

Abstract

Cable & Wireless Jamaica (C&WJ) has traditionally been regulated by the rate of return method. For the first year after the commencement date (March 1, 2000) of the Telecommunications Act, 2000 C&WJ's prices will continue to be controlled under the pre-existing rate of return regime set out in section 35 of the All Island Telephone Licence, 1988. Section 46 of the Act mandates that the Office of Utilities Regulation (the "Office") establish "rules providing for the imposition, monitoring and enforcement of price caps." At section 81 (1) "Rules made under section 46 in relation to price caps shall apply to the existing telecommunications carrier with effect from the relevant date."

This document sets out some general rules relating to price cap regulation in Jamaica and provides a timetable for the drafting and enactment of additional price cap rules. It also provides the consultation process to be followed by the Office with regard to the initial price control period for existing carrier.

The Office is inviting written submissions on the contents of this document from interested parties, including, legal advocates, consumer groups, carriers and service providers and other interested parties. Readers are also encouraged to comments directly on the drafting instructions for general price cap rules. These are set out in the last Chapter 3. Written submission are due no later than February 5, 2001.

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COMMENTS FROM INTERESTED PARTIES

Persons who wish to express opinions on this Notice of Proposed Rule Making (NPRM) are invited to submit their comments in writing to the OUR. Comments are invited on all aspects of the proposed rules. Respondents may choose to reply to only specific aspects of the proposed rules. Failure to provide comments on all aspects of the document will in no way reduce the consideration given to the response.

Any information designated confidential should be submitted separately and clearly identified as such. In the interest of promoting transparent debate, respondents are requested to limit the use of confidentiality markings. Respondents are encouraged to submit their responses in electronic form, so that they can be posted on the OUR's website.

Responses to this NPRM document are requested by February 5, 2001 and should be sent by post, fax or e-mail to:-

Ansord E. Hewitt
P.O. Box 593, 36 Trafalgar Road, Kingston 10
Fax: (876) 929 3635
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Arrangements for viewing responses

Responses may be placed on the OUR website. They will also be kept in files at the offices of the OUR and will be available to be viewed or copied by visitor. Individuals who wish to view the responses should make an appointment by contacting Granville Newell by one of the following means:-

Telephone: (876) 968 6053 (or 6057)
Fax: (876) 929 3635
E-mail: granewell@our.org.jm

The appointment will be confirmed by a member of the OUR's staff. At the pre-arranged time the individual should visit the OUR's Offices at:-

3rd Floor, PCJ Resource Centre, 36 Trafalgar Road, Kingston 10.

The individual will be able to request photocopies of selected responses at a price, which just covers the cost to the OUR.

CHAPTER 1: LEGAL FRAMEWORK FOR PRICE REGULATION IN JAMAICA

Introduction

1.0 Cable & Wireless Jamaica (C&WJ) has traditionally been regulated by the rate of return method with a permitted return on shareholders' equity of 17.5-20%.¹ Right across the globe this method of price regulation has been sharply criticised because it provides little or no incentive for efficiency. Price caps is an alternate method of price regulation. It was introduced in the United Kingdom in the 1980s and has since become increasingly popular in North America.

1.1 With price caps the regulated entity is allowed to increase rates by an amount equal to the inflation rate minus a productivity factor. One of the chief advantages of price caps is that it encourages efficiency because the regulated entity is allowed to keep any efficiency gains realised, at least until the next periodic review. It also gives the regulated entity more flexibility in setting prices. Such flexibility is important in markets where firms compete for customers and market share. Price cap regulation is also beneficial to customers because rates are set on the assumption that the regulated firm will achieve some level of efficiency during the life of the cap. A criticism that is often levied at price caps is that the regulated entity may cut cost by lowering service quality, instead of improving efficiencies.

1.2 The Office's position is that formal price control should only be put in place when they are needed. Otherwise, they can inadvertently distort the operation of competition in the market. The incumbent operator serves a range of markets, some of which may be open to competition but others which may remain monopolies. Thus, the charges for some services will be subject to formal price control. In the opinion of the Office, the necessary condition for price control to be imposed subsequently upon carriers or service providers that are initially non-dominant would be:-

- the operator or service provider is found by the Office to be dominant;
- the operator or service provider is found by the Office to be abusing that dominant position; and
- the Office is satisfied that there are no other measures which could be adopted, such as the removal of barriers to entry, that could reasonably be expected to remedy the abuse of dominance without undue delay.

Telecommunications Act, 2000

1.3 Section 46 (2) of the Act empowers the Office to make rules ".....providing for the imposition, monitoring and enforcement of price caps." Section 81(1) provides that "Rules made under section 46 shall

¹ Section 29(1) of the All Island Telephone Licence, 1988.

apply to the existing telecommunications carrier with effect from the relevant date.” Section 81(3) defines the relevant date as the date next following the first anniversary of the appointed day of the Act. The appointed date of the Act is March 1, 2000. Section 71(1) of the Act further empowers the Office to make rules on any matter that it considers necessary or desirable for the effective performance of its functions pursuant to the Act.”

- 1.4 The Office considers the objectives of price cap regulation to be consistent with sections 3(a)(b)(c)(d) and 4(c)(f) of the Act:-
- to promote universal service of high quality at affordable prices;
 - to foster competition in the Jamaican market for telecommunications services; and
 - to provide incentives for the incumbent telecommunications carrier and service provider to improve efficiency and innovativeness while allowing for the opportunity to earn a reasonable return on investment.
- 1.5 The Act specifically requires the incumbent telecommunications carrier, C&WJ to be subject to price cap rules. It does not explicitly makes this exclusive to C&WJ, however, and the Office has not ruled out the possibility that it may need to subject other carriers or service providers to price cap regulation in the future. Therefore, the Office is of the opinion price cap rules should be drafted in such a way as to be applicable to carriers other than C&WJ. As things currently stand however, it is envisaged that only C&WJ will be initially subject to price caps.

Structure of Document

- 1.6 The next Chapter (2) provides the justifications for the general price cap rules proposed by the Office. A distinction between general and specific price cap rules and it also provides a timetable for completion of various activities relevant to the imposition of the initial price control period for C&WJ. Chapter 3 contains the proposed drafting instructions for general price cap rules.

CHAPTER 2: PRICE CAP RULES

Introduction

2.0 Under the Telecommunications Act all rules made by the Office are secondary legislation and are subject to affirmative resolution by Parliament. Two categories of rules are envisaged: general rules, and specific rules. This document sets out the initial views of the Office in respect of general rules. The drafting instructions for general price cap rules are set out in the next chapter. It is the intention of the Office to have general price cap rules available for Parliamentary approval prior to March 2, 1001. General rules cover issues having to do with the following:-

- the establishment of the initial price-cap period;
- obligation of carriers and service providers to provide information for price-cap purposes;
- public consultation and complaints;
- compliance with Price-cap rules;
- penalties for non-compliance; and
- review and renewals of price-cap controls

Establishment of Initial Price Cap Period

2.1 In establishing the length of the initial price cap control period, the Office has to weigh the risks of mis-specification against the benefits of maximising the incentives for efficiency. The more frequently that the plan is renegotiated, the more the incentives for efficiency are reduced, as the regulated entity would likely be required to return to ratepayers, in some fashion, the gains it made through improving its operations. Nonetheless, a long price control period could involve excessive risk, particularly as market conditions change.

2.2 In Jamaica, there are risks, especially with regard to continued decreases in the international settlement rates and the extent of improvement in C&WJ's performance under price controls. The Office envisages, however, that there are a variety of ways to accommodate such risks. In the first place, a relatively short initial term might be set for price controls. Risk may also be reduced through the application of a "Z" factor in the price-cap mechanism to account for changes in factors beyond the company's control, *i.e.*, exogenous changes. Alternatively, risks can be reduced through the adoption of a "hybrid" price-cap plan that includes oversight of the regulated company's earnings and may employ a mechanism for sharing earnings above an allowed range.

2.3 As a means of balancing the risks of uncertainty with the need for an adequate duration of the plan to provide efficiency incentives and to evaluate C&WJ's performance, the Office proposes that the general rules

stipulates an initial four-year term for the price-cap regulation plan. Notably, while a four-year term carries some amount of risk, the Office proposes to consider the inclusion of a “Z” factor (as discussed above) to reduce the extent of such risk. The Office also takes the view that a four-year term will provide it with adequate time to examine C&WJ’s performance under price-cap regulation.

- 2.4 The general rules should provide that in the case of the existing telecommunications carrier and service provider the price-cap regime will take effect on March 2, 2001. It should also provide that prices in effect on that date shall remain in effect without change until rules for changing prices are in place. Such rules should come into effect, on or before September 1, 2001 (or upon affirmative resolution of Parliament). Notably, September 1, 2001 would have been the date on which the C&WJ would normally be entitled to rate adjustment under the old regime. The rules shall also specify the initial price-cap control period to extend until August 31, 2005.
- 2.5 The Office is aware that C&WJ’s prices on April 1, 2001 may not satisfy the price-cap when it goes into effect on September 1, 2001. In such an eventuality, rates should automatically be allowed to change to meet the price cap requirements. Prices should not be permitted to change prior to September 1, 2001.

Price-cap Data Requirement

- 2.6 The Act stipulates that price-cap mechanisms must be based on the level of the weighted prices of the regulated company (Section 46 (1)). This means that the Office will require a database of average prices (defined as revenues divided by quantities) and quantities for each rate element subject to the price-cap mechanism. The Office will, therefore, need to develop a database of current prices and realised quantities of demand from the most recent fiscal year of the company for each rate element subject to the price cap. The rules should provide for the Office to be supplied with the required information to establish and initiate such a database. Furthermore, if the Office is to meet its objective to have a price cap mechanism in place by September 1, 2001 the initial database should be completed by June 1, 2001 and the rules should provide for this to be accomplished.
- 2.7 Other components of the formula will include the “X” factor, reflecting annual productivity growth by the regulated company, and exogenous cost “Z” factors, if it is decided that they should be included in the price-cap mechanism. The “X” factor to be adopted will reflect C&WJ’s historic productivity growth under rate of return regulation and the potential for greater productivity in its operations under a price-cap regime. The “X” factor adopted by the Office should also afford C&WJ the opportunity to

earn its cost of capital. At the end of each price-cap year, the database of prices, quantities of demand and the applicable rate of inflation must be updated for operation in the next price-cap year.

- 2.8 Additionally, a price-cap plan in Jamaica may include the adoption of a “Y” factor that would be used to define an upward limit on the increases of certain telecommunications services in Jamaica. The purpose of the “Y” factor is to limit the rate at which C&WJ may rebalance rates in any given year. Rate rebalancing at a reasonable pace will be necessary in light of the reductions in international settlement rates, particularly between the U.S. and Jamaica. The “Y” factor will be developed in the same timeframe as the “X” factor. The Office’s position is that neither the “X” factor nor the “Y” factor should be updated until the end of the initial price-cap period (2005).
- 2.9 The rules should also provide for the submission of data and other information relating to quality of service as it is anticipated that this will be a component in the price cap mechanism. The Office proposes to require these reports to be filed on a quarterly basis. The performance standards will be specified in the specific price control rules.
- 2.10 In summary, the rules should require that any telecommunications carrier or service provider subject to price-cap regulation shall file such data and other information related to price-cap regulation as the Office may require for purposes of monitoring compliance with the price-cap plan or for the effective administration and enforcement of its price-cap rules. These data shall include such data and other information as the Office may require to ensure that a telecommunications carrier or service provider is providing services of acceptable quality as defined by the Office.
- 2.11 To ensure speedy delivery of data and reports, the Office proposes simultaneous, electronic delivery of all databases and reports required by price-cap rules. Price changes may also be provided by electronic communications in addition to the hard-copy notices.

Public Consultation and Complaints

- 2.12 Public consultation will be a critical element in the whole price cap exercise and so the rules should specifically provide for this. Furthermore, as C&WJ files its proposed rate changes under the price-cap plan, interested parties should be afforded a right of query. The price-control rules should include a notification mechanism by which interested parties are informed of price changes. For example, consumers could be informed of price changes through newspaper announcements or bill inserts. Nonetheless, price changes that are within the price cap and meet imputation requirements should go into effect without unwarranted delay.

- 2.13 As the initial price control period nears its end, the Office proposes to initiate a consultation process to examine C&WJ's performance under price regulation and to consider if and under what conditions to extend the price-cap plan in a second price control period.
- 2.14 The public and other interested parties should also have the right to file complaints with the Office in order to bring to the OUR's attention alleged violations of the price control rules. The Office will determine the procedures for the filing and processing of complaints.
- 2.15 Through the public consultation process, the OUR will consider the recommendations of the interested parties and the company. Further, the public consultation and development of specific rules will have regard to international best practices in order to design the most effective price-cap plan that meets the needs of telecommunications sector. The vast experience available from other countries will also be considered by the Office. For example, international best practices may provide guidance on the appropriate measurement of inflation, the calculation of the X and Y factors, the structure of the baskets, and the duration of the price control period.
- 2.16 The Office considers that it is sufficient that the general rules cover the following in respect of public consultation:
- the initial price control period
 - the general rules for changing prices under price-cap controls
 - that during the term of any price-cap control period, the public and other interested parties may file complaints at any time concerning violations of any term or condition of the price-cap rules, including the provisions relating to service quality.
 - that the process for receiving, evaluating and disposing of complaints shall be as determined by the Office.

Compliance with Price-cap Rules

- 2.17 The general rules for the price-cap plan must include mechanisms for compliance with price-cap rules including the filing of annual updates to the price-cap database, financial reporting and individual price change filings. The Office will have an obligation to ensure that each price is above the appropriate price floor and complies with an imputation test, where applicable.
- 2.18 A number of means may be used to ensure that C&WJ's price changes comply with the price-cap rules. One method is, at the end of the price-cap year, to examine whether, on average, given the price changes and resulting revenue changes, C&WJ's rates throughout the year were within

the cap. Such a mechanism would appear to act as a true-up and may require rate reductions later in the period to return the company to compliance. This is a rather complex operation. The Office is of the view that a simpler and more effective alternative is a requirement that each price change be within the cap at the time of the price change. This would require the company to file simultaneously price reductions sufficient to remain in compliance with the cap. This requirement is in use in price-cap plans in other jurisdictions, for example the United States and Canada.

- 2.19 C&WJ must file an annual report containing the new data to be used in setting the price-cap formula for the ensuing year. Since results of these formulae are changed on September 1 each year, the Office proposes to require this data to be provided by June 1 each year. This date provides the company with adequate time to develop the necessary data from its prior year's financial and operating results (using an April 1st to March 31st fiscal year) and further provides the Office with ample opportunity to examine the data and recommend changes or corrections prior to September 1.
- 2.20 C&WJ should face penalties if it charges rates that are not in compliance with the price cap or if it charges rates different from those on file with the Office (see discussion on penalties below). The Office may initiate investigations in instances where it appears that C&WJ may, in fact, be pricing outside the scope of the price cap or in violation of tariffs on file. The OUR may impose an appropriate penalty following its investigation.
- 2.21 Any carrier or service provider subject to price-cap controls shall file with the Office: An annual report reflecting quantities and average prices (defined as revenues divided by quantities) which represent the quantities and prices needed to calculate the price index to be used for each basket in the next year of the price-cap control period. This annual report shall also include, to the extent required by the Office, information needed to monitor the carrier or service provider's rate of return.
- 2.22 This data shall be filed with the Office no later than June 1 of each year during which the plan is in effect. The data shall be filed in the manner and format prescribed by the Office. Notice of any increase in any rate or rate element, along with the necessary support (including a showing that the rate increase complies with the price-cap rules) at least thirty (30) working days prior to the effective date. Notice of any decrease in any rate or rate element, along with the necessary support (including a showing that the rate decrease complies with the price-cap rules and applicable imputation rules and other competitive safeguards) at least seven (7) working days prior to the effective date. Quarterly reports in a format determined by the Office to permit the Office to monitor compliance with the obligation to provide services of an acceptable quality.

- 2.23 The filings with the Office required under this section shall, to the extent practicable, be provided both by electronic communications and by hard-copy. Notice of price changes shall also be provided to customers at the same time as they are filed with the Office. The term “customers” envisages both end-users in the case of a price change in any retail service and competitors in the case of any service that is used by a competitor as an input to one of its service offerings.
- 2.24 The data and other information required under this section, including data related to price changes, may be made available to other carriers and service providers subject to procedures determined by the Office. The procedures will be designed to provide reasonable protection of proprietary information to the filing carrier or service provider while also allowing other carriers and service providers with the assurance that the terms of the price-cap plan are been adhered to.

Penalties for non compliance

- 2.25 An effective price-cap regime must include clear conditions under which the required information must be filed with the Office as well as clear and certain penalties for failure to comply with the provisions of the price-cap rules. In general applicable carriers should face penalties for not filing complete information for each price change under price regulation. Furthermore, failure to provide annual updates to the price-quantity database from which the price index for each basket will be calculated should be subject to fines. Penalties for other data required by the Office may also be appropriate.
- 2.26 This Office considers that it is important to have a range of applicable penalties to ensure compliance with price control rules. These include: the civil penalties provided for under The Telecommunications Act, 2000; the ordering of refunds and/or bill credits; and adjusting the price cap formula to penalise the carrier for failure to perform; for example, for failing to meet service quality standards.
- 2.27 In an instance where the Office determines that there has been a pattern or practice of violating the Office’s rules or orders, the Office will consider recommending the suspension or revocation of a carrier or service provider’s licence. The Office may determine to assess additional penalties as necessary to enforce its price control rules.
- 2.28 In sum, rules in respect of penalties should afford the Office the latitude to assess penalties for the failure to comply with price control rules and allow for penalties to include but not be limited to:
- The imposition of civil penalties as specified in Sec. 71 (2) of The Telecommunications Act, 2000;

- A requirement that any telecommunications carrier or service provider subject to the price control rules issue bill credits or refunds to customers;
- The inclusion of a “quality of service” (“QoS”) adjustment to the price cap formula; and
- In the case of a pattern or practice of failure to comply, the suspension or revocation of the carrier or service provider’s licence.

Review and Renewals of Price-cap Controls

- 2.29 As the initial price control period nears an end, it will be appropriate for the Office to commence an examination of C&WJ’s performance under the plan. The Office proposes to establish a reporting process at that time to provide a clear signal of its intent to review fully the initial experience under price regulation. It is envisaged that the Office will initiate its consultation process six (6) months prior to the termination of the initial price-cap term.
- 2.30 Via a consultation document, the Office will announce its intentions regarding the continuation of the plan as well as any proposed revisions to the plan. Such revisions may include the value of various parameters (*i.e.*, “X” and “Y” factors), the basket structure, the range of earnings to consider, or the length of next price-cap control period. The OUR will announce any proposed revisions to the structure of the price-cap plan and begin a consultation process within thirty (30) days of its initial election to revise the plan. The Office proposes that parties be given thirty (30) days to comment on its proposed structural revisions to the price-cap plan.
- 2.31 It is envisaged that a review of the price-cap plan will be comprehensive, covering annual reports submitted under the price-cap plan; productivity achieved under price-cap regulation; the cumulative effect of rate rebalancing achieved over the initial term of the price-cap period and the performance with regard to any service quality standards set through under the plan.
- 2.32 Upon completion of the consultation process and the analysis of the performance of the initial plan, the Office will announce any proposed revisions to the price-cap formulae and price-cap indices. The Office should complete its review and consultation at least fifteen (15) days prior to the end of the first price-cap control period on August 31, 2005.
- 2.33 In summary, the general rules should afford the Office scope at the end of the initial or any subsequent term of a price-cap control period, to either elect to: (i) extend the price-cap control period subject to existing rules; or (ii) extend the price-cap control period subject to revised rules. They should stipulate a time period prior to the end of the cap for initiation of

this process of review (six months). Where the Office elects to revise its price-cap control rules, it shall announce any proposed revisions relating to changes in the structure of price-cap plan and begin a consultation process within thirty (30) days of its election. Parties shall have thirty (30) days to file comments on these structural revisions with the Office. Within thirty (30) days of receipt of the annual report from the carrier for that year, the Office shall announce any proposed revisions relating to changes in the price-cap formulae and price-cap indices. Parties shall have thirty (30) days to file comments on these proposed rules. The Office shall review all comments and issue a final decision no later than fifteen (15) days prior to the end of the term of the price-cap control period.

Specific Rules

2.34 Specific rules are intended to cover the micro aspects of price cap regulation and include procedures having to do with:-

- Determination of services to be covered by P+X and (sub-cap) P+Y.
- Removal of a service or group of services from the price cap basket.
- Introduction of new services.
- Provision of pricing and other information to consumers and other forms of consumer protection
- Safeguards against anti-competitive behavior.
- Notification requirements to competitors of price changes by the dominant operator and/or period for the regulator to consider whether the price changes are likely to raise concerns of anti-competitive behavior.
- Treatment of any “unused price cap”, ie where changes in the weighted basket price in any one year is less than that permitted under the price cap.
- “Timing constraint” to bind price changes throughout the year to ensure that increases are not all implemented at the beginning, whilst reductions are delayed until the end of the year
- Charges for services previously offered free of charge by a carrier or service provider.
- Discount tariff plans and promotional offers.
- service quality standards to avoid trade-off between cost containment and service quality.

2.35 In April 2001 the Office will issue for public comments a NPRM setting out the specific rules for price cap regulation. The intention is to have these rules in place prior to the commencement date of the initial price control period (September 01, 2001) for C&WJ.

Price Cap Design And Structure

2.36 In April 2001 the Office will issue a consultative document setting out its position with regard to the initial price cap control period for the existing carrier. This document will address various issue including inter alia :-

- the nature of the price cap to adopt (pure versus hybrid).
- services to be covered by price caps;
- number of service baskets and their structures
- index of inflation
- tariff rebalancing including modifications to the current Low User Package

2.37 Additional work will be needed in order to put in place a fair and workable pricing arrangement for C&WJ. Values of X and Y will have to be decided. Quantities of the various services to be covered by price caps, and the resolution of other issues are important to the establishment of C&WJ's initial price caps.

Conclusion

2.38 The discussions in this document and the drafting instructions set out in the next Chapter are intended to provide a broad framework under which price-cap regulation will be conducted in Jamaica. The development of both general and specific price-cap rules will be conducted by the Office through a process of public consultation of which, this represents the first stage.

CHAPTER 3: DRAFTING INSTRUCTIONS FOR GENERAL PRICE CAP RULES

Introduction

- 3.0 The following constitutes a set of drafting instructions to give effect to the objective that the Office has so far outlined in this document. Respondents are invited to comment on these indicating whether they are consistent with the stated objectives. Suggestions as to amendments and or additions are also welcomed.
- 3.1 Consistent with the Telecommunications Act the Price Cap Regime will take effect as of April 1, 2001 and not exceed five years. The prices of a telecommunications carrier or service provider, subject to price cap regulation which are in effect at that date shall then only be changed subject to the specific rules adopted for establishing the price cap regime and in accordance with the required procedures for effecting a rate change during the price cap control period.

Obligation of Carriers and Service Providers to Provide Information

- 3.2 Any telecommunications carrier or service provider subject to price cap regulation shall file such data and other information as may be required by the Office for the purposes of establishing, monitoring and enforcing the price cap regime. Such information may include:
- An annual report reflecting quantities and average prices (defined as revenues divided by quantities) which represent the quantities and prices needed to calculate the price index to be used for each basket in the next year of the price-cap control period. This annual report shall also include, to the extent required by the Office, information needed to monitor the carrier or service provider's rate of return. This data shall be filed with the Office no later than June 1 of each year during which the plan is in effect. The data shall be filed in the manner and format prescribed by the Office.
 - Notice of any increase in any rate or rate element, along with the necessary support (including a showing that the rate increase complies with the price-cap rules) at least thirty (30) working days prior to the effective date.
 - Notice of any decrease in any rate or rate element, along with the necessary support (including a showing that the rate decrease complies with the price-cap rules and applicable imputation rules and other competitive safeguards) at least seven (7) working days prior to the effective date.

- Quarterly reports in a format determined by the Office to permit the Office to monitor compliance with the obligation to provide services of an acceptable quality.
- 3.3 The filings with the Office required under this section shall, to the extent practicable, be provided both by electronic communications and by hard-copy.
- 3.4 Notice of price changes shall also be provided to customers at the same time as they are filed with the Office. The term “customers” as used in this paragraph includes both end-users in the case of a price change in any retail service and competitors in the case of any service that is used by a competitor as an input to one of its service offerings.
- 3.5 The data and other information required under this section, including data related to price changes, may be made available to other carriers and service providers subject to procedures determined by the Office. The procedures will be designed to provide reasonable protection of proprietary information to the filing carrier or service provider and to provide other carriers and service providers with a reasonable opportunity to monitor compliance with the terms of the price-cap plan or the Office’s price-cap rules.
- 3.6 Where applicable the Office may refer information or complaints to the Fair Trading Commission.

Penalties for failure to comply with price control rules

- 3.7 The Office may assess penalties for the failure to comply with its price control rules. These penalties shall include:
- The imposition of civil penalties as specified in Sec. 71 (2) of The Telecommunications Act, 2000;
 - A requirement that any telecommunications carrier or service provider subject to the price control rules issue bill credits or refunds to customers;
 - The inclusion of a “quality of service” (“QoS”) adjustment to the price cap formula; and
 - In the case of a pattern or practice of failure to comply, the suspension or revocation of the carrier or service provider’s licence.

Review and Renewal of Price-cap controls

3.8 At the end of the initial or any subsequent term of the price-cap control period, the Office may elect to either (i) extend the price-cap control period subject to existing rules; or (ii) extend the price-cap control period subject to revised rules. The Office will make this election six months prior to the end of the initial or any subsequent term. If the Office determines to revise its price-cap control rules, it shall announce any proposed revisions relating to changes in the structure of price-cap plan and begin a consultation process within thirty (30) days of its election. Parties shall have thirty (30) days to file comments on these structural revisions with the Office. Within thirty (30) days of receipt of the annual report from the carrier for that year, the Office shall announce any proposed revisions relating to changes in the price-cap formulae and price-cap indices. Parties shall have thirty (30) days to file comments on these proposed rules. The Office shall review all comments and issue a final decision no later than fifteen (15) days prior to the end of the term of the price-cap control period.

**Using Price Caps to Regulate Jamaican
Utilities**

**An Introduction to
Price Caps**

by
Jon Stern
London Business School &
n/e/r/a

18th November 1999

Format of Presentation

- 1. Introduction**
 - What is a price cap?
 - Price cap regulation and rate of return regulation
 - The economics of the price cap model
- 2. Key choices in making price caps operational**
- 3. Main steps in setting price caps**
- 4. Price cap regulation and developing countries**
- 5. Concluding comments**

What is a Price Cap?

- A price cap sets the *path* for the *maximum price* that a utility can charge its customers relative to the rate of inflation
 - it applies for a specified period e.g. 5 years
 - it includes an annual efficiency improvement target (e.g. 4% per year): the X factor

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Price Cap Regulation and Rate of Return Regulation I

Price cap regulation primarily looks *forward*

- Price cap is set to allow sufficient revenues to support continuous operations
 - including future investment needs *as well as* to provide return on past investments
- Provides incentives to improve productivity and reduce costs
 - profits earned by firm from beating efficiency cap higher for rest of price cap period

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Price Cap Regulation and Rate of Return II

Rate of return regulation primarily looks *backwards*

- Key question is checking all costs against what was previously approved
- Few risks but very weak incentives to improve efficiency and reduce costs
- Simpler to operate than price caps but difficult to sustain outside full monopoly environment
 - e.g. regional vertically and horizontally integrated power or water company

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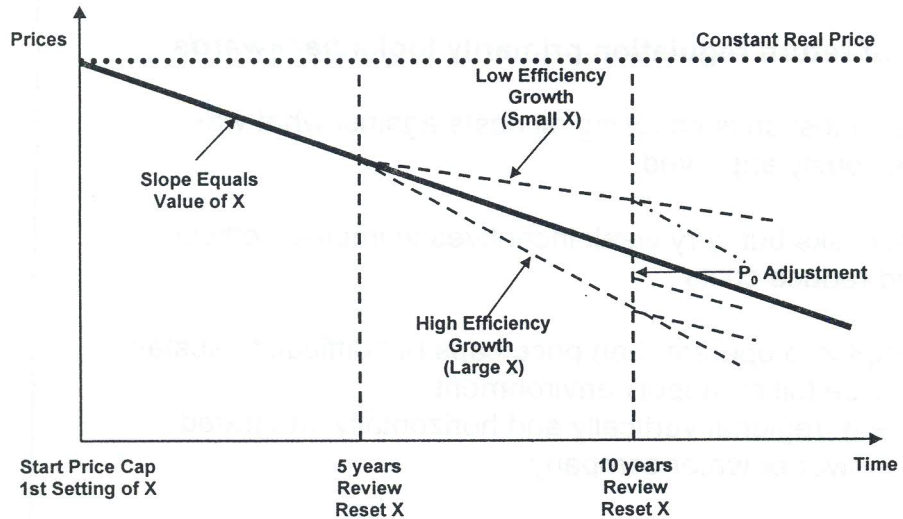
Price Cap and Rate of Return Regulation III

Price cap regulation does *not* mean that rate of return becomes irrelevant

- Definition and level of cost of capital/rate of return are always critical issues at regulatory review
- Unbundling and competition lead to different required rates of return in different parts of business
 - lower risk implies lower necessary rate of return for network services (electricity transmission)
- Incentive effects from price cap regulation only operate if reasonable certainty over expected rate of return

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Price Caps: A Diagram



Price Caps: The Simple Model

For period ($t \Rightarrow t+s$)

$$\text{Max Price of Utility Services} = \Delta \text{CPI} - X$$

Where:

Δ is the annual rate of change

CPI is the level of (average) consumer prices

X the Regulator's target for the annual rate of change of efficiency in the regulated activity

Price Caps: The General Model

For period ($t \rightarrow t+s$)

$$\text{Max Price of Utility Services} = a_0 + a_1 \Delta \text{CPI} + a_2 X + a_3 Y$$

Where

a_0 is any initial P_0 adjustment

Δ is the rate of annual change of (average) consumer prices

X is the Regulator's target for the annual rate of change of efficiency in the regulated activity

Y is the Regulator's allowed catch-up term e.g. to allow for previous under-investment, low prices, etc.

a_1, a_2, a_3 usually equal to 1.

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Key Choices in Making Price Caps Operational

1. What utility services should be subject to price cap?

- end-user price to all consumers **or**
- end-user price to small consumers only **or**
- prices of network services only

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Key Choices in Making Price Caps Operational

Services subject to a price cap

- **Services to large business (or all business) consumers typically excluded from price cap**
 - they don't need price cap protection
 - more likely to face competing suppliers
- **Single price cap to consumers usually starting point for price regulation in Transition economies and developing countries**
 - price cap usually set an annual basis
 - prices to small consumers frequently cover any operating costs and do not allow for rate of return (India, some African countries, Central and Eastern Europe)

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Key Choices in Making Price Caps Operational

2. Should there be a *single* price cap or *multiple* price caps?

- single price cap affecting average price paid by final consumers **or**
- price caps with limits on price re-balancing between (a) consumers and/or (b) types of service **or**
- separate price caps for separate parts of utility service
 - (a) electricity networks (b) electricity supply

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Key Choices in Making Price Caps Operational

- **Multiple price caps increasingly common in electricity**
 - potential efficiency gains and their determinants very different
 - different services need different X's
 - different services face different investment needs and risks (cost of capital)
 - catch-up (Y) factor most important for electricity prices to households and small farmers
- **Single price caps more common in telecoms**
 - price caps usually exclude some services (e.g. VANS)
 - proportion of excluded services tend to grow over time
 - price caps for telecoms more likely to have limits on price re-balancing
(call v. rental charges, local v. trunk v. international calls)

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Key Choices in Making Price Caps Operational

3. Is CPI the best price index?

- problem of specific costs
 - electricity often has separate fuel price adjustment factor, particularly with single price cap
- problem of exchange rate jumps
- problem of changes in sales taxes (included in CPI)

CPI usually taken as best indicator but small, open economies must allow for changes in prices of imports and exchange rate changes.

- major problem in recent years in S.E. Asia, Pakistan, some African countries

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Main Steps in Setting and Resetting Price Caps on Review

1. Define the regulatory asset base (RAB) and set the rules for rolling it forward (e.g. depreciation rules)
2. Calculate the appropriate cost of capital/rate of return
3. Project forward required investment in the regulated activities
4. Calculate plausible efficiency gains
 - in operating costs (opex)
 - capital costs (capex)
5. Set the efficiency factor X (and, if appropriate the catch-up factor Y)

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Problems in Price Cap Regulation for Developing Countries

- Data issues e.g. estimating value of regulating asset base
- Uncertainties over investment needs, cost of capital, exchange rates etc
- Need to include factors for, price re-balancing e.g. increased prices to small consumers, between types of services
- Complexity of multiple price caps

Implications

- 5 year price cap may initially be better done with review after 3 years
- alternatives include review triggers, profit (and loss) sharing, etc
- need to take account of exchange rate issues in price cap regimes

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Conclusions

- 1. Price caps have major advantages for developing economies**
 - incentives to improve efficiency
 - can assist in achieving relative price readjustments
- 2. Price caps are simple in theory but price cap reviews are complex and resource intensive**
- 3. If achievable, price caps are better than the alternatives particularly (a) with privatisation (b) with competition**
- 4. Provided review triggers allowed, price caps certainly feasible in developing countries using initial data approximations as necessary**