Newtel Solutions

3 September 2004

Office of Utility Regulation
Hirzel Court
St Peter Port
Guernsey
GY1 2NH

Dear Sirs

Re: Price Control for Telecommunications Services in Guernsey – Calculating Allowed Revenue and Cost of Capital - Consultation Document No: OUR 04/11

We refer to the above consultation document.

We appreciate the significance of these issues in the context of price controls but we would reiterate some headline points that we made in response to Consultation Document 04/10 as follows:

- that there is too little financial information in the public domain for us to usefully assess proposals on price controls and
- we are concerned that detailed retail price regulation could lead to competition being muted if competitors have little room for manoeuvre around an incumbent's pricing structure and facility portfolio.

We acknowledge the Director General's obligations under the Telecommunications (Bailiwick of Guernsey) Law 2001 and the point made in Section 4 that "the objective is to set the control at a level such that, if the regulated firm operates efficiently, it can expect to cover its costs, including earning a reasonable return on the capital employed (i.e. its cost of capital), over the period of the control". In this respect, and in relation to points made in Section 5, the cost of capital for competitors will be higher than that for the regulated firm and this should be recognised in setting price controls so that these do not, indirectly, limit margin opportunities for competitors.

With regard to setting the opening asset value (Section 6), we note the DG's recognition that the current costing approach has clear advantages in that "it sends efficient and correct economic signals to competitors in relation to market entry as it reflects the costs of investing in the market at current rates. It is also fair to consumers, reflecting the true cost of providing the services". We would support this view.

At the same time, we recognize that the effective use of the current costing methodology depends upon the DG being able to obtain accurate and reliable current cost accounting information from the C&WG and that C&WG has "been unable and unwilling to prepare regulatory accounts on a current cost basis, despite a direction from the OUR to do so". In the circumstances, we accept that the DG has little option but to apply an alternative approach to proxy current costs when considering the level of allowed revenues for the price controlled business. However, we would encourage the DG to maintain its drive to acquire appropriate financial information.

Against this background, we are pleased to provide the following responses to questions within the Consultation Document:

Questions 1- 5: We acknowledge that the MAR approach is an appropriate methodology, in the absence of current cost information, when deriving the opening asset base for a regulated utility that has been privatised at a price lower than the value of its assets.

Administration Address

Newtel (Guernsey) Limited
1 Colomberie St Helier Jersey JE4 9SY Channel Islands
Tel: +44 1534 506400 Fax: +44 1534 507979
mail@newtelsolutions.com

Questions 6-9: We support the view that, if the regulated business does not provide a suitable asset valuation based on current costs, it is appropriate for the DG to make such adjustments as are feasible based on other available information with respect the underlying valuation of the assets and, where current cost estimates have not been provided by the regulated business, we agree that the DG should make such adjustments as are feasible based on other available information with respect to the underlying depreciation charges associated with the asset base.

Question 10: We agree that it is appropriate, given the scale of Guernsey's economy and the need to ensure that future capital expenditure provides the economy with suitable strategic benefits, that it is necessary to ensure that capital expenditure proposals are justified, committed to and incorporated into the relevant licence conditions. As we commented in our response to Consultation Document 04/10, it is important for C&WG to invest in the interests of both consumers and competitors.

Questions 11-12: We agree that a regulated business should provide robust, logical, transparent and fully justified explanations regarding the efficiency of its base year and projected operating costs and that it is prudent for the DG to compare the regulated firm's operating cost levels with other, similar, operators.

Question 13: We have to assume, based on Section 12.1, that the terms of the loan to fellow group companies represents the economic opportunity cost of capital for C&WG.

Question 14: We consider the WACC methodology as the most appropriate mechanism for setting the cost of capital for C&WG.

Questions 15-16: We agree that, if the price control applies only to the fixed business, that a cost of capital should be calculated that excludes the mobile business and that a separate cost of capital should be calculated for the mobile business.

Question 17: We agree that it is appropriate to apply a separate cost of capital to investment pre and post privatisation.

We would be pleased to discuss particular aspects of our response with you in more detail if required.

Yours faithfully
NEWTEL GUERNSEY LIMITED

ROBIN BAIRD
COMPANY SECRETARY

cc Peter Funk - Newtel
Malcolm Taylor - Newtel