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THE STATES OF GUERNSEY

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Dear Sirs

Comments on Price Control for Telecommunications Services in Guernsey: Calculating Allowed Revenue and Cost of Capital: Consultation Document.

As Chief Minister of the States of Guernsey I wish to make a number of comments in relation to the opening asset value and the setting of "capital allowances" when setting future telecoms tariff regimes.

Guernsey Telecoms Limited was created by the commercialisation of the States Trading Board that had previously provided telecoms services. The terms under which Guernsey Telecoms Limited was sold to Cable & Wireless are set out in Billet X of 2002. Para 7 of the Billet states:

"Throughout the negotiation process the [Advisory and Finance] Committee's primary aim was to place the bailiwick in the strongest possible position to exploit telecoms services in order to grow existing businesses, including those in the financial services sector, and to attract new internet-related business. Its secondary aim was to achieve this on the most favourable financial terms possible."

The basis on which the comments below are made is not one of wishing to revisit those terms but rather of seeking to achieve (using the words on page 15 of the consultation document) "a fair distribution of gains between shareholders (of Cable & Wireless) and Guernsey's consumers". In this particular case however the previous owners of the telecoms provider and Guernsey's consumers are generally one and the same, that is the Guernsey community.

From the community's point of view therefore, the most fair way of valuing the opening asset value of the company for the purposes of setting future tariffs is to take into account the sale price of those assets as described in the market value/sale price to asset ratio (MAR) approach and to adjust the depreciation charge by the MAR approach as described in section 7.4. To do otherwise would be for the shareholders of Cable & Wireless to derive a windfall benefit from the returns of a tariff regime based on the previous level of investment undertaken by the community but which had not been fully reflected in the sale price.

One of the considerations taken into account when negotiating the terms of the sale of Guernsey Telecoms Limited was the ability and willingness of Cable & Wireless to commit to the high level of capital expenditure necessary to develop and maintain world-class telecoms services. The contract for the sale places an obligation on the company to make a specified level of e-commerce related investments.

There is no doubt that at the time of the sale, and for the future, an announced intention to invest in the telecoms infrastructure creates a climate of confidence. It is important however to ensure that the situation does not arise whereby the company benefits from tariffs that are based on an announced level of investment that for one reason or another does not materialise.

Section 8.2 of the consultation document explains that in the absence of a binding commitment to invest there are mechanisms by which the effects of any under-spend against announced intentions can be clawed back in subsequent tariff reviews and it describes the merits and de-merits of such mechanisms. An alternative would be for tariffs to be set on the basis of no capital investment with the company being allowed to claw back the benefit of any actual capital expenditure in subsequent tariff reviews. It is likely however that the de-merits of this approach would considerably outweigh the merits.

The form of "dynamic" approach described in section 8.2 of the consultation document should provide considerable comfort to both the community and the company. The inclusion in the licence conditions of commitments to invest and the development of processes to measure investment performance over the duration of the tariff regime would enable tariff adjustments to be made in either direction to reflect the commercial imperatives that drive investment decisions.

You will see from the above therefore that it is considered that the fairest way of balancing the interest of the community and that of the telecoms operator is to adopt the MAR approach to determining the opening asset value and allowed depreciation and the inclusion of commitments to capital investment with processes to measure investment performance in the licence conditions. I hope that these comments are useful to the consultation process.

Yours faithfully

Deputy L C Morgan
Chief Minister