Office of the Director of
**Telecommunications**
**Regulation**

**CONSULTATION PAPER**

# Review of the Price Cap on Certain Telecommunications Services

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# 1 INTRODUCTION

In accordance with the intentions as expressed by the Director of the Office of Telecommunications Regulation ('the Director') in Document 99/34, the ODTR is currently reviewing the amended price cap mechanism that has applied to eircom (previously Telecom Eireann) since January 1st 2000[1]. The Director is now issuing this consultation paper to assist her in carrying out the review.

The Director's intention is to make necessary changes, if any, to the price cap by 1 January 2003. This consultation paper is the first of three consultation papers planned for the price cap review. This paper introduces some of the main issues and asks respondents for their initial views.

During the coming months the Director plans to review the level of competition across a range of telecommunications services. The Director will then come to a preliminary view on which services should be subject to a price cap and consult on that view in a second consultation paper during the summer. At this stage the Director will also consult on the methodology to be used in setting the level of the price caps for relevant markets, if any.

In September, the Director proposes to issue a third consultation paper which will also consult on the level and structure of any price caps to be applied and which will include a draft tariff regulation amendment order. This consultation will be followed by a statutory two month consultation period. A final tariff regulation amendment order will then be issued after consideration of responses to the consultation.

In this first consultation paper the Director sets out the background to the price cap review (Section 2); seeks views on objectives for the price cap (Section 3); seeks views on which services should be subject to a price cap and on how this should be determined (Section 3); and seeks views on how a price cap, if any, should be set (Section 5).

[1] The current price cap mechanism is set out in the Telecommunications Tariff Regulation Order, 1996 (amended 1999) S.I. No. 393 of 1996

*This consultative document is not a legal document and does not constitute legal, commercial or technical advice. The Director is not bound by it. The consultation is without prejudice to the legal position of the Director or to her rights and duties to regulate the market generally.*

# 2 BACKGROUND

## 2.1 Irish Legislation

The Office of the Director of Telecommunications Regulation (ODTR) was established in 1997 under the terms of the Telecommunications (Miscellaneous Provisions) Act 1996 (the Act). The Act transferred to the Director a range of powers previously held by the Minister, including the granting of licences to provide telecommunications services.

Under Section 7 of the Act, the Director may introduce a price cap in respect of a basket (or more than one basket) of telecommunications services where the Director believes that there is no competition or that the provider of those services holds a dominant position. Before doing so, she must give the provider to whom the Order is to apply two months to make representations on the terms of the proposed order.

The Minister introduced a tariff regulation order which came into force on 1 January 1997[2] and, following a request from the Minister, the Director reviewed that Order, introducing a modified Order which came into force on 1 January 2000.[3] This is the price cap order that is currently in force.[4] During the previous review of the price cap the Director undertook to review the price cap again in three years. This is the position we are now in.

A price cap is defined in the Act:[5] it means limiting the price rises of one or more baskets of telecommunications services using the formula ($\Delta$CPI – X) per cent where:

"$\Delta$CPI" means the annual percentage change in the Consumer Price Index.
"X" means the adjustment specified by the Director.

Table 1 below shows which services are include in the current price cap basket, together with the caps that apply to the whole basket and each individual service under the current tariff regulation order.

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2 The Telecommunications Tariff Regulation Order, 1996 (S.I. No. 393 of 1996).

3 The Telecommunications Tariff Regulation (Modification) order, 1999 (S.I. No. 438 of 1999).

4 See Annex A.

5 Telecommunications (Miscellaneous Provisions) Act 1996, Section 7.

**Table 1 – The Current Price Cap**

| Telecommunications Service | Price Caps |
|---|---|
| The Price Cap Basket[6] | CPI – 8% |
| Provision of telephone exchange lines and ISDN lines | CPI + 2% |
| Telephone exchange line and ISDN connection and takeover | CPI + 2% |
| Local dialled calls | CPI + 2% |
| Trunk dialled calls | CPI + 2% |
| Operator calls | CPI + 2% |
| Payphone calls | CPI + 2% |
| Directory enquiry calls | No sub cap |
| Lower quartile bill | CPI + 0% |

The way in which the current price cap works can be explained through an example: the Central Statistics Office (CS0) reports that inflation, as measured by the CPI, in the year 2000 was 5% and the 'X' value in the formula ΔCPI – X is 8%. Following on from this, the capped operator would then be obliged to reduce prices for its basket of services overall in the year 2001, by 3% (calculated by 5% minus 8% = -3%).

Despite this required reduction overall, the capped operator is still allowed to increase prices for individual services within the basket eg local dialled calls has a sub-cap of CPI + 2%. Therefore from the same example, in the year 2001 the operator would be permitted to increase charges for local calls by 7% (5% + 2%) provided the overall basket fell by the 3% stated earlier.

The lower quartile bill is a representative bill paid by the 25% of residential customers who have the lowest bills. For example, say the average bill of the first quartile might be €80, the second quartile €65, the third quartile €50, and the fourth quartile (or lower quartile) €35. In this case the bill of the fourth or lower quartile of the customers is not permitted to increase in any year by more than CPI + 0% i.e. 5% + 0%. So from the above example, in the year 2001 the lower quartile bill would not be permitted to increase by more than €36.75 (calculated as

[6] The price cap basket includes all of the listed services except the lower quartile bill. This is capped separately.

$35*1.05 = €36.75). At present a sample of 4000 bills from residential customers in this lower quartile is used to calculate the representative bill.

## 2.2 Developments in EU legislation

A new EU regulatory framework was adopted by the Council of the European Union on February 14th 2002 for the provision of electronic communications throughout the internal market. The new framework consists of a package of directives which reflect technological and economic changes and which attempt to further harmonise the regulation of electronic communications:[7]

- a common regulatory framework for electronic communications networks and services (Framework Directive);
- authorisation of electronic communications networks and services (Authorisation Directive);
- access to, and interconnection of, electronic communications networks and associated facilities (Access Directive);
- universal service and users' rights relating to electronic communications networks and services (Universal Service Directive);
- a further Directive is also planned on data protection issues in the telecommunications sector.

Member States are now obliged to implement this 'telecoms package' in full over the next 15 months. As with the current framework, a mechanism has been included which triggers various regulatory obligations on markets such as access and interconnection. In the new framework this mechanism, still called significant market power (SMP), closely relates to the competition law concept of dominance.

Article 13 of the proposed Directive of the European Parliament and Council on a common regulatory framework for electronic communications networks and services (the "Proposed framework Directive") provides, *inter alia,* that;

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[7] The first four of these Directives, whilst adopted by the European Council, have not yet been published in the Official Journal of the European Communities. The final adopted texts are available from the European Commission's DG Information Society website.

> *"An undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers".*

Article 13 as well as catering for joint or collective dominance also provides for an operator to be designated as having SMP if power is leveraged between markets where *"links between the two markets are such as to allow the market power held in one market to be leveraged into the other market, thereby strengthening the market power of the undertaking"*.

Article 14 of the proposed Framework Directive sets out the Market definition procedure. In particular, it provides that the Commission shall adopt a Recommendation identifying the product and service markets, the characteristics of which may justify the imposition of regulatory obligations as set out in the Specific Directives. The Commission has also issued draft guidelines to assist regulators in defining markets and gauge SMP.

Article 15, which sets out the market analysis procedure, precludes the imposition of sector specific regulatory measures where a market is deemed to be "effectively competitive".

The current price cap review is being carried out under existing Irish legislation. Given that the notion of SMP under the new EU framework has been strongly aligned to the concept of dominance, the Director will take note of those aspects of the new Directives that relate to SMP, including any accompanying guidelines, or recommendations with respect to the issues of market definition and assessment of dominance. The ODTR does not expect there to be a conflict on this point between existing Irish legislation and the new EU directives. It should be noted that the interpretation of the term "dominant position" in the 1996 Act in the same way as the term would be understood in the context of competition law is consistent with the approach taken by the Director at the last review of the price cap in 1999.[8]

[8] See ODTR "Review of the Price Cap on Telecom Eireann: Report on the Consultation", ODTR 99/34, May 1999.

## 2.3 Prices of Currently Capped Services

Table 2 below gives a brief overview of the prices of eircom's services that are subject to the current price cap. Since the current tariff regulation order was introduced on 1 January 2000, eircom has increased PSTN rental charges whilst reducing local and national call charges. In addition, payphone charges and Directory enquiries (no sub-cap) have increased and overall connection charges have declined slightly, although there have been larger adjustments within the connections basket itself and between years. The percentage changes shown in the table reflect the CPI and any additional allowable changes under the cap, including carryover from previous periods.

**Table 2 - Prices of Currently Capped Services**

| Services | Jan 1 2000 | Jan 1 2001 | Jan 1 2002 | % Change Nominal 1 Jan 00 – 1 Jan 02 |
|---|---|---|---|---|
| Rental PSTN[(1)]<br>Rental ISDN BRA<br>Rental ISDN PRA | €13.00<br>€36.82<br>€368.22 | €13.87<br>€36.82<br>€264.11 | €15.07<br>€36.82<br>€264.11 | 15.9%<br>0%<br>-28% |
| | % Change during year | | | |
| % Change During Year | 2000 | [Provisional] [(2)] 2001 | | [Provisional] [(2)] % Change Nominal 1 Jan 00 – 1 Jan 02 |
| Connection Basket[(3)] | -13.8% | +12.6% | | -3% |
| Local Calls | -32.6% | 0% | | -32.6% |
| National Calls | -30.8% | 0% | | -30.8% |
| Operator Assisted Calls | 0% | 0% | | 0% |
| Payphones | +2.12% | +11.10% | | +13.46% |
| Directory Enquiry | +75.97% | 0% | | +75.97% |
| Overall Change in Basket Prices | -15.49% | *Tbd* | | *tbd* |

(1) Rental is the provision of telephone exchange lines. Monthly rates quoted.

(2) Only provisional figures available for 2001 in certain cases as a review of compliance in 2001 is yet to be carried out. Consequently, overall % change column figures are also provisional in all cases. Price changes since Jan 1 2002 are not incorporated in this table.

(3) Connection is telephone exchange line connection and takeover. PSTN and ISDN are included in same basket. All installation charges quoted in part 1 of eircom's telecommunications scheme used to calculate overall % change in prices.

*tbd* – to be determined.

Note: Prices prior to 2002 were actually quoted in £IR and figures here are converted to nearest euro cent

# 3 OBJECTIVES FOR THE PRICE CAP REVIEW

## 3.1 Objectives for the Price cap

In reviewing the current price cap the Director believes that any decisions coming out of the review need be aimed at achieving the maximum social outcome from a number of objectives.

A price cap can only be applied in Irish telecommunications markets where there is no competition or where an operator is dominant[9] - the well recognised purpose of price capping is to prevent dominant operators from exploiting their market power by raising prices to consumers above the competitive level. National legislation also requires USO designated operators to maintain the affordability of certain services and that the Director should have regard to these requirements when reviewing the price cap.[10]

Against this background, one way to describe the principal objectives for the price cap review could be:

- to ensure that the prices charged by dominant operators to all customers are brought closer to competitive prices than they would be in the absence of price controls;
- where appropriate, to ensure affordable access to a universal service and in particular, to address the needs of specific vulnerable social groups; and
- to encourage the rapid development of effective competition in the supply of telecommunications services.

These principal objectives need to be met in such a way that they:

- do not endanger the continuing provision of high quality telecommunications services to customers;
- do not distort or restrict competition, including the development of future competition;
- encourage efficient provision of telecommunications services;

[9] Telecoms (Miscellaneous Provisions) Act, 1996, Section 7(3).

[10] Regulation 8 of S.I. No. 71 of 1999, European Communities (Voice Telephony and Universal Service) Regulations, 1999.

- ensure that there is no discrimination in the treatment of undertakings in the market.

**Q1.** *Do you agree with the policy objectives of the ODTR with respect to its current review of the price cap? Which objectives should have priority? Does the respondent feel that this list excludes other important objectives that need to be considered? If yes, please list.*

### 3.2 Ensuring Affordable Access

National legislation[11] requires USO designated operators to adhere to the principle of maintaining affordability for directory enquiry, public payphones and the provision of connections and access to telephone services. In particular affordability has to be maintained in rural and high cost areas, for vulnerable user groups such as the elderly, those with disabilities and those with special needs. The Director needs to have regard to these requirements when reviewing the price cap.

In addition, the Department of Social, Community and Family Affairs operates the Free Telephone Rental Allowance (FTRA) scheme in conjunction eircom plc. The aim of the scheme is to ensure that the elderly, carers and certain persons with disabilities under the age of 66 have access to a telephone free of charge and thus provides an element of protection and security for older and disabled people in their homes. The scheme ensures that they are able to access assistance, medical or otherwise when the need arises. At present eircom provides a telephone service to over 200,000 customers who are in receipt of this telephone allowance. Eligibility for the scheme is determined by the Department of Social, Community and Family Affairs. This consultation paper does not relate to the FTRA scheme as it falls outside of the remit of the ODTR. The consultation does relate to the extra measures that the ODTR might take through its powers to set price caps.

The provision of an additional constraint on the "lower quartile bill" in the current price cap on eircom's retail services seeks to provide additional protection for vulnerable/low volume users (eg. low income or pensioner households) from radical rebalancing effects or pricing strategies that progressively adversely affect such customer groups. In effect, this lower quartile bill (explained in 2.2) is used as a proxy for the bills that might be incurred by such vulnerable users, as referred to above. Currently, this notional lower quartile bill must not increase by more than CPI + 0% in any year. This compares with a sub-cap of CPI + 2% for all services (except directory enquiry calls) within the basket.

Alternative approaches might be aimed more directly at specific vulnerable groups, rather than relying on the lower quartile bill, which relates to low volume users. This could mean the control of prices for certain services within the basket and/or controls on the costs of bills to specific groups of customers. For instance, the fixed line rental charge is likely to make up the bulk of a vulnerable user's fixed line bill. Vulnerable users are likely to have a strong requirement for 'access' to making calls (the service charged as 'rental') to allow them, for example, to make calls to emergency services, while demand for the services offered over the network (the different types of calls) might be less important or not in as great a demand for these customers. In this instance, controlling the price of the 'access service' i.e. rental would be of greater benefit to a vulnerable user than controlling the price of other services.

There might also be other alternatives to the "lower quartile bill" constraint currently in operation. For instance, if 'access' (rental) is more important to the vulnerable user, then one way in which such users might be better accommodated, would be to have lower access charges for vulnerable or low volume users (lower than the standard rate charged) coupled with higher charges for calls (higher than the standard rate charged). If this policy were adopted, then the vulnerable user's 'priority' service would be available at a more affordable cost.

**Q2.** *Views are invited on whether the protection of vulnerable customers is best achieved by controls on particular tariffs or the bills of particular customers or whether both are needed? Which tariffs? Which customer groups? In the case where the respondent believes controls on bills are required, should the scope of monitoring these bills only be considered with respect to services that would be included in a price cap basket? Please give explanations of responses.*

**Q3.** *If low-user tariffs schemes are implemented by an operator, charged with a responsibility to protect vulnerable-user customers under a new price cap, should these operators be allowed credit against the price controls (eg in the event that a "lower quartile bill" policy is maintained, could low-user discounts be factored into the calculation of the year-on-year changes in this bill)?*

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[11] Regulation 8 of S.I. No. 71 of 1999, European Communities (Voice Telephony and Universal Service) Regulations, 1999.

**Q4.** *Do respondents believe there are any other ways that the price cap could contribute to achieving the social objective of protecting vulnerable-user customers other than those outlined above? If so, please explain what other alternatives should be considered.*

# 4 THE SCOPE OF THE REVIEW

National legislation provides that a price cap can only be introduced for a telecommunications service where there is either no competition in the market for the supply of the telecommunications services concerned, or where the provider of the telecommunications services concerned holds a dominant position in the market for the supply of those services.[12] In the remainder of this consultation paper we have used the phrase "no effective competition" to describe the position where one or both of these situations holds true.[13]

In order to assess the level of competition, markets must first be defined and then the degree of market power in the market needs to be determined. Even if it is concluded that there is no effective competition in a market, the Director may decide that other factors suggest that a price cap is not the most appropriate policy instrument.

## 4.1 Market Definition

Before the level of competition in a market can be assessed the relevant market must first be defined. Market definition is not a mechanical or abstract process but requires an analysis of any available evidence of past market behaviour and an overall understanding of the mechanics of a given sector. A dynamic rather than a static approach is required when carrying out a prospective market analysis. The definition of the relevant markets is of fundamental importance since effective competition (and consequently an assessment of whether or not an operator/s is dominant) can only be assessed by reference to the market thus defined.

The approach to market definition in standard competition analysis focuses on the existence of constraints on the price-setting behaviour of firms. Under this analysis there are three main aspects to consider when defining a market: demand-side substitution, supply-side

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[12] Telecoms (Miscellaneous Provisions) Act, 1996, Section 7(3).

[13] The phrase "no effective competition" is also used in in the EU's New Framework legislation (see Section 2.2) where it describes the position where dominance is present in a market.

substitution (both can be assessed by applying the "hypothetical monopolist test"[14]) and potential competition. The first two considers competitive constraints in assessing the behaviour of undertakings on the market, the third however, is a tool which is likely to be more useful when establishing whether or not an operator(s) is dominant in a particular market.

Demand-side substitutability is used to measure the extent to which consumers are prepared to substitute other services or products for the service or product in question *eg* in general it might be the case that a call to a fixed line is not a substitute for a call to a mobile as a fixed line recipient can only receive calls at a fixed location. Supply-side substitution indicates whether suppliers other than those offering the product or services in question would switch their line of production or offer the relevant product or service without incurring significant additional costs *eg* a network operator might easily switch capacity over its network from supplying one type of service to another service.

As previously stated, all available data should be used in an assessment of the relevant markets. To assist her in the task of defining markets and assessing dominance, the Director intends to make use of data currently available to the office *eg* data acquired during historical and the imminent SMP reviews and, where appropriate, responses to previous questionnaires etc. In addition the office may issue a questionnaire/s in the coming weeks to collate further data that it might deem to be necessary to carry out this review.

The Director believes that the concepts of demand and supply substitutability referred to above should be considered with respect to a list of possible markets that the office has initially identified based on existing (a-priori) knowledge and experience, the screening of national and international market studies, journals, previous consultations etc. Consequently all markets previously considered under the initial and last price cap review will be considered in addition to other possible markets. Whilst it might not always be appropriate to consider markets currently subject to other forms of regulation as part of this price cap review, respondents may see a price cap on these markets/services as a potential alternative to

[14] For defining the product and the geographical dimension of markets, demand and supply-side substitution processes have to be considered. For both dimensions of markets one possible approach is the hypothetical monopolist test. This concept can be viewed as an experiment of thought, postulating a hypothetical small but significant and non-transitory change in relative prices - usually that means an increase of 5 to 10% - and evaluating the likely reactions of customers/suppliers to that increase. The test is applied up to the point where it can be established that a relative price increase within the geographic and product markets defined will not lead consumers to switch to readily available substitutes or to suppliers located in other areas.

existing regulation in these areas. In the last price cap review, mobile telephony was removed from consideration at an early stage in the review process. At the time the mobile telephony market was in the early stages of development and so the Director did not consider it was appropriate that the market should be subject to price controls. However, the market has evolved significantly since that time, the Director believes that it is appropriate that mobile telephony should be included as part of the review at this stage.

The Director is interested in the views of respondents on possible markets to be considered. As an aide to respondents, the following non-exhaustive list provides examples of possible markets.

- Provision of telephone exchange lines – Retail & Wholesale (Unbundled local access including bitstream access)
- Provision of Integrated Services Digital Network Lines
- Telephone exchange line connection and takeover
- Integrated Services Digital Network line connection and takeover
- National Leased Lines – Retail & Wholesale
- International leased lines
- Local Dialled Calls
- Trunk Dialled Calls
- International Dialled Calls
- Operator Calls
- Directory Enquiry Calls
- Payphone Calls
- Fixed to Mobile Calls
- Internet Calls
- International Roaming Services
- On Net Mobile to Mobile Calls
- Off-Net Mobile to Mobile Calls
- Off-Net Mobile to Fixed Calls
- Fixed call origination
- Fixed call termination
- Transit
- Interconnection of leased lines

- Mobile call origination
- Mobile call termination

In some cases it might be appropriate that some of these markets be further refined. For instance, in the case of call services, there might be a distinction between markets for business and residential customers and/or between peak and off/peak calls, for international calls there might be a relevant market for a specific routing of the call, for mobile calls there might be prepaid v post paid markets etc. In addition, it is possible the geographic dimension of each market might not necessarily be national *eg* there may be some markets that could be sub-divided into urban and rural.

It might also be the case that in certain instances some of the services listed above should be bundled together e.g. local and national calls might be considered to be in the same relevant market as a bundled product.

**Q5.** *Do you agree with the ODTR's proposed approach to defining markets? If not, please outline your preferred methodology.*

**Q6.** *Do you agree that there is a distinct stand alone/relevant market for each of the markets outlined in the list above? In any instance, should these markets be fragmented further e.g. in the case of local and trunk calls, should the office consider further markets depending on parameters such as peak/off peak, business/residential or in the case of International Calls are there route specific markets etc?*

**Q7.** *Are there any markets not included in the list above that should be considered in the context of the price cap review? If possible, please support your comments with analysis.*

**Q8.** *With respect to the geographic dimensions of market, are there any markets in the list above or identified in Q4 that should be defined other than in a national context? Please, support your comments with analysis.*

**Q9.** *With respect to the service that was removed following the last price cap review i.e. international calls, in the respondents view has the international calls market benefited from being removed from the price cap? In your view what affect has the removal of international calls from the price cap basket had on this market?*

## 4.2 Assessing Effective Competition

Once markets have been defined it is necessary to establish whether or not the markets are effectively competitive, i.e. whether or not one or more undertakings in the market are dominant.

The assessment of the effectiveness of competition embraces a wide range of factors, including the identification of the relevant market, the use of competition indicators and the assessment of whether the market would be effectively competitive if existing regulations e.g. currently capped services, were removed.

The assessment of the effectiveness of competition may consist of two strands of analysis

- Market analysis, focussing on the extent to which effective competition in the market segment is working or feasible;
- Analysis of the outcome for consumers and analysis of barriers to effective choice. This will enable an assessment of whether or not consumers are getting benefits consistent with an effectively competitive market.

*Market Analysis*

In a competitive analysis of the market it is necessary to consider both the structure of the defined market and supplier behaviour in that market. There is no ready to use/exhaustive list of indicators which need be considered in all cases, but typical factors are: market shares, barriers to entry/exit, potential entry, buyer power, asymmetry of information etc. Consequently all available information such as concentration levels, price elasticities, characteristics of the market in terms of switching costs etc. should all be considered when looking at market structure.

Supplier behaviour indicators relate to operators conduct and performance. The main issues to be considered from this perspective are among others, activity in price (looking at price trends) and analysis of profitability.

*Analysis on the Outcome for Consumers*

One way of measuring the benefits to the consumer is by comparing their measurable outcomes (eg prices, quality of service and range of service offerings) with consumers in similar markets elsewhere. It is also important to examine issues such as quality of service and the absence or otherwise of non-economic barriers to consumers switching suppliers (eg consumer inertia).

**Q10.** *Do you agree with the Director's proposed approach to evaluating whether or not competition exists in a relevant market? If not, please outline a preferred approach.*

**Q11.** *With due respect to ODTR's proposed approach to market analysis, in the case of each of the markets listed in section 3.1.1 above please indicate which statement best describes the current status of the market defined:*

*(a) the market is sufficiently competitive now so that price controls are unnecessary*

*(b) the market is likely to be sufficiently competitive by 2005 so that price controls will be unnecessary*

*(c) the market is likely to be sufficiently competitive by 2007 so that prices controls will be unnecessary*

*(d) the market is unlikely to be sufficiently competitive by 2007*

*(e) the market is sufficiently managed by other forms of regulation so that price control in the form of a price cap is unnecessary*

*Reasons for views expressed by respondents should be given, and supporting analysis or data where possible.*

**Q12**. *In the event that the respondent believed the definition of some/all of the markets in the list should be fragmented further, for instance into business and residential in certain markets, please indicate which of the statements A-E in Q9 best describe these markets. Again please give reasons for views expressed and supporting analysis or data where possible.*

**Q13.** *In the event that respondents have answered in the affirmative to Q7 above, please indicate which of the statements A-E in Q11 above best describes these markets. Again please give reasons for views expressed and supporting analysis or data where possible.*

**Q14.** *In the case of each the markets defined above/identified by the respondent, does the respondent believe that the market should be subject to some form of price control?*

**Q15.** *Are there any services, or services for particular groups of customers, which should be controlled separately on the basis that competition may soon develop to the point where controls can be dropped? If so, please state which services and your reasons why.*

### 4.3 Other Factors

In the event that there is no effective competition in a particular market, the Director will consider other factors before deciding whether a price cap is the most appropriate policy response to the lack of effective competition.

These other factors might include:

- the prospects for an increase in the level of competition arising from likely changes in market circumstances. These changes might be market driven, perhaps as a result of technological changes, or they might be driven by other forms of regulation.

- the scope and effects of existing regulation. In some markets where competition is limited regulatory action may already have been taken which makes a price cap unnecessary;

- the potential impact of a price cap on the development of competition. The ODTR will need to consider carefully whether and how the introduction or continuation of a price cap in a particular market will effect the development of future competition.

**Q16.** *In the event that there is no effective competition in a market what other factors should the ODTR consider before deciding to impose a price cap? Do respondents agree with the factors listed above? Can respondents provide examples of markets where these factors may apply?*

# 5 SETTING THE PRICE CAP

## 5.1 Introduction

As discussed in the previous section, a price cap will only be applied where there is no effective competition and where other factors do not suggest that a price cap would be inappropriate. The Director's assessment of the level of competition in various telecommunications services will be undertaken in the coming months. Until that assessment is complete it is not possible to say whether or where a price cap will continue to be applied. Nevertheless, there are a number of issues relating to the way in which a price cap could be applied on which it is useful to consult now in preparation.

## 5.2 Start Date for Any New Control

The current control is constrained by the terms of the 1996 Act[15] to operate on an annual basis and currently works on a calendar year. This control will continue in operation unless amended. In the last price cap review respondents were asked whether they believed it was administratively simpler and cheaper to manage a price cap that is related to the financial year of the controlled company. At that time there were no submissions that outlined a clear advantage to aligning the price cap to a financial year of any price-capped operators. The ODTR believes that any new controls or changes to the existing controls should be introduced on January 1st 2003.

**Q17.** *Do you agree that any new price caps or changes to existing price caps should be introduced on January 1st 2003? If not, please indicate what you believe would be a more appropriate date for the imposition of a new cap/s and why.*

## 5.3 Duration of Controls

The 1996 Act afforded the Minister the power to direct the Director to review and modify if necessary, the price cap after a period of 2 or more years.[16] The Minister exercised this right in 1999 and the price cap order was modified and a new price cap came into effect in

[15] Telecoms (Miscellaneous Provisions) Act, 1996, Section 7(1).

[16] Telecoms (Miscellaneous Provisions) Act, 1996, Section 7(5).

January, 2000. The current price cap has been in place since January 1st 2000 and the Director intends that this should remain in place until December 31st 2002 (a period of three years).[17]

There are a number of precedents for price caps being set for a period of five years in other utility sectors elsewhere. During the last price cap review, however, the Director expressed a view that a price cap period of five years was too long for the Irish telecommunications market. A five year cap provides strong efficiency incentives to capped operators but in a dynamic, technology driven market such as the telecom sector there is greater uncertainty about technical development and consequently competitive development. The Director continues to feel that a five year duration period for a price cap would be too long and a shorter period of 3 years might be more appropriate. Alternatively, the Director could consider the removal or continuation of the price cap in the light of an ongoing assessment of developments in the market without committing to any specific time period. Although this would bring benefits in terms of flexibility it might reduce the incentives on operators subject to the price cap to make efficiency gains as the period over which these gains were retained would be uncertain.

**Q18.** *Does the respondent believe setting a period for the price cap/s is appropriate or should the removal or continuation of a price cap be considered in light of competitive developments in the market? If a specific period is set, what period would be most appropriate?*

## 5.4 Carryover

The Director currently has discretion[18] to permit carryover from year to year for unmade increases permitted on individual sub-capped services in the basket or on the overall basket itself.

In relation to carryover in setting a new control, there are a number of options which can be considered:

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[17] Following the transfer of powers to the Director under the 1996 Act (through the Second Schedule of that Act), the Director now has discretion over the timing of the price cap review.

[18] Article 6(b) of S.I. 393 of 1996 as amended.

- Allow automatic carryover of price reductions beyond the target so that the operator/s can reduce prices by less the following year or years than it would have to if the price cap was applied on a strictly annual basis.

- Allow carryover from year to year only at the discretion of the Director

- Do not allow carryover in any instance

It is the view that of the Director that carryover in certain instances, be this automatic or discretionary, should continue to be allowed as refusing to allow carryover in all instances would deny consumers of the benefits of early reductions as the operator/s is likely to make just the minimum price reduction required in each year.

**Q19.** *Of the three options outlined above, which option is preferable to the respondent in dealing with the issue of carryover? Please give reasons why.*

It should also be noted that currently the Director has discretion to allow for carryover of unmade increases as opposed to reductions plus unmade increases e.g. if the allowable increase on a sub-capped service in a particular year was, say, 5% and the company in question reduced the price for the service by 2%, the maximum carryover that the Director could grant is the 5% and not the 7% had she taken account of the actual decrease in the price.

**Q20**. *In the event that carryover over is permitted (either automatically/discretionary) under a new price control, should carryover be constrained to unmade increases or should price reductions also be considered? Please consider a response to this question with respect to (a) the overall price cap on the basket of services (b) sub-capped services within the price and (c) the lower quartile bill (if such a control is retained)? Please give reasons in each case.*

When the current price cap was introduced eircom was not permitted carryover in any cases from the previous cap to the current cap. With respect to the new price cap the Director will review whether or not a similar policy is appropriate on this occasion. If some form of carryover were allowed, it might be the case that the Director allows this for the basket of services generally and/or allows carryover for particular services in the basket from the current price cap to a new cap, in the event that some or all of these services were retained in the basket.

***Q21***. *Should eircom be permitted carryover from the current price cap on (a) the overall basket and/or (b) currently sub-capped services, to a new price cap that might include some/all of these same services?*

## 5.5 Level and Structure of the Control

In the event that the Director deems that the price cap should be retained or indeed that a new price cap should be introduced for a particular basket/s of services it will be necessary to determine what the appropriate level of X should be in the formula prescribed by legislation i.e. CPI – X.

A standard approach to determining the appropriate level of X would involve assessments of the following factors:

- Value of the assets used in the provision of price capped services, taking into account prospective capital expenditure, depreciation and appropriate asset lives
- Financing costs (cost of capital)
- Operating costs relevant to the price capped services
- Estimates of the efficiency gains operator/s can be expected to make
- Forecasts of revenues for price capped services

Information of this nature would be used to come to a view on what change in the level of prices would allow the dominant operator to earn a reasonable return on capital for the service in question.

**Q22**. *Do respondents agree that this is the appropriate approach for determining the value of X in the formula CPI-X? If not, please indicate your preferred approach.*

Under the current tariff regulation order, a cap is placed on a basket of services which allows eircom a degree of freedom to adjust the prices of services within that basket. This freedom is restricted through the use of sub-caps on most of the individual elements of the price cap basket. The effect of these sub-caps is that in addition to ensuring that the average changes in prices for the services within the basket fall below the overall cap (currently CPI - 8%), eircom must also ensure that the prices for individual services fall below the sub-caps (CPI+2% for most services).

**Q23.** *Do respondents believe that the use of sub-caps on services within an overall basket should be continued? Are there specific sub-caps that are particularly desirable or undesirable? How restrictive should any sub-caps be in comparison to the cap on the overall basket?*

# 6 SUBMITTING COMMENTS

All comments are welcome, but it would make the task of analysing responses easier if comments were referenced to the relevant question numbers from this document.

The consultation period will run from March 1st 2002 to April 5th 2002 during which the Director welcomes written comments on any of the issues raised in this paper. Having analysed and considered the comments received, the ODTR will review responses and publish a report on the consultation in June which will *inter alia* summarise the responses to this consultation and consult on the Director's views on which markets should be subject to a price cap. In order to promote further openness and transparency the ODTR will publish the names of all respondents and make available for inspection responses to the consultation at her Offices.

The Director appreciates that many of the issues raised in this paper may require respondents to provide confidential information if their comments are to be meaningful. Respondents are requested to clearly identify confidential material and if possible to include it in a separate annex to the response. Such information will be treated as strictly confidential.

All responses to this consultation should be clearly marked "Reference: ODTR Price Cap Consultation ***02/21***" and sent by post, facsimile or e-mail to:

FREEPOST
**Ms Louise Power**
Office of the Director of Telecommunications Regulation
Irish Life Centre
Abbey Street
Dublin 1
Ireland

Ph: +353-1-8049600 Fax: +353-1-804 9680 Email: powerl@odtr.ie

to arrive on or before ***5pm, April 5th***.

**Office of the Director of Telecommunications Regulation**
**March 1st, 2002.**

# ANNEX A

## Consolidated Text of Telecommunications Tariff Regulation Order, following modification by S.I. No 438 of 1999.

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) Except as provided for in Article 2 of this Order in the definition of "lower quartile bill", this Order shall apply to the telecommunications services specified in the First Schedule to this Order and provided by the company.".

2. In this Order -

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

   "basket of telecommunications services" has the meaning assigned to it by Article 3;

   "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 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 in the State or in Northern Ireland which is regarded as adjacent to the first-mentioned telephone group;

"lower quartile bill" means a notional bill for telecommunications services (including telecommunications services other than those referred to in the First Schedule) 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;

"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;

"vulnerable user scheme" means any discount scheme which has been approved as such by the Director and which is aimed at vulnerable groups of users, within the meaning of

Regulation 8(2) of the European Communities (Voice Telephony and Universal Service) Regulations, 1999 (S.I. No. 71 of 1999);

3. The telecommunications services set out in the First Schedule to this Order shall be the basket of telecommunications services specified for the purposes of this Order and "basket of telecommunications services" shall be construed accordingly.

4. (1) The Minister hereby specifies $\Delta$CPI – 8% 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 (other than directory enquiry calls) contained in the basket of telecommunications services, the price cap shall be $\Delta$CPI +2%, and

(b) in respect of the lower quartile bill the price cap shall be $\Delta$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 and 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

$$\sum_{i=1}^{n} \Delta Pi \quad * \quad (Ri \ / \ Rt)$$

Where,

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

ΔPi is the percentage change in the tariff (before discounts, except for any light user scheme or vulnerable user scheme) for telecommunications service "i" calculated in accordance with a method to be specified by the Director after consultation with the company from either:

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

(ii) on the basis of a representative sample (approved of by the Director after consultation with the company) of call records for the service "i" provided by the company;

Ri 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;

Rt 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;

ΔPi is the percentage change in tariff (before discounts, except for any light user scheme or vulnerable user scheme) for telecommunications service "i" calculated in accordance with a method to be specified by the Director after consultation with the company from either:

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

(ii) on the basis of a representative sample (approved of by the Director after consultation with the company) of call records 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.