

26 May 2010

Gibraltar Regulatory Authority
Attn. Mr John Paul Rodriguez
Head of Regulation
Suite 603
Europort
Gibraltar

Dear John Paul,

Public Consultation 03/10 Price cap control compliance

Enclosed please find Gibtelecom's response to the GRA's latest public consultation on price cap control compliance (Public Consultation 03/10).

Gibtelecom has some concerns with the timing of the Authority's public consultation, which was published four days before the first price cap year ends. As such, Gibtelecom is providing some comments on the impact of this, together with the effects of the additional time required to release the resulting decision notice.

In the enclosed response, Gibtelecom also comments on the applicability of the penalties for non-compliance being proposed, together with the controls on fixed to mobile retail prices. The Company has recently submitted to the Authority an independently audited mobile accounting separation report (ASR) which shows that Gibtelecom's wholesale mobile voice termination rate is 9.52p/min. This information was previously not available and presumably this is the reason why the Authority calculated an implied mobile termination rate, using this to impose a glide path fixed to mobile retail price control on the Company. By now having identified a more accurate wholesale mobile termination rate, reflective of the service's true costs, Gibtelecom considers that the Authority should now employ this rate in its control compliance procedures.

Yours sincerely,



Dwayne Lara
Regulatory Manager

Enc.



Gibtelecom Response to the Public Consultation 03/10

Price cap control compliance

26 May 2010

Gibtelecom Response to GRA price cap control compliance public consultation

In response to Public Consultation 03/10 on price cap control compliance forming part of the Significant Market Power (SMP) obligations described but not defined in detail in Decision Notice 05/08 issued by the Gibraltar Regulatory Authority (GRA) on 11 August 2008 (itself the outcome of the market analysis undertaken in the GRA's Retail Fixed Markets public consultation initiated 10 April 2007), and subsequent GRA Decision Notice 03/09 – SMP obligations in relevant fixed markets – application of rebalancing and a price cap control on Gibtelecom – the Company is pleased to present its comments.

Q1: Do you agree that the deadline for the compliance statement should be four months after the end of each price control year? If not, please give reasons for your answer.

Gibtelecom is concerned with the timing of this public consultation, being issued very close to the end of the first control year (ending 30 April 2010) with a closing date for comments of 26 May 2010. As a result, for the first price control year at least, Gibtelecom would be working to a much tighter timescale than is being proposed for each of the three years the price caps are in place. Furthermore, the Company is not aware when the Authority will publish the resulting decision notice arising from this public consultation. On the assumption that this may take at least an additional month from the date the public consultation closes (i.e. the decision notice will be published at the end of June 2010) then in effect Gibtelecom would now only have two months (July and August 2010) to populate, prepare and submit the compliance documents, rather than the originally suggested four. This issue could be compounded if the decision notice takes even longer to be released. In trying to ameliorate the burden a reduced timescale for the first control year could impose on the Company, the Authority proposes to keep any additional information provision requirements to a minimum. Gibtelecom welcomes this move, however, given the current uncertainties surrounding the timing of the public consultation/decision notice process and the resulting Authority's pronouncements, it would not be appropriate for the Company at this stage to comment on the feasibility of having a four month deadline for the first price control year. Gibtelecom would therefore ask the Authority give consideration to extending the deadline for the submission of compliance documentation for this year (the first price control year). Such points should be set out and clarified in any resulting decision notice following this public consultation.

Looking forward, and as would have been the case for the first year under more normal circumstances, Gibtelecom does not currently foresee any operational issues in submitting a compliance statement within four months after the end of each price year, i.e. by the end of August.

Q2: Do you agree that the compliance statement should refer to the calendar year which corresponds to two years prior to the end of the price control year? If not, please give reasons for your answer.

Gibtelecom is not clear on the Authority's statement that "the compliance statement shall make use of **regulatory accounts data** [emphasis added]..."¹, as this could imply that Gibtelecom has to rely on information contained in the annual regulated accounting separation report (ASR) provided to the Authority. If this is the case the Authority should be

¹ Third paragraph of page 13 of Public Consultation 03/10

aware that the purposes, and data, behind an ASR are completely different to that meant to demonstrate compliance. The ASR does identify some of the information required, but not all or in the separations required (for example, the ASR cannot identify a split between business and residential line rental revenue). If what the Authority is seeking is to have any financial or statistical information to be submitted as part of the compliance procedure to have gone through an independent verification process then it would make more sense to rely on the information used to build the statutory audited financial statements produced every year. If this is the case then Gibtelecom has no objection in principle to having the compliance statements refer to such information and for the period suggested, that is to say, for the financial year ended 31 December two years prior to the end of the control year.

Q3: Do you also agree that for the first year a reduced amount of data should be required from Gibtelecom in order to confirm compliance with the price controls? If not, please give reasons for your answer.

Given the timing of the public consultation Gibtelecom considers it would not be reasonable to subject the Company to additional information and compliance requirements if these were to impact the delivery of the first compliance statement by 31 August 2010. The Authority proposes to get round this by requiring a reduced amount of data for the first year. Gibtelecom points the Authority to its response to Q1 above.

Q4: Do you agree with the GRA inserting values in steps A-E and for Gibtelecom to make clear its position on these values? Do you agree that one party should notify the other party of any disagreement with the inserted values within ten business days? If not, please give reasons for your answer

Gibtelecom is content with having the values in fields A to E of forms PCY1 through PCY3 (one for each price control year) filled in by the Authority, with the Company making clear its position on the values. Having said this, it is not clear from the public consultation at which point the Authority intends to issue the form for the first price control year to Gibtelecom for checking. Will this be done once the resulting decision notice is published? The Authority also mentions that it will subsequently provide Gibtelecom with the form for the ensuing price control year, PCY2, once Gibtelecom submits the compliance statement for year 1. Can the GRA provide more details on the exact timing for the provision of the PCY2 and PCY3 forms?

With regards the actual notification timescales, Gibtelecom believes it would be able to meet the ten business day's deadline. To provide greater regulatory certainty and consistency, can Gibtelecom assume that the Authority would also be subjected to the same timescale should it query any of the values filled in by Gibtelecom under fields F through L?

Q5: Do you agree with the proposed way of measuring inflation in the retail price control compliance statement? If not, please give reasons for your answer.

Although there are a number of different ways inflation rates across predetermined periods could be calculated Gibtelecom considers the approach adopted by the Authority to be relatively straightforward and providing greater regulatory certainty than was previously the case under public consultation 06/08 and decision notice 03/09.

Gibtelecom would like to point out that there are a number of typing and arithmetical errors in the calculations for inflation rates put forward by the Authority. Under the table "Data

used to compute inflation in Form PCY1” on page 17 of the public consultation document, the indices for the quarters ending October 2008, January 2009, April 2009, July 2009, October 2009 and January 2010 as quoted are incorrect. These should be 126.08, 124.13, 126.28, 129.12, 129.66 and 128.41 respectively. Even though the Authority's index figures are incorrect, the percentage change over the last 12 months column appears unaffected. In addition, the Authority's calculation for the inflation rate to be used for Form PCY2 on page 18 show a minor arithmetical error. This figure should be 3.18% instead of 3.16%. Corrections to this figure should also therefore be made where these are needed across the public consultation, for instance under the **“Step C”** paragraph of page 18, amongst others.

Q6: Do you agree with the proposed penalties for dealing with non-compliance? If not, please give reasons for your answer.

Gibtelecom does not agree with the proposed penalties for dealing with non-compliance.

The compliance procedure is based on the premise of having a limited carryover privilege of one year. The Authority has previously indicated that any positive carryover not used in the subsequent year would be lost. In prior correspondence (for example the Company's reply to Q.10 of the Authority's public consultation document 06/08) Gibtelecom has argued for an extended carryover period to balance out the highs and lows of any inflationary pressures in the future. The Authority should be aware that by keeping carryover to a very limited time (currently one year) this could have an undesired effect on pricing in times where the retail price indices (RPI) are above the offset productivity factor (i.e. where RPIs are higher than 3%). As an example, suppose a regulated firm were not to increase prices for a price control year when the RPI is higher than the offset productivity factor. Customers have in effect obtained a price reduction in real terms. The positive carryover would then be taken forward to the next price control year, but not the next. In this case, there is an obvious greater incentive for the regulated firm to increase prices in the year of carryover to make use of the soon-to-be-expired carryover. Gibtelecom therefore requests that the Authority consider having a system in place which will allow regulated firms the benefit of using positive carryovers over more than one year. By restricting carryover to one year, Gibtelecom could find itself in a position where it would be looking into carrying out a review of the charges for those services under the regulated basket, with a view to making full use of the year's available carryover.

The Authority is now proposing a second form of carryover which may not be consistent with its own views on positive carryovers. Should a regulated firm fail to comply with the price controls for a particular year but demonstrates that it reasonably anticipated to meet the price controls then a negative carryover will be taken forward to the next control year (If the regulated firm were not able to demonstrate that it reasonably expected to meet the price controls then the Authority proposes to reimburse customers with the difference, together with taking forward the negative carryover to the next year). The Authority then goes on to state that should compliance not be achieved in two consecutive years (and the regulated firm cannot demonstrate that it reasonably anticipated to meet compliance) then the Authority proposes a reimbursement to customers of three times the difference. In addition, the Authority would mandate that the negative carryover is taken forward to the next year. Does this mean that, unlike the one year limited positive carryover privilege, negative carryovers can be moved across more than one year? Gibtelecom also questions the apparent arbitrary reimbursement figures being put forward, together with the practicality and logistics of having to carry out such an exercise. For instance, should compliance not be met for any reason, this would be show under form PCY as a general

non-compliance, and not specific to any particular service under the regulated basket of services. In the unlikely event a refund to customers were to be required, how does the Authority propose to handle the identification of which service the refund relates to?

Furthermore, Gibtelecom would like to point out that there should also be a mechanism in place to allow for minor differences in price control compliance calculations. For example, it would not be practicable in the real world for a regulated firm to reduce the price of a particular service by an amount such as 1.2356p in order to be compliant with the price controls. Instead, the regulated firm will either decrease the price by a more rounded figure such 1p, 1.5p or even 2p. By doing so, it may turn out that when it comes to preparing the compliance statements, the regulated firm may be 'out' by a small or fraction of a percentage when comparing against the maximum allowable revenue change for that year. Gibtelecom suggests that there should therefore be some kind of flexibility factored into the compliance for materiality purposes.

Q7: Do you agree with the GRA's proposal to make use of calendar year regulated accounting data for revenue? Do you also agree with the non-disclosure of the data supplied in the final two columns of Form 1A? If not, please give reasons for your answers.

Please refer to the Company's response to Q2.

With regards the non-disclosure of the data supplied in the final two columns of Form 1A, this information is commercially sensitive. Gibtelecom therefore agrees with the Authority's proposal not to have this information made public or disclosed to third parties.

Q8: Do you agree with the GRA's methodology in calculating the figures in Form 1A? If not, please give reasons for your answers.

Gibtelecom does not see any major issues with the Authority's proposed methodology for calculating the figures in form 1A as long as account is taken of changes in volume². However, the Company's comments under this particular question should be read in conjunction with the responses to Questions 2 above together with 9 and 10 below.

Q9: Do you agree with the GRA's methodology for computing the change in price of fixed to fixed domestic calls? Do you agree with the GRA's proposal to make use of a simple arithmetic average in the absence of readily available data about minutes of traffic across the three calling periods for fixed to fixed domestic calls? If not, please give reasons for your answers.

Gibtelecom does not see any major issues with the way the Authority proposes to compute the price changes of fixed to fixed calls, although unlike for the compliance requirements for other services within the regulated basket, there is no scope to handle more than one change in prices over a particular year, should this be the case (There are fields only for Starting Price and Year Price). For example, forms PCY1, 1C, SCRA and SCBA all capture such changes via an average or weighting according to the time of the year (month). Gibtelecom acknowledges that there have been no prices changes in fixed to fixed calls for 2009/10 but can it assume that going forward column II of form 1B would show average prices (if changes are made part way through the year)?

² (please refer to our response to Q12 of the Authority's public consultation document 06/08)

Referring to the Authority's proposal to make use of a simple arithmetic average, Gibtelecom has developed a way to extract data on the number of minutes across the three calling periods for fixed to fixed domestic calls. There is therefore no requirement for the Authority to employ its proposed arithmetic averaging calculations.

Q10: Do you agree with the GRA's methodology for computing the change in price of IDD calls? Do you agree with the GRA's proposal to make use of a simple arithmetic average based on 'major' IDD calling services in the absence of readily available data about minutes of traffic for IDD calls? If not, please give reasons for your answers.

Gibtelecom does not see any major issues with the way the Authority proposes to compute the price changes of international direct dialled calls.

As for fixed to fixed calls, Gibtelecom believes it has developed a way to extract data on the number of minutes across the different calling periods for international direct dialled calls. There is therefore no requirement for the Authority to employ its proposed arithmetic averaging calculations.

Q11: Do you agree with the GRA's proposal with regard to Gibtelecom only needing to check the figures in all tables for the price control year 2009/10? If not, please give reasons for your position.

Gibtelecom is content with the Authority's proposal, as this might help in reducing the burden imposed as a result of the additional compliance requirements now being put forward. In this regard Gibtelecom refers the Authority to the Company's response under Q1 related to the timing of this public consultation.

The Authority indicates that going forward (i.e. price control years 2 and 3) Gibtelecom will check fields A to E of forms RSCY and BSCY as the figures for these will be provided by the Authority. Gibtelecom will be required to complete fields F to J on the same forms, together with inserting values in all the fields under forms SCRA and SCBA. The public consultation is not clear when Gibtelecom is to submit the various forms. Presumably this will only be done once the decision notice following this public consultation is published? Will the Authority also be providing Gibtelecom with the subsequent years' forms to complete and verify, and by when? Can Gibtelecom also assume that there would be timescales involved for the validation of the fields completed? Would these be the same as for those suggested and discussed (ten business days for the regulated firm, and the Authority) under Q4?

Q12: Do you agree with the proposed penalties for dealing with non-compliance? If not, please give reasons for your answer.

Gibtelecom does not agree with the proposed penalties.

In the case of negative carryover for the line rental sub baskets, the Authority proposes to deal with this in a slightly different way by requiring the starting price for the following year to be amended rather than having a percentage figure as would be the case for the proposed non-compliance penalties under the general basket of services. The Authority also indicates that Gibtelecom should reimburse customers with the difference. If Gibtelecom were not to comply in the second consecutive year then the compensation to customers would be three times the difference. Gibtelecom refers the Authority to the Company's response under Q6 for its general views on these matters.

In addition, in the event a refund to customers is due for repeated non-compliance in the line-rental sub-baskets, how would this be factored into form 1A, which also shows figures for line-rental, and ultimately form PCY, so that any possible 'double-counting' does not take place?

Q13: Do you agree with compliance test for the wholesale mobile termination charge in terms of Gibtelecom's fixed to mobile calls? If not, please give reasons for your answer.

Gibtelecom does not agree with the compliance test for the wholesale mobile termination charge.

The Authority states that a price control on retail fixed to mobile services in the form of a **cost orientation** [emphasis added] obligation shall apply. Gibtelecom shall demonstrate compliance by reference to the three main cost components of the services, i.e. wholesale fixed call origination, wholesale mobile termination and other costs.

The Authority previously calculated an implied mobile termination rate in the absence at the time of mobile regulatory data. A reducing glide-path price control was subsequently applied to Gibtelecom based on the implied termination rate. Gibtelecom recently (30 April 2010) submitted an accounting separation report (ASR) for the year ended 31 December 2008 providing audited details on the Company's mobile termination services. The Authority will note that the ASR shows that the cost of terminating a call on the Gibtelecom mobile network is 9.52p/min. In accordance with regulatory principles and obligations on cost orientation, Gibtelecom argues that this should be set as the wholesale mobile termination rate, and should substitute the current implied rate and associated glide-path controls. This being the case, there would no longer be a requirement to compute or justify Gibtelecom's mobile termination rate on the basis the Authority is proposing in the public consultation. The Authority will now be obtaining the cost-based termination rates annually as part of the ASR process, much like it is receiving the fixed origination rates it is using as part of its proposed wholesale mobile termination compliance tests.

Q14: Do you agree with using the value of 15.3% as a proxy for the markup to cover common costs? If not, please give reasons for your answer.

Gibtelecom agrees with using the value of 15.3% as a reasonable rate of return to cover common costs and overheads. The Company has long explained the well-founded principle of having a reasonable margin on costs, and has argued on a number of occasions that using 15.3% as a proxy was a fair proposition (as this figure has already obtained regulatory approval). In any case, the Authority should note that the mobile termination rate should now be that computed by the recently submitted audited mobile ASR and not the implied mobile per minute call termination cost.

Q15: Do you agree with compliance test for the fixed to mobile cost orientation obligation? If not, please give reasons for your answer.

Gibtelecom does not agree with the compliance test for the fixed to mobile cost orientation obligation in principle. The Authority should allow the Company to revise its mobile termination rate in accordance with the Company's cost orientation obligations to that established by the recently submitted audited mobile ASR. Without prejudice to its rights to seek a review of the mobile termination rate, the Company believes that any compliance

test should take account of the fixed to mobile price reductions made by Gibtelecom over the past years which were based on the Authority's implied (non-cost orientated) mobile termination rates.

Q16: Do you agree with the proposed penalties for dealing with noncompliance? If not, please give reasons for your answer.

Gibtelecom does not agree with the proposed penalties, particularly at a time when the implied mobile termination rates are not consistent with the data available through the audited mobile ASR.

Until such time as Gibtelecom is allowed to review its mobile termination rates it would not be appropriate for the Company to provide more detailed comments on this particular question. Gibtelecom also refers the Authority to the Company's responses under Questions 6 and 12 above for its more general views on the matters.

End of submission