changes for all the servicves in the specific set is no greater than the controlling percentage. It is clear fromn the expression that volumes in the price control year, as measured at the end of the year, do not feature in the price control. Thus, if the sales volumes were to expand in the current price control year – this is reflected in the following price control year.

Note 3: While the expression in (A.5) is readily understood, it is often the case that compliance is stated in revenue terms rather than in percentage price changes. The following shows how this is achieved.

The expression in (A.5) may be rewritten as follows:

$$[1/\ (\mathbf{p}_{t-1}\mathbf{q}_{t-1})] \times \{\Sigma_{\ i = 1 \text{ to } n}\ [(((p_{(i,t)} - p_{(i,t-1)}) /\ p_{(i,t-1)}) \times 100) \times (p_{(i,t-1)} \times q_{(i,t-1)})]\}$$

$$\leq\ CP_{(t)} \qquad \text{(A.5a)}$$

Note 4: The fraction $[1/\ (\mathbf{p}_{t-1}\mathbf{q}_{t-1})]$ *appears in every term i=1, ... ,n and may therefore be taken outside and premultiplied into the remainder of the expression.*

Note 5: The expression in (A.5a) can also be written as $L \leq 1 +$ $CP_{(t)}$, where L is the Laspeyre index of price changes:

$L = [\ \Sigma_{\ i = 1 \text{ to } n}\ (p_{(i,t)} \times q_{(i,t-1)})]/\ \mathbf{p}_{t-1}\mathbf{q}_{t-1}$

which measures the change in prices with reference to the most recent (last period) quantity data. Alternatively it measures the change in expenditure due to price changes associated with last year's output levels. In periods of inflation the value of L exceeds 1, in periods of deflation L would be less than 1. In the absence of inflation this implies that the weighted average of the prices changes in the specific set cannot exceed the controlling percentage (or alternatively must decline in real terms where x is positive).

The expression in (A.5a) is also the same as:

$\{\Sigma_{\ i = 1 \text{ to } n}\ [(((p_{(i,t)} - p_{(i,t-1)})/\ p_{(i,t-1)}) \times 100) \times (p_{(i,t-1)} \times q_{(i,t-1)})]\}$

$\leq\ CP_{(t)} \times \mathbf{p}_{t-1}\mathbf{q}_{t-1}$ (A.5b)

Note 6: By multiplying both sides of (A.5a) by $\mathbf{p}_{t-1}\mathbf{q}_{t-1}$ *this leads to the expression in (A.5b). The expression on the left hand side of the inequality in (A.5b) states that the percentage change in price for service i in the current price control year multiplied by the <u>reported revenue</u> associated with service i in the year <u>preceding</u> the current price control year summed over all the services in the specific set shall not exceed the total revenue associated with services in the specific set in the year preceding the current price control year multiplied by the controlling percentage.*

Note 7: By multiplying both sides of (A.5a) by $\mathbf{p}_{t-1}\mathbf{q}_{t-1}$ *this leads to the expression in (A.*

If the controlling percentage is known, compliance requires use of information about (i) price changes in the current price control year and (ii) revenues for services in the specific set for the year preceding the current price control year.

The controlling percentage is expressed algebraically as follows:

$CP_{(t)} = \Delta\ IRP_{\ (t-1)} - x_{\ (t)} + C0_{\ (t-1)}$ (A.6)

The expression for the controlling percentage in (A.6) contains three variables: (i) inflation Δ IRP $_{(t-1)}$ as measured by the index of retail prices IRP, (ii) an offset factor x determined by the Authority to be equal to 3 in each current price control year and (iii) a 'carry-over' factor C0 $_{(t-1)}$ which allows any unused price change allowances to be transferred from one year to the next. These are described further below.

$x_{(t)} = 3.0\%$ (A.7)

$\Delta IRP_{(t-1)}$: shall be measured as the year-on-year percentage change (from March to March) in the Index of Retail Prices, compiled and published by the Statistics Office of the Government of Gibraltar, which shall be defined as:

$$\Delta IRP_{(t-1)} = ((IRP_{(t-1)} - IRP_{(t-2)})/(IRP_{(t-2)})) \times 100 \quad \text{(A.8)}$$

where

(t-2): is the year preceding (t-1)

$IRP_{(t-2)}$: is the Index of Retail Prices for the month of March of the year (t-2)

$IRP_{(t-1)}$: is the Index of Retail Prices for the month of March of the year (t-1)

$CO_{(t-1)}$: is the percentage of the unused part (if any) of the allowed revenue increase in year (t-1) carried over to year (t), which is calculated as follows:

$$CO_{(t-1)} = [\Delta IRP_{(t-2)} - x_{(t)}] - [(RC_{(t-1)}/RR_{(t-2)}) \times 100] \quad \text{(A.9)}$$

where

$RC_{(t)}$: the total Revenue Change, which is calculated as follows:

$$RC_{(t)} = \Sigma_{i = 1 \text{ to } n} RC_{(i,t)}$$

and

$RC_{(i,t)}$: is the revenue change of the *i*-th service in year (t), which is calculated as follows:

$RC_{(i,\,t)} = RR_{(i,\,t\text{-}1)} \times \Delta P_{(i,\,t)}$

and

$RR_{(i,\,t\text{-}1)}$: is the Reported Revenue of Gibtelecom for the *i*-th service in the specific set from the year preceding the current Price Control Year, starting with revenue over the period 1 May, 2008 through 30 April 2009 for the first year, and 1 May through 30 April for each subsequent 12 month period for the duration of the Price control period.

$RR_{(t\text{-}1)}$: is the reported revenue of Gibtelecom, in preceding year to the Price Control Year, of the specific set of services, and is calculated as follows:

$$RR_{(t-1)} = \Sigma_{\,i = 1 \text{ to } n}\, RR_{(i,\,t-1)} = \mathbf{p}_{t-1}\mathbf{q}_{t-1}$$

In the RPCC the retail price control was expressed (see equation (4.1)) in the following way:

$$(RC_{(t)}/RR_{(t-1)}) \times 100 \leq \Delta\ IRP_{(t-1)} - X_{(t)} + C0_{(t-1)} = CP_{(t)} \quad (A.10)$$

The above expression is exactly the same as that derived in (A.5b) above. To see this note that (A.10) can be rewritten as:

$$RC_{(t)} \times 100 \leq CP_{(t)} \times \mathbf{p}_{t-1}\mathbf{q}_{t-1} \qquad (A.10a)$$

Noting $RC_{(t)} = \Sigma_{\,i = 1 \text{ to } n}\, RC_{(i,t)}$ the above can be written as:

$$\Sigma_{\,i = 1 \text{ to } n}\, RC_{(i,t)} \times 100 \leq CP_{(t)} \times \mathbf{p}_{t-1}\mathbf{q}_{t-1} \qquad (A.10b)$$

Noting $RC_{(i,t)} = \Delta P_{(i, t)} \times RR_{(i, t-1)}$ (A.10b) can be rewritten as:

$$\Sigma_{i = 1 \text{ to } n} \Delta P_{(i, t)} \times RR_{(i, t-1)} \times 100 \leq CP_{(t)} \times \mathbf{p}_{t-1}\mathbf{q}_{t-1} \qquad \text{(A.10c)}$$

Finally, given

$$RR_{(i, t-1)} = p_{(i,t-1)} \times q_{(i,t-1)}$$

Is the reported revenue in the previous year it can be seen that the expression in (A.10c) is identical to that in (A.5b).

A.3 Exchange line rental sub-caps

In addition to the overall retail price cap above, Gibtelecom shall also comply with:

(a) A residential sub-cap consisting of line rental for the basic telephone service.

(b) The annual rate increase for the residential sub-cap shall be set to satisfy the criteria in the formula below:

$$\Delta IRP_{(t-1)} + x_{(t)}$$

where $x_{(t)} = 2.0\%$

and comply with;

(c) A non-residential (business) sub-cap consisting of line rental for the basic telephone service.

(d) The annual rate increase for the non-residential (business) line rental sub-cap shall be set to satisfy the criteria in the formula below:

$$\Delta IRP_{(t-1)} + x_{(t)}$$

where $x_{(t)} = 5.0\%$

A.4 Carryover

Gibtelecom shall be allowed to carry over to the next Price Control Year any unused part of the allowed tariff increase in the current Price Control Year. The unused part of the allowed tariff increase in both the overall cap and the exchange line rental sub-caps in the current Price Control Year will lapse if not used in the next price control year. The value of carry over in 2009 shall be zero.

A.5 Guidelines for compliance with the retail price controls

Gibtelecom shall comply with the Transparency SMP obligations set out in Decision 05/08 issued 8th August 2008. The Authority may veto notified tariffs where proposed tariff changes fail to comply with the terms of the retail price control obligation in this Decision. Gibtelecom shall submit to the Authority a written statement of compliance no later than four months after each full year of the application of retail price controls. The compliance statement shall apply to the previous twelve months. Gibtelecom is expected to supply the Authority with at least three compliance statements over the duration of the SMP obligations in these markets.

In Table 6 the Authority provides a hypothetical illustration of how compliance may be demonstrated to the Authority in practice. The Authority emphasises the illustrative nature of the example below. Gibtelecom shall be free to choose any method for demonstrating compliance with the obligations in this Decision. The data shown in Table 6 would have been presented to the Authority no later than 31 March 2008, on the assumption the Price Control Year starts 1 January each year and inflation is measured with reference to the price index three months prior to the start of the Price Control Year. Gibtelecom shall use a measure of inflation over a twelve month period starting three months prior to the start of the price control year.

Table 6 Price-cap compliance for price control year 2007 (illustrative data)

The steps in assessing compliance with the retail price controls			
A	October 2006 IRP		114.74
B	October 2007 IRP		117.41
C	Percentage increase in IRP (inflation)		2.3%
D	Productivity offset factor x		3.0%
E	IRP – x	C – D	-0.7%
F	Carryover of excess reductions from 2006		0.9%
G	Controlling percentage	E + F	0.2%

H	2006 revenue earned from sales of the specific set of services (reported in 2007) (this is expression (A.3) above)		£11.1m
I	Maximum allowable change in revenue for the specific set of services (this is the right hand side of expression (A.5b) above)	G x H	£22,200
J	Maximum allowable regulated revenue 2007	H + I	£11,122,200
K	Regulated revenue change as a result of price changes using 2006 regulated quantities (left hand side of expression (A.5b) above)		£5,000
L	Regulated revenue in the current price control year 2007	H+K	£11,105,000
M	Percentage increase in regulated revenue	(L − H)/H x 100	0.05%

<u>Steps in the compliance illustrative framework</u>

1. The first part of compliance requires information about the inflation rate to apply in the price cap. This is obtained from published official data sources and shown in **Rows A, B** and **C**.

2. **Row D** shows the value of x used in the retail price control formula and **Row E** shows the difference between the rate of inflation and the value of x. In this case the value is negative – which means that retail prices should on a weighted average basis fall in real terms. Put differently, the revenue weighted average nominal price changes for the services in the specific set should be negative. Note that the revenue weights in the current price control year make use of quantities in the year <u>preceding</u> the current price control year.

3. **Row F** is the carryover from the previous year, here assumed to be 0.9%. In other words, the weighted average nominal price change for services in the specific set was 0.9% below the value permitted under the retail price control applying in the preceding year. If 2007 were the first year of the retail price control, the carryover value would be equal to zero. In the retail price control price cap described in this Decision the value of carryover is zero for 2009.

4. **Row G** is the controlling percentage and represents the cap applied to the weighted average price changes for the services in the specific set.

5. The next rows provide guidance on the range of price changes compatible with the controlling percentage. **Row H** states the revenue reported earned from sales of services in the specific set in 2006. **Row I** is the maximum allowable change in revenue for the specific set of services evaluated using

the quantities from the previous year – this is the value associated with the right hand side of expression (A.5b) above. **Row J** is the maximum allowable regulated revenue permitted for the specific set in the current price control year 2007 based on the quantities in the previous year.

Note 7: The price control essentially controls price changes by reference to quantities from the previous year. In this respect it is applying a Laspeyre price index, see Note 5 above.

6. **Row K** is the measure of the change in revenue arising from actual price changes in the current price control year based on the quantities applicable in the previous year. This is the left hand side of expression (A.5b) above.

7. **Row L** measures the revenue associated with services in the specific set, with the revenue in the current price control year evaluated using prices in the current price control year and quantities in the previous year.

8. **Row M** is the measure of the percentage change in revenue associated with services in the specific set between the current price control year and the previous year.

Compliance is met if the value in Row M is less than the value in Row G. It is seen in Table 6 that compliance is achieved in the hypothetical example as Row G is 0.2% and Row M is 0.05%.

A.6 Within the current price control year price changes

Gibtelecom shall take all reasonable steps to ensure that the revenue it accrues as a result of individual tariff changes during a Price Control Year are no more than that which would have accrued had all of those tariff changes been made at 1st January in the Price Control Year (or where the price control year starts after 1st January, on the applicable date at the start of the Price Control Year).

In the case of a single change (for the purposes of understanding the formula below it is helpful to consider the price change as a price increase) in charges within the Price Control Year, the following formula should be satisfied:

$$RC_{(i,\,t)}\,(1-D) \leq TRC \qquad \text{(A.11)}$$

Where D is the elapsed proportion of the Price Control Year, calculated as the date on which the change in charges takes effect, expressed as a numeric entity on a scale ranging from 1st January = 0 to 31st December = 364, divided by 365. In the case of a leap year it is calculated as the date on which the change in charges takes effect, expressed as a numeric entity on a scale ranging from 1st January = 0 to 31st December = 365, divided by 366;[12] and

12 Where the Price Control Year starts at a date later than 1st January, the value 0 will be assigned to the start date of the Price Control Year and a value determined by the number of days between the start and end dates of the Price Control Year shall apply.

TRC is the target revenue change required in the Price Control Year to achieve compliance (equivalent to **Row I** in Table 6 above), calculated by the Percentage Change required in the Price Control Year multiplied by the revenue accrued during the Relevant Financial Year.

Note 8: If the specific set comprised a single service and its price were required to increase by no more than the rate of inflation less 3 and the regulated firm increased price by this amount on 31st December, then for 364 days of the year there would not have been any price increase in effect (that is D=364). As a result (1-D) would be close to zero and the amount of unused revenue carried over to the next price control year would be relatively large.

Annex B. Treatment of fixed-mobile retail services

The following reproduces the note written by the Authority's consultant Dr Chris Doyle, Apex Economics submitted to Gibtelecom on 18th November 2008.

Note on mobile termination and implementation of Retail Price Controls

By Chris Doyle, Consultant for the Gibraltar Regulatory Authority

Explanatory note

1. A number of queries regarding the proposed retail price control[13] and mobile termination were raised in a stakeholder workshop held between the Authority and Gibtelecom on Friday 24 October.

2. One issue concerned an alleged occurrence of 'circularity'.

3. It was observed by Gibtelecom that the weighted average mobile termination charge is calculated by the Authority by deducting the cost of call origination from the retail price of a call to a mobile handset. In other words, the amount billed for a call to a mobile handset is assumed to flow to the mobile operator less any charge levied by the originating network (i.e. call origination charges).

4. Call origination charges for calls from the domestic fixed and mobile networks are assumed equal to the wholesale interconnection cost as specified in the Reference Interconnection Offer (RIO) plus 10% to reflect a contribution to other (overhead) costs.

5. In Public Consultation 06/08 which deals with regulation of retail calls and access in the fixed network it is stated:[14]

   (i) "The Authority proposes to control in effect only the amount in the price of calls to mobiles that Gibtelecom retains (the retention rate). This would be achieved in practice by creating a "cost-pass through" for the cost of mobile termination for Gibtelecom. In calculating the application of the price control rules, the Authority would count the cost of mobile termination as a cost incurred by Gibtelecom and deduct this total amount from the revenue used in the price control compliance calculation.

   (ii) Adopting this approach means that when the cost of mobile termination falls due to regulation, if the retail prices of calls to mobile remain unchanged, then by implication this would be treated as a

13 "Retail Price Controls – Application of Rebalancing and a Price Cap Control on Gibtelecom", Public Consultation 06/08, GRA.

14 See page 35.

price increase as Gibtelecom's retention rate would have increased. In this setting Gibtelecom would need to lower either: the retention rate (and hence the retail price of fixed to mobile calls) and/or lower the prices of other services in the services basket. This approach does not guarantee a one-for-one pass through of reductions in mobile termination rates.

(iii) The Authority regards this to be the best solution, since it is relatively simple and straightforward, removes mobile termination revenues from the regulated basket and does not alter the simple way in which the price cap works".

6. The retention rate is the amount of revenue retained by the originating fixed network. This amount is hypothetical and does not necessarily correspond to the call origination charge as set out in the RIO.

7. It was suggested by Gibtelecom that circularity arises because:

(i) as the cost of termination falls due to regulation it follows

(ii) that call retention (the amount retained by the fixed operator) increases, but if

(iii) retail price controls of regulated fixed calls result in fixed to mobile charges declining (passing through the lower cost of mobile termination), then

(iv) call termination will be lower which implies that

(v) call retention increases and so on.

8. The Authority does not regard circularity to be an issue. It appears that a misunderstanding about the form of price controls proposed has led to the suggestion of circularity. This note is intended to clarify the issue and demonstrate why circularity would not arise.

9. In the market review[15] examining call termination charges an SMP obligation requires that the mobile termination charge should decline as follows:

(i) From January 1, 2009, the <u>maximum price</u> of the termination of a voice call on Gibtelecom shall not exceed 9.5 pence per minute.

(ii) from January 1, 2010, the <u>maximum price</u> of the termination of a voice call on Gibtelecom shall not exceed 8.5 pence per minute.

(iii) from January 1, 2011, the <u>maximum price</u> of the termination of a voice call on Gibtelecom shall not exceed 7.5 pence per minute.

15 "Decision and SMP Obligations – Wholesale Mobile Markets", Decision Notice 03/08, 11 August 2008, GRA.

10. In Decision Notice 03/08 the Authority calculated the weighted average mobile termination rate at 9.6ppm (rounded). The Authority wishes to clarify that the calculated weighted average termination rate was undertaken to guide it towards identifying an appropriate ceiling for all mobile termination rates.

11. The weighted average termination rate is calculated by deducting call origination charges from retail prices, then multiplying by the traffic share (the weight).

12. Call origination charges are taken from the RIO at 1.8ppm in the Standard period and 1.3ppm in the Cheap period, plus 10% for a contribution to overhead costs.

13. In Decision Notice 04/08[16] dealing with wholesale fixed markets, the following SMP obligation applies to call origination charges:

    (i) "Gibtelecom shall charge as a cost on its profit and loss accounts a fee not exceeding 1.8 pence per minute plus 10%, as a contribution to other costs incurred on the fixed network, on average for calls destined to terminate on an authorised national mobile network in Gibraltar. The average shall be calculated using weights based on revenues."

14. Consider a call from the fixed Gibtelecom network to the mobile Gibwireless network in the Standard period:

    (i) This currently costs 16ppm. In calculations performed by the Authority 1.8ppm plus an overhead contribution 0.1 x 1.8 = 0.18ppm comprises the per minute call origination charge: 1.98ppm.

    (ii) The Authority computed that termination revenue is equivalent to 13.37ppm.

15. Consider a call from the fixed Gibtelecom network to the mobile Gibwireless network in the Cheap period:

    (i) This currently costs 14ppm. In calculations performed by the Authority 1.3ppm plus an overhead contribution 0.1 x 1.3 = 0.13ppm comprises the per minute call origination charge: 1.43ppm.

    (ii) The Authority computed that the termination revenue is equivalent to 12.06ppm.

16. In January 2009 the maximum mobile termination rate is required to be no higher than 9.5ppm.

17. Therefore termination rates for calls to the mobile network will need to fall to a level no higher than 9.5ppm on 1 January 2009.[17]

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16 "Decision and SMP Obligations – Wholesale Fixed Markets", Decision Notice No. 04/08, 11 August 2008, GRA.

17 Note that the implied termination charges of mobile to mobile calls already comply with the SMP obligation.

18. Although the current (2008) weighted average mobile termination rate is 9.6ppm, the Authority notes that the termination charges implicitly levied for calls originating on the fixed network are significantly above 9.6ppm. The SMP obligation on mobile termination rates requires that these charges shall not exceed 9.5ppm from 1 January 2009.

19. In the absence of merchant transactions in the wholesale mobile termination market[18], the Authority shall assume that the fixed to mobile termination charge will be 9.5ppm on 1 January 2009.

20. It shall also be assumed by the Authority that the call origination charge levied by Gibtelecom for a fixed to mobile call in the Standard period shall be 1.98ppm (rounded to 2ppm) and in the Cheap period wholesale call origination costs would be 1.43ppm (rounded to 1.5ppm).

21. Instead of incorporating mobile retention rates within the broad price cap, the Authority shall apply a price control on fixed to mobile services in the form of cost orientation requirement (as permitted under Section 38(8)a of the Communications Act 2006). Gibtelecom shall demonstrate compliance by reference to the three main cost components of the services:

    (i) Wholesale fixed call origination which is subject to a SMP price control obligation;

    (ii) Wholesale mobile termination which is also subject to a SMP price control obligation; and

    (iii) Other costs (such as a proportion of overheads).

    Given the wholesale SMP price control obligations in (i) and (ii) above and information about other costs in (iii), the Authority shall determine whether Gibtelecom is compliant with a cost orientation obligation for these retail services. This process may require Gibtelecom to provide the Authority upon written request with sufficiently detailed cost accounts for fixed to mobile voice call services.

22. Gibtelecom shall be free to set retail fixed to mobile calling charges at rates which are compliant with the relevant retail SMP obligations.

23. Circularity does not arise.

24. Further, the Authority shall remove reference to the fixed to mobile retention rate in its forthcoming Statement on retail SMP obligations.

25. Consequently the regulated revenues in the fixed retail market review shall not include fixed to mobile retention revenues.

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18 Wholesale merchant transactions are likely to occur in the future following the grant of a third generation mobile services licence to CTS (Gibraltar) Limited on 2 March 2009.

26. The Authority notes that the combined effect of SMP obligations adopted in both the wholesale fixed and mobile markets require changes to retail charges set for fixed to mobile calls.

27. Implementation of the SMP obligations should be consistent with the result of the computations shown above in paragraph 23.

End

Annex C. Further explanation on the price control applied to mobile voice call termination services supplied by Gibtelecom

In a letter to the Authority, dated 26 February 2009, Gibtelecom elaborates at length about the regulatory treatment of fixed to mobile calls. An SMP obligation applicable to mobile voice call termination services is a price control. The price control was first outlined in the Authority's Consultation Document 03/07 published 10 April 2007.

In the Consultation Document 03/07 the Authority proposed that mobile voice call termination services would decline in price by 3 pence per minute (on average) over two years.[19] The average was to be measured by taking account of traffic in the Standard and Cheap periods, as the Authority took account of the fact Gibtelecom applies different fixed to mobile tariffs in these periods.

The Authority holds the view that the cost of terminating voice calls onto the mobile network ought to be invariant to the type of originating network used to place a call. However, the Authority was prepared to accommodate price flexibility over the different time periods used by Gibtelecom in setting retail rates, and this was the reason for making use of a weighted average.

In response to the consultation Gibtelecom raised a number of points. In particular, it criticised the Authority for not taking account of voice calls terminating on the mobile network that originated on the mobile network. In the Authority's response to consultation and notification to the European Commission, document 15/07 published 31 October 2007, mobile to mobile calls were taken into account within a proposed modified price control.

In Table 16 on page 65 and in the preceding paragraph to Table 16 the Authority highlighted the revised form of the price control was to apply to mobile voice call termination in a way that is identical to that applied by Arcep (the French NRA). Hence the Authority placed a ceiling on mobile voice call termination rates by use of the word 'maximum'. The price control was extended over a three year period and was expected to start in 2008.

The Authority removed reference to average (that is the average over Standard and Cheap), because assessment of the mobile to mobile call termination costs were seen to be invariant across these periods and importantly the costs of termination were below those associated with calls originating on the domestic fixed network.

Nevertheless, the Authority continued to admit the possibility for variation in termination rates across the time periods Standard and Cheap. In document 15/07 this was presented in analysis surrounding Table 18 on page 68. In a footnote (footnote number 95) to Table 18 it was stated:

"The Authority has not differentiated the termination rate across Standard and Cheap. However, it would be possible for Gibwireless to set differential rates as long as the weighted average rate is no higher than the ceiling stipulated."

19 See Table 7 on page 47 of Consultation Document 03/07.

Thus the price control proposed would admit the possibility for Gibtelecom to set voice call mobile termination rates in one period (say Standard) above the maximum, as long as the rate in the other period (say Cheap) were below the ceiling and the weighted average of the two rates did not exceed the ceiling.

In the Decision Notice 03/08 published on 11 August 2008, the Authority stated the price control SMP obligation that would apply. The details of the price control were presented on page 10 in Decision Notice 03/08. This reiterated the Authority's application of a maximum charge alongside the possibility for variation across time periods.

An annex to Decision Notice 03/08 elaborated further factors used by the Authority in formulating the price control. In this annex the weighted average cost of terminating calls on the mobile network were calculated and this was shown to be 9.58 pence per minute. Table A4 in the Annex included the cost of calls originating on networks licensed outside Gibraltar that terminate on Gibtelecom's mobile network.

According to data provided by Gibtelecom, some 21.7% of calls terminating on the mobile network originate from carriers licensed outside of the territory. It was also stated by Gibtelecom that the charge levied for the termination of these calls was 5.64 pence per minute over the period assessed.

The account of the different sources of calls terminating on the mobile network led to a lower estimate for the weighted average cost of termination on the mobile network of 9.58 pence per minute. More significantly, the additional traffic was evidently terminating onto the mobile network at charges significantly below those levied for calls originating on the domestic networks (fixed and mobile).

The Authority has always sought to apply the principle of technological neutrality and in this regard it supports symmetry in wholesale charges for calls originating from different networks, as these, within the same time period, ought to impose the same costs onto the receiving network.

Gibtelecom, on page 3 of its 26 February 2009 letter claims that the approach adopted by the Authority for wholesale voice call termination price control differs from that applied in the control of prices for wholesale call origination. This claim is erroneous.

The Authority uses a weighted average for wholesale call origination charges on the same fixed network, where the weights are based on revenues over different time periods (Standard and Cheap). The same weights could be applied in the Authority's price control applicable in wholesale voice call termination.

Gibtelecom also asserts in its letter that the Authority "reached another conclusion that the LRIC cost of MTR is 8.25ppm". In fact the Authority stated it believed on the basis of its assessment of available evidence (retail rates in pre-paid mobile) that the mobile termination rate was <u>no higher</u> than 8.25 pence per minute (see for example the highlighted statement on page 46 in Document 15/07).

Gibtelecom claims that the effect of the price control ceiling will be to lower the weighted average (as measured according to weights derived from the minutes of originating traffic on fixed, mobile and international networks) mobile termination charge in each of the three years of its application to a level below the ceiling required. Gibtelecom has presented the Authority with computations demonstrating this effect (Appendix A of the Gibtelecom letter 26 February 2009).

The Authority is not surprised by the workings presented by Gibtelecom, as some charges for termination lie below the ceiling and this will necessarily lead to an average, based on the weights used, which lies below the ceiling.

The purpose of the price control is to lead to prices that are cost orientated. The Authority maintains the position that this is achieved effectively by placing a price ceiling on mobile voice call termination services – which is non-discriminatory across the type of originating network (technologically neutral).

The Authority is not persuaded on the basis of the claims made by Gibtelecom in its letter of 26 February 2009 to amend the form of the wholesale price control applied to mobile voice call termination services. The Authority maintains it has been transparent throughout the process.

Gibtelecom also raised the issue of currency variation in its letter of 26 February 2009. In particular it notes that the value of sterling has fallen considerably over the last year against the Euro and other leading currencies, as a result of the credit crisis. The change in the value of sterling means that termination rates in Gibraltar do not look as high against Euro denominated currencies as previously.

As the Authority relied in part on international benchmarking to formulate the SMP obligation, the matter raised by Gibtelecom needs to be addressed. When performing the benchmarking the Authority did not anticipate the prospect of currency variations of the magnitude experienced. Having noted this, the Authority did not receive compelling arguments against the use of the rate of exchange applied in its benchmarking analysis.

Sterling has fallen against the Euro exchange rate used in the Decision by around 25%. However, while some of Gibtelecom's costs may have increased as a result – there is little reason to believe the costs of terminating voice calls on the mobile network would have increased by anywhere near this amount.

In the absence of detailed cost data on the LRIC of mobile voice call termination, which the Authority believes Gibtelecom could compile, the Authority shall continue to enforce the SMP obligations as published in Decision 03/08.