
Office of Utilities Regulation

Specific Price Cap Rules

Notice of Proposed Rule Making



OFFICE OF UTILITIES REGULATION

April 2001

Abstract

In January of this year the Office published a Notice of Proposed Rule Making (NPRM) document setting out its initial position on general rules for the imposition, monitoring and enforcement of price caps. Subsequent to a review of responses to the NPRM on general rules, the Office has submitted a set of general rules to the Minister of Commerce, Industry and Technology for affirmative resolution by Parliament. Indications were given in the NPRM on general rules that the Office would be proceeding to issue specific rules for consultation in April.

This document sets out the proposed specific rules on which the Office seeks comments. It sets out in further details the proposed approach to enforcing the general rules set out in the previous consultation. It also indicates, *inter alia*: the categorisation for items under price caps and the underlying criteria, treatments of unused caps and discount, and the proposed price cap formula.

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 Chapter two (2). Written submission should be made no later than April 30, 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 although 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 April 30, 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
E-mail: ahewitt@our.org.jm

Arrangements for viewing responses

Responses will 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: Specific Rules

Introduction

1.1 The Office's authority to make rules regarding price caps is set out generally at Section 71 and specifically at Section 46 of the Telecommunications Act 2000. Section 71 allows the Office to make rules prescribing any matter required by the Act to be prescribed whereas, Section 46 requires the Office to make rules providing for the imposition, monitoring and enforcement of price caps. The Office has already undertaken consultation on general price cap rules, a set of which has been passed to the Minister of Industry, Commerce and Technology for affirmative resolution by Parliament.

1.2 This document sets out and discusses the Office's proposals on specific rules. Chapter one (1) contains discussions of the specific rules regarding price caps while Chapter two (2) contains the specific rules in draft format. The 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 price caps;
- Reclassification of services;
- Treatment of new services;
- Provision of information to consumers and competitors;
- Information to be provided on filing of rate changes;
- Treatment of "unused" price cap;
- Constraint to ensure compliance throughout the year;
- Discount tariff plans and promotional offers;
- Service quality standards to avoid trade-off between cost containment and service quality;
- Treatment of exogenous factors;
- Price cap index formula

The office proposes to publish a consultation document in May incorporating all the work done on price cap to that date and inviting public comments on among other things, the appropriate inflation index, the approach to rebalancing under price cap and the various price cap parameters.

Initial Basket Structure

1.3 As a general principle, the Office takes the view that price caps should only apply to products that are in retail markets that are deemed to be not subject to effective competition. An outline of the approach the Office will take to determining effective competition is set out below under the discussion of reclassification of services. In determining the categories for the initial baskets, the Office has considered the following:

- The extent to which competition exists or is imminent;
 - Whether there are other retailers of the service;
 - Whether the Telecommunications Act restricts the supply of the service to C&WJ;
 - Whether the Office deems that the rate for the service requires rebalancing and that there is a need to regulate the extent and rate of any such rebalancing;
- 1.4 The Office has delineated four categories of products and services for the assessment of price caps viz. no price regulation, retail mobile services, retail fixed to mobile services and basic retail offerings. The first category constitutes those services that the Office considers to be currently the subject of effective competition and so they do not require price cap regulation. The second category consists of mobile retail offerings, not now the subject of competition but this is expected to change shortly. The third consists of fixed to mobile services, the fixed element of which is still subject to some degree of monopoly control. Finally, the fourth category (by far the largest) consists of all basic retail services that are deemed to be not subject to effective competition.
- 1.5 A table showing the recommended initial classification of services is attached to this report as Annex A.

Reclassification of services

- 1.6 The Office envisages that as competition emerges in different market sectors there will be a need to reclassify products in order to remove them from price cap regulation. Such a reclassification may be undertaken either at the initiative of the Office or at the request of a carrier or service provider. The critical consideration in deciding to remove a product or service from price cap regulation should be a determination that the product is subject to effective competition. The Office will consider a product or service to be subject to effective competition if all of the following conditions are met:
- At least one competitor is actually operating in the relevant market using its own switching and transmission facilities;
 - Other competitors, in aggregate, have capacity in place to meet a large portion of total demand in the relevant market; and
 - The market is not characterised by anti-competitive practices or pricing, including collusion among competitors.
- 1.7 Prior to reclassifying a product as being subject to effective competition, the Office will consult with the Fair Trading Commission.
- 1.8 Although it is anticipated that the market for telecommunications services will become increasingly competitive and that over time the number of products

and services regulated by price cap will fall, the Office does not rule out the possibility that a product or service, once deemed to be subject to effective competition may subsequently require price cap regulation. In such an eventuality, the Office retains the right to reclassify a product or service to fall within one of the categories subject to price cap regulation. Such a reclassification shall take place following a determination, whether at the Office's initiative or after a complaint, that such service is no longer subject to effective competition and that a reclassification is necessary to protect consumers.

- 1.9 The Office takes the view that new products and services should not be subject to price cap regulation as this may present a deterrent to innovation. At the same time, there is a clear need to ensure that a service presented as new is not simply a repackaging of a pre-existing offering. As a safeguard, the Office takes the view that a service should qualify as a "new service" only if it is not currently being offered and has not been offered within the previous twelve-month period. Additionally, an existing service should not be withdrawn without the consent of the Office.

Provision of Information to Consumers and Competitors

- 1.10 The general rules provide that a carrier or service provider subject to price cap regulation must provide the Office and the public with adequate notice of proposed rate changes. In the case of a rate increase, the notice period is thirty (30) working days, while in the case of a decrease, the period is seven (7) working days. Notice should be provided to the public at the same time that the proposed rate is filed with the Office. Notice to the public should be given both by way of a billing insert to customers of the service and by publication in a major newspaper with general circulation.

Veracity of Information Submitted to the Office

- 1.11 The information in respect of price changes filed by a carrier regulated under price caps should clearly indicate that the proposed rate complies with the price cap rules and satisfies an imputation test. In this regard, the Office proposes to make it a requirement that each filing for a rate change shall be accompanied by a signed statement from a director of the Company certifying that the proposed rate change complies with the price cap rules and demonstrating that it satisfies the relevant imputation test.
- 1.12 At the time of filing of a rate change, the carrier or service provider shall supply data indicating that in the aggregate, the revenues from each service category cover its fully-distributed-costs ("FDCs"). For this purpose, the carrier or service provider shall impute the costs of interconnection at the prices charged to competitors. Alternatively, the carrier or service provider

may file estimates of incremental costs, with full supporting information, to show that in the aggregate, the revenues of each service category that is subject to competition (but which has not been designated as subject to effective competition), cover the long-run incremental costs of services in such service category.

- 1.13 Notwithstanding the fact that it does not object to a proposed rate change, the Office should retain the right to investigate any rate or rate element if it has reason to believe that it does not satisfy the relevant imputation tests. In which case, the carrier or service provider should be obliged to provide the Office with the detailed revenue and cost information required by the Office for such an investigation in a timely manner.
- 1.14 The Office concedes that a carrier should not be prevented from proceeding with a rate increase because of an investigation. By the same token, the Office takes the view that if a carrier fails to furnish information relating to a price increase on a timely basis, this should provide the basis for rescinding the rate change. Where, after investigation, the Office determines that a rate change violated the price cap provisions, the rules should provide for a rate roll back and, if applicable, a refund to the affected consumers.

Treatment of “Unused” Cap

- 1.15 In order to allow the carrier to maintain greater flexibility in terms of the timing of its rate changes, the Office takes the view that “unused” cap should be carried from one period to another. “Unused” cap refers to any room for rate increases within the constraint of the price cap index formula that has not been exhausted within a period. This approach would allow the carrier the option of delaying legitimate rate increases if it so desires.

Approach to Ensuring Compliance throughout the Year

- 1.16 The Office has considered two approaches to ensuring that price changes comply with price cap conditions. One would be to check each proposed rate change to ensure it complies with the price cap. The other is to allow the carrier the option of charging rates above price cap during the year as long as there is an adjustment at the end of the year to ensure that average price for the year was in compliance with the cap. The Office considers the first approach to be preferable as, it provides ongoing protection for consumers and does not allow the carrier a potential windfall from maintaining rates (and the associated revenues) above the cap for most the year, while lowering them only at year’s end.
- 1.16 Having regard to the above position, the Office takes the view that to ensure compliance with price cap rules, the carrier or service provider shall demonstrate that each price change satisfies the Actual Price Index (“API”) constraints, defined in Section 1.25. In this regard, the effect of price

changes on the API shall be cumulative for each year and may not result in the API exceeding the Price Cap Index (“PCI”), as defined in Section 1.22, in any year.

Treatment of Discounts and Promotional Offers

- 1.17 The Office has already indicated that it is apprised of the need for a carrier to retain some degree of flexibility in respect of the use of discounts and promotional offers¹. This is particularly applicable with regard to services falling within the basic basket. There is a need to ensure, however, that as the market becomes increasingly competitive, such offers are not used for anti-competitive purposes. In this regard, a service offering designated “promotional” should not be available for more than ninety (90) days. Additionally, there should be no successive promotional offerings to the same customer groups.
- 1.18 A promotional offering of a competitive service should also be required to comply with the requirement of a relevant imputation test. This demonstration shall apply to the particular rate elements subject to the promotional offering. Moreover, promotional offerings should not be used when calculating the amount of “unused” cap available to a carrier.

Service Quality Standards to Avoid Cost and Quality Trade-offs

- 1.19 Notwithstanding the voluntary adoption of quality of service standards by a carrier or the imposition of quality of service standards by the Office pursuant to Section 44 of the Telecommunications Act, the Office should retain a right to include specific quality of service penalties as part of an overall price cap regime. Such quality of service penalties may include a requirement that a telecommunications carrier or service provider subject to price control rules issue bill credits or refunds to customers for failure to meet the standards specified.

Exogenous Factors

- 1.20 As indicated in the Office’s Notice of Proposed Rule making on general price cap rules, there is sometimes a need to take account of the possibility of exogenous events in designing a price cap regime. An exogenous event is one that has a significant effect on the commercial performance of a carrier (is specific to the carrier or the sector) but is totally outside of its control and cannot be mitigated by its actions.

Rebalancing

- 1.21 The downward movement in international settlement rates and the drive towards a competitive market for telecommunications will require realignment of rates for a number of services that will fall under price caps. At

¹ See Notice of Proposed Rule making on General Price Cap Rule, January 2001.

the same time, there may be a need because of social and other considerations to manage the pace at which specific rates are adjusted. This may be done by the use of a sub-cap to limit the rate of upward movements on certain rates. Alternately, rebalancing could be effected by adopting a schedule of sub-constraint for the services that are identified as requiring special treatment. To this end, the specific rules will provide for the Office to impose sub-constraints as part of an overall rebalancing strategy.

Proposed Price Cap Index Formula

1.22 The price cap plan requires a clear, identifiable formula that the Office, C&WJ, and other interested parties can understand and agree as to its meaning. The Office proposes the following as constituting a workable price cap formula.

$$PCI_0 = 1$$

$$PCI_t = PCI_{t-1} [(P_t/P_{t-1}) - X \pm Z_t - Q_t], t > 0$$

where,

PCI is Price Cap Index

t = year ($t = 0$ at the start of the price-cap plan);

PCI_t = the price cap index for year t ;

P_t = the relevant general price index in year t (P_t should be for the most recent twelve-month period for which data are available.);

X = the productivity adjustment factor; and

Z_t = the exogenous adjustment factor in year t .

Q_t = Quality of service adjustment factor

1.24 The Office proposes to establish numerical values for the all parameters of the PCI equation by end of July 2001.

1.25 The weighted average price level, known as the Actual Price Index ("API"), for each basket shall be calculated according to the following formula:

$$API_0 = 1$$

$$API_t = API_{t-1} \left(\frac{\sum_i w_i^j p_t^i}{\sum_i w_i^j p_{t-1}^i} \right), t > 0$$

where,

API_t = the actual price index in year t ;

p_t^i = the price of rate element i in year t ;

w_t^j = the base-period quantity of rate element i in year t .

1.26 It is envisaged that the price cap will be adjusted annually on 1 September. The base period for calculating w_t^j shall be the twelve months ending the previous 31 March.

The condition for compliance with the price cap regulations is that, for each price change in year t , the cumulative API_t shall remain less than or equal to PCI_t for each basket.

CHAPTER 2:

Drafting Instructions for Specific Rules

Introduction

- 2.1 The following constitutes a set of drafting instructions for specific rules to give effect to the objective that the Office has so far outlined in this document. Specific rules for price cap shall be interpreted and applied together with the general rule for price caps. Respondents are invited to submit comments on these rules indicating whether they are consistent with the stated objectives. Suggestions as to amendments and or additions are also welcomed.
- 2.2 The rules outlined below constitutes specific rules for a price cap regimes and shall be read, interpreted and applied together with the general rule for price caps.

Classification of Services

- 2.3 The Office shall establish and provide notice of the initial categories of services for the purposes of price cap regulation.
- 2.4 The Office acting on its own or upon a petition from a carrier or service provider may reclassify any service covered by the price cap regime.
- 2.5 A service shall only be removed from price cap regulation upon a finding by the Office that such service is subject to effective competition. In reclassifying a service the Office may consult with the Fair Trading Commission (FTC) on have regard to its opinion on the matter.
- 2.6 A service is subject to effective competition when all of the following conditions are present:
- At least one competitor is actually operating in the relevant market using its own switching and transmission facilities;
 - Other competitors, in aggregate, have capacity in place to meet a large portion of total demand in the relevant market; and
 - The market is not characterised by anti-competitive practices or pricing, including collusion among competitors.
- 2.7 The Office may return a service to regulation under the price cap regime if it determines, on its own or upon a complaint, that such service is no longer subject to effective competition and that reclassification is necessary to protect consumers. Prior to taking a decision to reclassify a service as no longer subject to effective competition, the Office may consult with the FTC and have regards to its views on the matter.
- 2.8 No new services shall be subject to price cap regulation. A service will qualify as a “new service” only if it is not currently being offered and has not

been offered within the previous twelve-month period. No existing service may be withdrawn without the consent of the Office.

Veracity of Information Submitted to the Office

- 2.9 In keeping with the requirements set out in the general rules, a carrier subject to price cap regulation shall provide notice to the Office and the public of proposed rate changes. Such notice shall be provided by way of a billing insert to customers of the service and announcement in a newspaper with general circulation.
- 2.10 When a carrier or service provider subject to price cap regulation files a price change with the Office, it shall supply the Office at the same time with evidence that the rate satisfies the relevant imputation test. A director of the corporation shall be required to certify to this effect.
- 2.11 The imputation test shall require the carrier or service provider to file data showing that, in the aggregate, the revenues of each service category that is subject to competition (but has not been designated as facing effective competition) covers its fully-distributed-costs (“FDCs”), evaluating the costs of interconnection at the prices charged to competitors. Alternatively, the carrier or service provider may file estimates of incremental costs, with full supporting information, to show that in the aggregate, the revenues of each service category cover the long-run incremental costs for all services in such category.
- 2.12 Any price change that meets the above requirements shall be allowed to go into effect.
- 2.13 The Office may investigate any rate or rate element if it has reason to believe it does not satisfy the relevant imputation test. The carrier or service provider shall provide the Office with the detailed revenue and cost information required by the Office for such an investigation in a timely manner.
- 2.14 If, following such investigation or upon failure of the carrier to provide the required information in a timely manner, the Office determines that the rate or rate element is improper, it may require the carrier to rescind the price change and refund any revenues improperly collected to the affected consumers.

Treatment of “Unused” Cap

2.13 The “unused” cap for any carrier or service provider at any time shall be available for use toward future price changes. The “unused” cap is defined as the amount of additional price increase allowed by the price cap index formula that has not been exhausted by the carrier or service provider through price increases.

Approach to Ensuring Compliance throughout the Year

2.14 The carrier or service provider shall demonstrate that each price change satisfies the Actual Price Index (“API”) constraints, defined at Section 2.25. The effect of price changes on the API shall be cumulative for each year and may not result in the API exceeding the Price Cap Index (“PCI as defined at Section 2.21), in any year.

Treatment of Discounts and Promotional Offerings

2.15 Promotional offerings of services within the “basic” classification, including discounted rates, shall be exempted from non-discrimination rules. A service offering shall qualify as “promotional” if it is characterised as such by the carrier or service provider, is available for no more than ninety (90) days, and there are not successive promotional offerings to the same customer groups.

2.16 If a promotional offering of a competitive service is made, the carrier or service provider must demonstrate, at the time that the offering is made, that the offering satisfies the relevant imputation test. This demonstration shall apply to the particular rate elements subject to the promotional offering.

2.17 Promotional offerings shall be excluded from the price cap plan and as such any price decreases embodied in a promotional offering shall not generate any “unused” cap that can be used to increase prices of other basic services.

Service Quality Standards

2.18 Notwithstanding any quality of service commitment issued by a carrier to its customers or any quality of service standard imposed by the Office pursuant to Section 44 of the Telecommunications Act, the Office may elect to include service quality penalty as part of an overall price cap regime.

Exogenous Factors

2.19 The price cap formula may take account of positive or negative exogenous factors that have a direct effect on the commercial operations of a carrier subject to price cap but are outside of its control. Provided that such considerations shall not include factors that the carrier could have taken steps to mitigate.

Rebalancing

2.20 A carrier or service provider subject to price cap regulation shall be permitted to rebalance rates on specific services subject to limitations or sub-constraints developed by the Office. Services to be the subject of such sub-constraints shall be determined by the Office after consultation with the carrier.

Price Cap Index Formula

2.21 The Office shall apply the following formulation for setting the price cap index ("PCI"):

$$PCI_0 = 1$$

$$PCI_t = PCI_{t-1} [(P_t/P_{t-1}) - X \pm Z_t - Q_t], t > 0$$

where,

t = year ($t = 0$ at the start of the price-cap plan);

PCI_t = the price cap index for year t ;

P_t = the relevant general price index in year t (P_t should be for the most recent twelve-month period for which data are available.);

X = the productivity adjustment factor; and

Z_t = the exogenous adjustment factor in year t .

Q_t = Quality of service adjustment factor

2.22 The weighted average price level, known as the Actual Price Index ("API"), for each basket shall be calculated according to the following formula:

$$API_0 = 1$$

$$API_t = API_{t-1} \left(\frac{\sum_i w_i^j P_t^i}{\sum_i w_i^j P_{t-1}^i} \right), t > 0$$

where,

API_t = the actual price index in year t ;

p_t^i = the price of rate element i in year t ;

w_t^i = the base-period quantity of rate element i in year t .

2.23 The price cap shall be adjusted annually on 1 September. The base period for calculating w_t^i shall be the twelve months ending the previous 31 March.

2.24 The condition for compliance with the price cap regulations is that, for each price change in year t , the cumulative API_t shall remain less than or equal to PCI_t for each basket.

Annex A: Proposed Initial Classification of Services

Service Classification	No Price Regulation	Retail Mobile Services Basket	Retail Prices of Fixed-to-Mobile Call Basket	"Basic" Retail Offering Basket
Charge free services:				
Directory assistance				X
Repair services				X
Billing queries				X
General queries				X
Emergency calls				X
Other				X
Intra-parish traffic				X
Inter parish traffic				X
Access (B&R)	Centrex			Non-Centrex
Extension access point	Centrex			Non-Centrex
Instrumental rental	X			
Line installation (B&R)	Centrex			Non-Centrex
Operator assisted calls:				
Person calls				X
Station calls				X
Conference Calls				X
Collect call				X
Access cellular		X		
Rental of unit cellular:				
Mobile	X			
Portable	X			
Fixed	X			
Transportable	X			
Tel-cel	X			
Traffic cell. to cell.		X		
Traffic cell. to fixed		X		
Traffic fixed to cellular			X	
Satellite based mobile comm.				X
Cardphone usage				X
Cardphone international				X
Worldtalk card				X
International outgoing				X
Operator assisted int. calls				X
Collect calls incoming				X
Collect calls outgoing				X

Service Classification	No Price Regulation	Retail Mobile Services Basket	Retail Prices of Fixed-to-Mobile Call Basket	"Basic" Retail Offering Basket
Advertisement on card				X
Business systems	X			
Internet access	X			
Voicemail	X			
Voicemail cellular		X		
Teleclass features				X
Magic touch				X
Terminal equipment	X			
Toll free services (business)				X
Toll free services (mobile)		X		
Datacommunication				X
Leased lines				X
International dataservices				X
Interactive billing information				X
Telex				X
Telegraphy				X