



Office of the Director of
**Telecommunications
Regulation**

Information Notice

Proposed amendment to the Telecommunications Tariff Regulation Order, 1996, (S.I. No. 393 of 1996).

Price Cap on certain services provided by eircom

Document No. ODTR 99/61

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1 Introduction

Section 7 of the Telecommunications (Miscellaneous Provisions) Act, 1996 (the 1996 Act) allows a price cap to be placed on the charges for telecommunications services in Ireland where the provider of those services holds a dominant position or where there is no competition in the provision of the relevant services. In 1996, the Minister for Transport Energy and Communications imposed a price cap on Telecom Eireann (now eircom) in relation to the supply of a specified grouping of services. This price cap mechanism is set out in Telecommunications Tariff Regulation Order, 1996 (S.I. No. 393 of 1996).

In accordance with Section 7(5) of the 1996 Act, the Minister for Public Enterprise, Mary O'Rourke, TD, (the Minister) directed the Director of Telecommunications Regulation (the Director) to review the price cap mechanism. The legislation provides that, having reviewed the mechanism, the Director may amend it if appropriate.

The Office of the Director of Telecommunications Regulation (the ODTR), commenced a review of the price cap mechanism with an initial consultation paper (see ODTR documents 99/19 and 99/34). In the report on the consultation (ODTR 99/34), the Director concluded that further information gathering and analysis were needed before any amendment to the structure and parameters of the price cap. Additional work has been carried out by the ODTR and consultants engaged to advise on this matter. Having regard to the direction by the Minister, the consultation carried out earlier this year, and the additional work carried out since then, the Director now proposes to make a number of amendments to the Price Cap Order.

The legislation requires the Director to inform eircom, as an affected provider of telecommunications services, of her intention to make an order amending the price cap order and of the right to make representations to her on the terms of the proposed new order. Such a notification was made on 19 October 1999.

In accordance with the ODTR policy of openness and transparency which is underpinned by relevant legislation, the Director is also publishing the terms of the proposed new order and welcomes any comments from other interested parties, particularly from users or user groups. To assist understanding of the proposals, a consolidated version of S.I. 393 of 1996 and the proposed amending order is attached at annex 1 of this paper, setting out in a concise form the proposed terms as they will apply when the new order is made.

The statutory period during which comments may be submitted by eircom runs to 19 December 1999, and comments received from other parties up to that date will also be welcome. However, it would help greatly if comments could be provided as early as possible to allow the maximum possible time for consideration before the end of the year. The Director will take into consideration any comments received from eircom, other interested parties and any other information she regards as being of relevance, in particular information in eircom's regulatory accounts, in making the final amendment to the price cap order. It is her intention that a final order will be in place by 1 January 2000 so that the terms of the revised price cap on eircom can have effect from that date.

This paper does not constitute legal, commercial or technical advice. The Director is not bound by it. The paper is without prejudice to the legal position of the Director or her rights and duties under legislation.

All responses pursuant to this paper should be clearly marked "Reference: Submission re ODTR 99/61" and sent by post, facsimile or e-mail to:

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to arrive on or before 17:00, 19 December 1999.

Apart from acknowledging responses, the Director regrets that she will be unable to enter into correspondence with persons contributing comments on this paper.

2 Structure and parameters of the draft amended price cap mechanism

2.1 Services to be included in the price cap

In ODTR 99/34, the Director stated her initial view that at least the following services should be included in the new cap:

- The provision of telephone exchange lines;
- Telephone exchange lines connection and take-over;
- Local dialled calls; and
- Payphone calls.

The Director also stated that with regard to the remaining services in the existing price cap, she considered that further investigation was required.

The ODTR has undertaken a further examination of the markets for fixed line telecommunications services, concentrating on those services that are in the price cap and that were listed in ODTR 99/34. The Director would like to thank all those who assisted this examination, in particular those operators who provided detailed market information for measurement purposes. Using this and other available information, the ODTR has considered demand and supply-side evidence as to the degree of competitiveness in the relevant markets, and the likely prospect of the development of competition in those markets.

Having considered the information available, the Director concludes that in addition to the services listed above, eircom is at this time dominant in the markets encompassing all the services included in the existing price cap. Moreover, she takes the view that there is no prospect of effective competition being established in any of these services over the term of the proposed price cap, with the single exception of international dialled calls.

The Director proposes to remove international dialled calls from the price cap and to leave all other services in the price cap.

The full set of services the Director proposes to include in the new price cap is:

- The provision of telephone exchange lines
- Telephone exchange lines connection and take-over
- Local dialled calls
- National dialled calls (removing the existing distinction between weekday and weekend calls)
- ISDN connection and take-over
- The provision of Integrated Services Digital Network (ISDN) lines
- Operator calls
- Directory enquiry calls
- Payphone calls

2.2 Structure of the price cap basket

The Director proposes that all affected services should be included within a single basket for the purpose of applying the CPI-X constraint, as in the existing price cap. Creating additional baskets would increase the complexity of the price cap mechanism, reduce its flexibility and add to the cost of compliance. If there were very substantial differences in the degree of prospective competition between services included in the price cap, there might be a case for allocating services to two or more baskets. However, on the basis of the information available the Director does not consider that such differences are sufficiently pronounced to justify a change in the price cap mechanism at this time.

2.3 Phasing of price reductions and the level of the control

A key objective of the price cap is to ensure that the interests of consumers are protected. Users benefit from lower prices as the value of X increases. However, other considerations must also be taken into account. For example it is important that X not be so high as to reduce prices beyond a point consistent with an efficient operator receiving a normal return on capital or undermine the development of competition. The Director has examined the likely effects of the price cap having regard to each of these considerations.

First, the Director notes that a number of eircom's retail tariffs are above European best practice levels and she considers that Irish consumers should benefit from prices that are more in line with such best practice. Second, ODTR research suggests that eircom makes substantial returns on capital on the price-capped services. Third, eircom has the scope to make efficiency improvements over the next few years which should contribute to price

reductions. The ODTR has also examined the likely effects of the price cap on efficient entrants wishing to provide price-capped services.

In the light of her assessment of these various indicators the Director proposes to set X within the range of 7–9%. Reductions in the price level will be spread over the duration of the period of control to allow time for introduction of efficiency improvements. This approach is also consistent with stability in pricing, which facilitates forward planning by users and operators. The Director considers that values of X in the range indicated above will not place an undue burden on eircom.

2.4 Sub caps on individual services

The Director also takes the view that sub caps on the prices of individual services should be retained. The purpose of such a sub cap is to ensure that no single service within the basket is subject to a substantial relative increase. This is consistent with the requirement to protect the interests of users by ensuring that rebalancing takes place in a progressive and affordable manner, particularly for vulnerable groups. For the generality of services in the basket, it is considered appropriate to continue to apply sub caps at a level of CPI+2. This is intended to allow eircom some flexibility in pricing while protecting users from a substantial relative increase in any one individual service.

Providing such protection is particularly important in the case of line rentals: eircom claims that line rental charges do not cover the costs of the relevant services and therefore need to be rapidly rebalanced. The ODTR examination of this matter indicates that while the line rental charges are out of line with costs, the margin is not as great as claimed by eircom. The sub cap applied to line rentals in the existing scheme (CPI+0) leaves little scope for eliminating this gap. If no sub cap were to be included in the price cap for the line rental tariffs, it is possible that eircom would increase line rentals substantially. Clearly this would have a significant effect on many users.

When setting the price cap in exercise of her functions under Section 7 of the Telecommunications (Miscellaneous Provisions) Act, 1996, the Director is required to have regard to Regulation 8(2) of the Voice Telephony and Universal Service Regulations, 1999 (as specified in Regulation 8(3) thereof). That regulation requires the Director to set the price cap in such a way as to take into account eircom's obligations to maintain the affordability of services, particularly for users in rural and high cost areas and members of vulnerable groups. Tariffs must be progressively adjusted in order to achieve tariffs that are based on costs, except in those cases where doing this would conflict with the obligation to maintain affordability.

A substantial increase in the rental charge would have a significant effect on a large number of customers but in particular on the bills of those with low telephone usage. Even if with a cap on the lower quartile bill (see section 2.5 below), such consumers would undoubtedly lose out.

On the basis of the information available the Director considers that imposing sub caps of CPI+2 on all individual services in the price cap would not prevent eircom from continuing to make an adequate return on the totality of its regulated businesses throughout the price cap period. It can also be assumed that eircom can make efficiency gains, and taken together, these factors suggest that any remaining imbalance in tariffs will not place an unreasonable burden on the firm.

In addition, there is little evidence that unbalanced line rental tariffs are a significant

impediment to competition. We note that only one European country (the Netherlands) has undertaken a one-off rebalancing exercise.

In conclusion, in order to meet statutory requirements on affordability, and at the same time allow for progressive rebalancing, the Director proposes that the sub cap on line rentals be set at CPI+2.

The existing price cap allows low-user discount schemes approved by the Director to count towards eircom's price cap obligations and the Director proposes to retain this provision. The Director notes that eircom has not to date proposed such schemes.

2.5 Sub cap on the lower quartile bill

In addition to the sub cap on individual services in the price cap, the Director considers that the existing sub cap on the lower quartile bill of CPI+0% should remain. This sub cap acts as an extra safeguard for a particular group of users – residential consumers with low usage of telephony services. Such users are less likely to benefit directly from the early stages of the development of competition than higher spending users. It is also likely that many vulnerable persons are in the low user category and the Director, as set out in section 2.4 above, must consider the affordability of services to such users. The Director therefore proposes to maintain this sub cap.

2.6 Duration of control and extent of carry-over

The Director considers that the new price cap control should be set initially for three years as this period gives the right trade-off between providing an adequate period for eircom to gain from reducing costs, and allowing the controls to be revised as market conditions change.

As discussed in ODTR 99/34, the Director intends to permit carry-over of unmade increases or excess reductions within the price cap period, as this gives eircom an incentive to make price reductions early, thus benefiting users.

The Director does not plan to allow eircom to carry over unmade increases from the existing price cap to the proposed one. eircom's over-achievement of its target in the current period has produced a carry-over backlog of considerable magnitude. Allowing credit for these reductions into the new price cap period would seriously undermine the effect of the new price cap, unless X were increased in compensation. The evidence assembled in this review suggests that the existing price cap has allowed eircom to make substantial returns on capital on the regulated businesses despite cutting prices faster than the cap dictated. eircom has also been able to charge higher effective prices on some services, particularly local calls, than best practice in other European countries. Allowing carry-over from the existing cap could result in consumers paying unnecessarily high prices. The issue of whether carry-over will be permitted between the proposed price cap and any subsequent price cap is left open for future consideration.

2.7 Compliance assessment process

The Second Schedule to S.I. No. 393 of 1996 sets out formulae that enable the assessment of compliance with the price cap mechanism. The Director proposes to make amendments to the text of this schedule. She considers that these changes will assist the compliance assessment process and make the relevant rules clearer.

2.8 Guidelines for submission of comments

The Director welcomes any comments from interested parties on the proposed terms of the amended price cap order.

All comments are welcome, but it would make the task of analysing responses easier if comments follow the headings in this document or the articles of the consolidated text of the proposed order in section 3. In the interests of promoting openness and transparency, the ODTR will make available any comments received for inspection on request, excluding information that the Director considers to be of a commercially sensitive nature. Where confidential material is included in responses it should be clearly marked as such and included in an Annex to the response.

3 Consolidated draft text of S.I. No. 393 of 1996 including proposed amendments

I, Alan Dukes, T.D., Minister for Transport, Energy and Communications, in exercise of the powers conferred on me by section 7 of the Telecommunications (Miscellaneous Provisions) Act, 1996 (No. 34 of 1996), hereby order as follows:

1. (1) This Order may be cited as the Telecommunications Tariff Regulation Order, 1996.

(2) This Order shall come into operation on the 1st day of January, 1997.

(3) This Order shall apply to the basket of telecommunications services specified in the First Schedule to this Order and provided by the company and in this Order 'basket of telecommunications services' shall be construed accordingly.

2. In this Order -

"the Act of 1996" means the Telecommunications (Miscellaneous Provisions) Act, 1996;

"the company" means eircom plc;

"connection and takeover charge" means a charge made by the company for the connection of a customer to the company's networks or to services on the company's networks;

"the Director" means the Director of Telecommunications Regulation appointed under the Act of 1996;

"directory enquiry call" means a call made to the company's directory enquiry service for the purpose of obtaining telephone numbers;

"Integrated Services Digital Network" means a network whereby telephone calls are made over switched end to end digital transmission paths;

"light user scheme" means any discount scheme which has been approved as such by

the Minister and which is aimed at certain residential users whose bills for a basket of telecommunications services are, in the opinion of the Minister, following consultation with the company, low in monetary terms;

"local dialled call" means a dialled call made from a telephone exchange line in the State to a telephone exchange line in the same telephone group or to a telephone exchange line in another telephone group which is regarded as adjacent to the first-mentioned telephone group;

"lower quartile bill" means a notional bill for a basket of telecommunications services which stands specified by the Minister, following consultation with the company and is based on a representative sample of bills imposing charges for a specified period on residential users of such services;

"operator call" means a call which is completed with the assistance of an operator of the company for which a charge is made by the company;

"payphone call" means a call originating from a public telephone owned by the company on public property;

"the provision of Integrated Services Digital Network lines" means a service for which a recurring charge is made by the company for the availability of Integrated Services Digital Network lines and does not include connection and takeover charges;

"the provision of telephone exchange lines" means a service for which a recurring charge is made by the company for the availability of telephone exchange lines and does not include connection and takeover charges;

"relevant year" means any period of 12 months beginning on 1 January during which an order under section 7(3) of the Telecommunications (Miscellaneous Provisions) Act, 1996, continues in force;

"trunk dialled call" means a dialled call made from a telephone exchange line in the State to a telephone exchange line in another telephone group in the State or in Northern Ireland which is not a local dialled call;

3. The grouping of telecommunications services specified in the First Schedule to this Order is hereby prescribed as a basket of telecommunications services for the purposes of this Order.

4. (1) The Director hereby specifies $\Delta\text{CPI} - [7-9]\%$ to be the price cap in respect of the basket of telecommunications services to which this Order applies.

(2) Without prejudice to subarticle (1) of this Article, the following adjustments to the price cap formula shall apply:
 - a) in respect of any individual service contained in the basket of telecommunications services, the price cap shall be $\Delta\text{CPI} + 2\%$, and
 - b) in respect of the lower quartile bill for the basket of telecommunications services, the price cap shall be $\Delta\text{CPI} + 0\%$.

5. (1) The restrictions and adjustments to the price cap formula, set out in Part I of the Second Schedule to this Order, shall be applied for the purpose of determining compliance with the price cap specified in Article 4(1).

(2) The restrictions and adjustments to the price cap formula, set out in Part 2 of the Second Schedule to this Order, shall be applied for the purpose of determining compliance with the adjustment to the price cap specified in Article 4(2)(b).

6. Notwithstanding Article 4 of this Order, the Director may make the following adjustments to the price cap formula:
 - a) to the extent that the company has made, during any relevant year, a reduction in charges that is greater than the reduction required by subarticle (1) of that Article, the difference may be taken into account by the Director in applying the said subarticle (1) in the relevant years subsequent to the relevant year in which the reductions were made;
 - b) to the extent that the company has made, during any relevant year, an increase in charges (including an increase of 0%) that is less than any increase allowed under subarticle (2)(a) of that Article, the amount by which those increases are less than the increase so allowed may be carried forward and added to the increase allowed for the individual service in question in the relevant years

subsequent to the relevant year in which the increase was made.

First Schedule

The provision of telephone exchange lines;

The provision of Integrated Services Digital Network lines;

Telephone exchange line and Integrated Services Digital Network connection and take-over;

Local dialled calls;

Trunk dialled calls;

Operator calls;

Directory enquiry calls;

Payphone calls.

Second Schedule

Part 1

$$\sum_{i=1}^n \Delta P_i * (R_i / R_t)$$

Where,

n is the total number of services in the basket of telecommunications services;

ΔP_i is the percentage change in the effective tariff (before discounts, except for any light user scheme) for telecommunications service "i" calculated in accordance with a methodology specified by the Director either:

(i) from the base of the effective tariff pertaining at the end of the year preceding the relevant year, or

(ii) on the basis of a representative sample, approved by the Director, of bills for the service "i" provided by the company;

R_i is the total revenue before discounts for the telecommunications service "i" in the financial year ending on or about 31 March in the relevant year;

R_t is the overall total revenue before discounts in the financial year ending on or about 31 March in the relevant year for all telecommunications services in the basket.

Part 2

$$\sum_{i=1}^n \Delta P_i * (LR_i / LR_t)$$

Where,

n is the total number of services in the basket of telecommunications services;

ΔP_i is the percentage change in the effective tariff (before discounts, except for any light user scheme) for telecommunications service "i" calculated in accordance with a methodology specified by the Director either:

- (i) from the base of the effective tariff pertaining at the end of the year preceding the relevant year, or
- (ii) on the basis of a representative sample, approved by the Director, of bills for the service "i" provided by the company;

LRi is the amount charged for the telecommunications service "i" in the lower quartile bill in the financial year ending on or about 31 March in the relevant year;

LRt is the overall total charge for all telecommunications services in the lower quartile bill in the financial year ending on or about 31 March in the relevant year.

Given under my hand,
this _____ day of _____, 1999.

Etain Doyle
Director of Telecommunications Regulation.