



Office of Utility Regulation

C&WG Reference Offer and Interconnection Rates

Draft Decision

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Office of Utility Regulation
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1. Introduction

In June 2009 the Office of Utility Regulation (“OUR”) published its consultation document on Cable & Wireless Guernsey Ltd (“C&WG”)’ proposed interconnection and access charges going forward¹.

One of the roles of the OUR is to review and assess the interconnection and access charges included by C&WG in its Reference Offer (“RO”), in order to ensure that they are cost oriented. The provision of interconnection and access services at reasonable and non-discriminatory rates is critical to the development of a well functioning, competitive telecommunications market. It is important that prices for interconnection and access services are set at cost in order to:

- support the development of effective competition;
- provide efficient ‘build or buy’ signals to new entrants; and
- enable the provision of competing services in retail telecommunications markets.

The June 2009 consultation document mainly dealt with the methodology and data used by C&WG to calculate its proposed interconnection and access charges, given that the actual rates will be based on the latest information to be submitted by C&WG in its regulatory accounts. These accounts are expected to be submitted by the end of October 2009.

The DG received three responses to the consultation, from Guernsey Airtel Ltd (“Airtel”), Wave Telecom Ltd (“Wave”) and C&W Guernsey Ltd (“C&WG”). Two main issues emerged out of the responses, namely how and whether charges should be differentiated by time of day (i.e., the time of day gradient), and how interconnection link services should be charged for.

This draft decision presents the DG’s current best view on the issues raised in the consultation document and the responses to that document.

The DG would like to acknowledge the very high level of co-operation provided by C&WG, Airtel and Wave in this work to-date.

This document does not constitute legal, technical or commercial advice; the Director General is not bound by this document and may amend it from time to time. This document is without prejudice to the legal position or the rights and duties of the Director General to regulate the market generally.

¹ C&WG Reference Offer and Interconnection Rates, Consultation Document, OUR 09/08, June 2009, available at the OUR website.

2. Structure of the draft decision document

2.1 Structure of the draft decision document

This consultation is structured as follow:

- Chapter 3: sets out the legal framework and provides the regulatory background to the DG's review of the RO and interconnection rates;
- Chapter 4: summarises the C&WG proposed new RO and interconnection rates;
- Chapter 5: summarises the key points made by respondents to the June 2009 consultation;
- Chapter 6: sets out the DG's current thinking on the TOD gradient and treatment of interconnection link services and a number of other issues raised by respondents; and
- Chapter 7: sets out the next steps.

2.2 Timetable for Responses to Consultation Paper

Responses to this document should be submitted in writing and should be received by the OUR before **5.00pm on 6th November 2009**. Written comments should be submitted to:

Office of Utility Regulation,
Suites B1 & B2,
Hirzel Court,
St Peter Port,
Guernsey, GY1 2NH.

Or by email to **info@regutil.gg**

In accordance with the OUR's policy on consultation set out in Document OUR 05/28 – "Regulation in Guernsey; the OUR Approach and Consultation Procedures", non-confidential responses to the consultation will be available on the OUR's website (www.regutil.gg) and for inspection at the OUR's Office during normal working hours. Any material that is confidential should be put in a separate annex and clearly marked so that it can be kept confidential. However, the DG regrets that he is not in a position to respond individually to the responses to this consultation.

3. Legal Background & Regulatory Framework

3.1 Legal Background

Section 10 of the Telecommunications (Bailiwick of Guernsey) Law, 2001 (“the Telecoms Law”) sets out the DG’s powers with regard to interconnection and access and describes the requirements that the DG may impose on *inter alia* any licensee whom he determines has a dominant position in a relevant market. The DG has determined (Documents OUR 01/14 and 08/07), that C&WG has a dominant position both in the fixed telecommunications network and services market and in the mobile telecommunications network and services market. The OUR further informed C&WG that the provision of section 10(2) of the Telecoms Law would apply to it, thus requiring it in due course to;

- (a) make its procedures for the provision of interconnection and access publicly available on a non-discriminatory basis in a manner that is to the reasonable satisfaction of the DG;
- (b) offer a standard interconnection and access agreement (referred to as the “Reference Offer”) which is available under non-discriminatory terms, conditions and charges, and on a non-discriminatory basis, no less favourable than that offered to -
 - (i) any of C&WG’s own services; or
 - (ii) any associated company of C&WG’s or services of such a company;
- (c) provide interconnection or access on terms, conditions and charges that are transparent and cost-oriented having regard to the need to promote efficiency and sustainable competition and maximise consumer benefits;
- (d) provide interconnection or access at any technically feasible point in its telecommunications network; and
- (e) provide interconnection or access in a manner that is sufficiently unbundled so that the person requesting interconnection or access does not pay for telecommunications network components or telecommunications services that he does not require.

The legal responsibility is on C&WG to ensure that it provides such information as is necessary to fully demonstrate that any proposed charges for its interconnection and access services comply with its obligation under the Telecoms Law.

In addition, the Telecoms Law makes provision for the DG to direct changes to the standard interconnection and access offering and to require C&WG to justify its costs or charges for the provision of interconnection and access services.

3.2 Regulatory framework

Apart from having to comply with the Telecoms Law, the licensee also has to comply with the Licence conditions which the DG issued in 2001 and Directions which the DG has issued since.

The DG granted a ‘Fixed Telecommunications Licence’² to C&WG “to establish, operate and maintain the Licensed Telecommunications Network”. Part IV of this Licence includes a number of licence conditions applicable to dominant operators. As set out earlier, the DG has determined that C&WG has a dominant position both in the fixed telecommunications network and services market and in the mobile telecommunications network and services market.

The Licence also contains a section on information provision. Furthermore, in May 2005, the OUR published an information note on C&W Guernsey Interconnection and Access Charges³, which provides detailed guidance to C&WG on the minimum level of information which C&WG should provide when submitting any proposed charges for interconnection and access services in order to ensure compliance with its obligations under the Telecommunications (Bailiwick of Guernsey) Law, 2001 and its licence. This followed a detailed review of the previous submission made by C&WG in November 2003⁴.

² OUR 01/18, available at <http://www.regutil.gg/docs/our0118.pdf>

³ OUR 05/11, available at <http://www.regutil.gg/docs/our0511.pdf>

⁴ The details of this review are set out in OUR 05/09, available at <http://www.regutil.gg/docs/OUR0509.pdf>

4. C&WG proposed new RO and interconnection rates

4.1 2009 RO Submission by C&WG

In February 2009 C&WG submitted proposals for new interconnection and access rates. The proposals were submitted in the form of a number of spreadsheets. Tables 1 to 3 show the differences between the current rates and the proposed rates for the various services.

Table 1 Differences between C&WG current rates and proposed rates (for a 1 minute call)

SERVICE	PEAK			OFF-PEAK		
	Feb-06	Proposed	Change	Feb-06	Proposed	Change
On-Island Termination	0.347	0.406	16.9%	0.258	0.315	22.2%
On-Island Origination	0.605	0.455	-24.8%	0.436	0.352	-19.4%
On-Island Origination (with Operator Assistance)	194.654	254.597	30.8%	194.380	254.406	30.9%
On-Island Transit	0.248	0.265	6.7%	0.189	0.211	11.8%
Off-Island Transit	0.823	0.500	-39.2%	0.587	0.385	-34.5%
On-Island FreePhone Origination	0.605	0.455	-24.8%	0.436	0.352	-19.4%
On-Island LocalCall Origination	0.605	0.455	-24.8%	0.436	0.352	-19.4%
Calls via operator - to Jersey	195.194	254.775	30.5%	194.753	254.538	30.7%
Calls via operator - to UK	195.194	254.775	30.5%	194.753	254.538	30.7%
Calls via operator - to Irish Republic	195.194	254.775	30.5%	194.753	254.538	30.7%
Local Reverse Charge	127.512	244.831	92.0%	127.218	244.622	92.3%
Local Information Services	0.296	0.321	8.6%	0.223	0.253	13.5%
Weather Forecast - Guernsey Bailiwick	5.296	5.321	0.5%	5.223	5.253	0.6%
Guemsey Met. Office Info Line	25.960	25.787	-0.7%	25.681	25.596	-0.3%
Time (was Gsy, now UK)	0.296	10.500	3447.3%	0.223	10.385	4556.8%
Alarm	88.595	257.253	190.4%	88.045	257.078	192.0%
Emergency Services	150.059	211.217	40.8%	149.736	211.027	40.9%

Table 2 Customer Sited Interconnect

Customer Sited Interconnect

	2007		Proposed 2009		% Variation	
	Instalation	Quarterly Rental Charge	Instalation	Quarterly Rental Charge	Instalation	Quarterly Rental Charge
Per System including the initial 2 x 2 Mbit circuits (minimum number) & Equipment	£34,176.01	£1,659.92	£37,029.39	£170.82	8.35%	-89.71%
Ducting & cabling per metre	£68.44		£80.86		18.15%	
Additional 2Mbit links	£2,044.59	£829.96	£145.08		-92.90%	
New Fibre Termination - per route			£617.76			
Existing Fibre - Lighting - per route			£338.52			
New fibre per m			£1.30			
New duct per m			£80.86			
Existing fibre per m				£0.02		
Existing duct per m				£0.58		

Table 3 In-Span Interconnect

In-Span Interconnect

	2007		Proposed 2009		% Variation	
	Instalation	Quarterly Rental Charge	Instalation	Quarterly Rental Charge	Instalation	Quarterly Rental Charge
Per System including the initial 2 x 2 Mbit circuits (minimum number) & Equipment	£28,500.41	£1,659.92	£28,590.69	£170.82	0.32%	-89.71%
Ducting & cabling per metre	£68.44		£80.86		18.15%	
Additional 2Mbit links	£2,044.59	£829.96	£145.08		-92.90%	
New Fibre Termination - per route			£617.76			
Existing Fibre - Lighting - per route			£338.52			
Joint box			£3,147.13			
New fibre per m			£1.30			
New duct per m			£80.86			
Existing fibre per m				£0.02		
Existing duct per m				£0.58		

4.2 The DG's main observations on the proposed rates

The OUR identified a number of minor issues in relation to the methodology used by C&WG, such as some calculation errors in relation to calculating the Time of Day (TOD) gradient and duct and fibre rental charges.

However, an issue which arose was C&WG's approach to calculating the TOD gradient, and especially the fact that C&WG excludes local calls from these calculations. In the June consultation the DG stated that in his view local calls should be included in the TOD gradient calculation. It is not clear why C&WG decided to exclude local calls as these calls use the network and hence potentially could give rise to network constraints. The effect of C&WG's approach to exclude these calls has been to increase peak rates and reduce off peak rates. The DG's view is that this approach might negatively impact on competition, by reducing the margin available between retail and interconnection rates for calls in the peak period.

The DG recognises that there have been some reasonably significant changes in the relative level of charges. However, C&WG has provided information which suggests that the proposals will be approximately revenue neutral for its interconnection business.

5. Responses to the June 2009 Consultation

This chapter deals with the main issues raised by the respondents and is therefore not exhaustive. The full responses can be found on the OUR website.

The two main issues which emerged from the consultation responses were:

1. The Time of Day (“TOD”) gradient; and
2. The charging for interconnection link services.

Apart from these, a number of other issues were also raised by at least one respondent. Most of these issues, especially if they required further clarification from the OUR, are also discussed in this chapter.

5.1 The Time of Day Gradient

Background

A time of day gradient converts the standard cost per minute into a peak or off-peak price per minute. Therefore, different tariffs are charged according to whether the call is carried in the peak or off-peak period. These gradients have typically served two purposes.

Firstly, a time of day gradient can support network traffic management. At times of relatively high demand for the network, operators will be charged the higher peak wholesale price, which will flow through to their retail prices and therefore flatten demand. Conversely, at times of relatively low demand for the network, operators will be charged the lower off-peak wholesale price, which will flow through to their retail prices and stimulate demand. Therefore, this pricing structure should encourage smoother network usage patterns. Network dimensioning is driven by demand in the peak hour. Therefore, if a time of day gradient reduces traffic in the peak hour it can serve to reduce the network capacity that is required and hence the costs of the network.

Secondly, given the nature of demand for telecommunications services, a time of day gradient may also act as a proxy for Ramsey pricing, whereby common costs are recovered relatively more from consumers with a higher willingness to pay. This is because most business customers (who may have a higher willingness to pay for communications services than residential customers) will make calls in the (more expensive) peak period, whilst residential customers will call primarily in (cheaper) off-peak periods.

C&WG Approach

The approach taken by C&WG to calculate the time of day gradients broadly follows the methodology devised by BT in the UK. The gradient is determined using the retail prices of those services which are dependent on the wholesale service under consideration. Using the weighted average retail price per minute at peak and off-peak times, a peak gradient (the ratio between the peak and average retail price) and an off-peak gradient (the ratio between the off-peak and average retail price) are determined. In addition, any call types (such as premium rate services and fixed to mobile calls) where the retail price charged is dominated by termination charges from another network are excluded. This is because the pattern of demand for these call types cannot reasonably be influenced by the originating operator (C&WG in this case).

June 2009 Consultation

In the June 2009 Consultation document the DG noted a number of differences with the approach described by BT, namely:

- Fewer retail services were included in C&WG's calculation, i.e. national geographic and non-geographic calls were included, but local and non-geographic calls were excluded. C&WG's reason for excluding non-geographic calls seemed to be that it is unable to directly influence the retail prices for these calls. C&WG stated that it excluded local calls from the tariff gradient because it predominantly charges for these on a flat rate;
- The calculation had been incorrectly interpreted, although the impact on the results was fairly minor;
- Although retail prices for fixed Jersey and UK national calls are differentiated across three charging periods, the associated interconnection charges are only differentiated across two charging periods. Therefore, in calculating the peak and off-peak gradients, the volumes and revenues associated with off-peak and Sunday retail traffic are bundled together.

The DG considered that charging local calls at a flat rate is not a reasonable rationale for excluding these calls from the calculation of the tariff gradient. Local calls make a significant contribution to the total volume of traffic on C&WG's network and hence the pattern of traffic across its network.

Local calls make up around 40 per cent of total traffic that uses C&WG fixed network, but when considering only fixed originated calls (e.g. local voice and internet calls, calls to the UK and Jersey, other international calls and calls to mobiles) then local calls make up nearly 50 per cent.

If a tariff gradient is to be used to manage traffic on C&WG's network, it therefore seems reasonable for it to reflect all traffic that C&WG carries and for which it has a primary

influence on retail prices. In addition, excluding local calls from the gradient means that the peak gradient is higher and the off-peak gradient lower than would otherwise be the case. Consequently, this will lead to relatively higher peak period charges for on-island call origination and call termination than would otherwise be the case, with relatively lower charges in off-peak periods. The DG therefore believed that these calls should be included in the calculation of the tariff gradient.

Linked to this, the DG considered that it might be appropriate for wholesale charging to be aligned with retail charging.

Responses to the June 2009 Consultation

The two OLOs both argued that the TOD gradient approach for calculating interconnection rates should be abolished and that a flat rate should be adopted instead. However, C&WG argued for the status quo, e.g. a TOD gradient approach excluding local calls.

Flat wholesale charge

The two OLOs have provided a number of reasons why in their view the TOD gradient should be abolished:

- It would be simpler for OLOs as it would make interconnect invoice reconciliation easier;
- It would allow operators to introduce simpler pricing structures for consumers;
- It would reduce costs for OLOs and ultimately consumers (lower billing costs);
- There are in practice no capacity constraints on C&WG's network which require usage to be smoothed and furthermore, against the background of reducing fixed traffic volumes (and the transition to NGN) it is unlikely that capacity issues will occur in the near future; and
- It would be consistent with the approach to mobile termination rates (flat MTR was adopted in April 2009):

Status Quo approach

C&WG stated in its response that it did not believe that local calls should be included in the calculation of the TOD gradient as proposed by the DG in the consultation document. C&WG argued that given that local calls are currently charged at a flat 4.8 pence per call rate, C&WG was not able to influence the timing and the duration of these calls and hence the demand for network capacity as a result of these calls. In its response C&WG also stated that some of these calls last days for the same charge (e.g. 4.8 pence for the call).

Furthermore, C&WG argued that including local calls would result in an inefficient use of C&WG's fixed network as it would not reduce the busy hour traffic on the network (because it would flatten the tariff gradient and hence the difference between peak and off-peak charges).

Following completion of the consultation period, the OUR has had further discussions with C&WG on the TOD gradient and the possible adoption of a flat interconnection charge. C&WG's view is that adoption of a flat rate would likely result in network inefficiencies as it would re-introduce the potential for the network to become overloaded at peak times and underutilised at off-peak times. C&WG also argued that it would have to review all its residential tariffs, including 'Sure Home tariffs', and that in all likelihood all residential customers would face higher prices as a result. C&WG also stated that it would likely result in serious capacity constraint issues if the other OLOs decide to send UK bound traffic via C&WG in order to get a lower average ppm interconnection rate.

Further, C&WG stated that it would require new traffic forecasts from the OLOs to ensure that it could configure its network appropriately to deal with changes in traffic profiles.

C&WG also argued that it would not be appropriate for retail pricing to be aligned with wholesale pricing as it would result in the retail call types being reduced from three periods to two periods.

5.2 The charging for interconnection link services

Another issue raised in the consultation, was how to charge for interconnection link services: e.g. purely on a time and materials basis or the current approach based on a fixed upfront price.

It was recognised that the main advantage of an approach based on time and materials is that it could better reflect costs. However, as observed by the respondents there are also a number of disadvantages. C&WG pointed out that it could be difficult to provide a cost estimate to interested parties and that it might lead to disputes, should there be a significant difference between an initial estimate and the actual costs.

One of the OLOs stated that it preferred the current approach as it provides cost certainty and enables the OLO to budget accordingly. It also argued that charging on a time and materials basis could give C&WG the opportunity of allowing time to slip outside of the agreed timescales with additional charges raised for the work undertaken.

However, the other OLO argued that given the bespoke nature of these types of services a time and materials approach would be more appropriate. However, this OLO did consider that transparency would be very important to enable the OLO to verify that charges are reasonable.

5.3 Other issues raised in the consultation

There was general agreement on most other issues raised in the June 2009 consultation document. However, some respondents made some specific comments which are presented below.

5.3.1 Reasonableness of other charges

One OLO considered that the proposed cost of providing the 'Time' product seemed excessive and that C&WG should be encouraged to identify a more cost effective method of delivery.

5.3.2 Increasing transparency going forward

In its response, C&WG argues that its recent restructuring of its model has resulted in less detailed information about individual services, but greater visibility of how costs and revenues are associated with each of those services. C&WG also points out that once it has made further planned enhancements transparency will be further increased.

5.4 Other issues raised by respondents

In addition to those issues raised by the DG in the consultation, respondents have raised a number of other issues.

5.4.1 Removal of TOD gradients from the regulatory accounts

C&WG welcomes the consideration of the removal of TOD gradients from the regulatory accounts as their inclusion has caused confusion in the past. C&WG stresses the importance that the pricing of RO services is based on the most accurate information and therefore requests that the TOD gradient should be excluded from the 2008/09 regulatory accounts as their submission precedes the DG's final decision on the RIO.

5.4.2 Rental charges for on-going interconnection link services

In its response, C&WG asks for guidance on an appropriate approach to establishing rental charges for on-going interconnection link services.

5.4.3 Proposed increase in termination rates

One OLO questions the size of the proposed increase in termination rates. This OLO argues that the utilisation of C&WG network infrastructure should be similar for both the voice

termination and voice origination products. It points out that utilisation of switches, concentrators, transmission and access infrastructure should be similar whether a voice call is made or received. Furthermore, it argues that terminated calls might actually use less concentrator resource (which costs have increased) and more switch resource (which costs have decreased). It therefore questions the reasons behind the proposed 22% increase in fixed termination charges, particularly in the light of the fact that the proposed increase is well in excess of inflation.

5.4.4 NGN

One OLO raised the issue of interconnect arrangements in an NGN environment and stated that it would welcome being part of operator discussions on C&WG network developments going forward.

6. Director General's Draft Decision

In this chapter we present the DG's current thinking on the main issues raised by respondents to the June 2009 consultation document.

6.1 *Time of Day gradient*

The DG considers that the OLOs have presented strong reasons why it might be appropriate to abolish the Time of Day gradient in calculating interconnection charges.

Generally speaking, it is important to ensure that prices accurately reflect the underlying costs of providing the service in question. This provides appropriate price signals to business customers and consumers alike and ensures best use of scarce resources. Network capacity requirements are driven by demand in the peak period and therefore relatively higher peak charges could be reasonable. Furthermore, if a time of day gradient reduces demand in peak periods and increases demand in other periods it avoids a situation where a network operator has to invest in new capacity to meet peak demand whereas there is still excess capacity available at off-peak times. For these reasons, a tariff gradient is typically applied to interconnection (and retail) services offered over communications networks.

However, in deciding whether a tariff gradient remains appropriate in this case it is important that the DG takes into account how the situation in the Bailiwick differs from that in other jurisdictions. The DG has been provided with no evidence to suggest that in the Bailiwick there are network capacity issues and notes that forecast traffic volumes are declining. There is therefore no need to smooth demand in order to avoid new investment to meet peak demand for capacity. Given that the majority of peak period traffic is originated by businesses it is also not clear the extent to which the gradient has actually affected traffic patterns.

Furthermore, it is important that the DG ensures that there are no unnecessary obstacles to the development of competition. It is therefore of particular interest that both OLOs argue for flat rates. It is possible that a flat rate for charges in C&WG's RO could further increase competition as it will reduce the peak period interconnection charges paid by OLOs.

C&WG has argued in its supplementary response on this issue that abolishing the TOD gradient would favour business customers and penalise residential customers. The DG is not convinced by this argument. However, the DG does recognise that it could mean that prices for off peak calls might increase, relative to calls in the peak period, if operators, including C&WG, were to pass the cost differentials to their customers. However, it could also lead to operators (including C&WG) introducing new and innovative pricing structures, thus benefitting consumers.

The DG notes that C&WG has not been able to submit any evidence that such a change would result in physical network constraints. Furthermore, the DG would have expected

that if there was a significant concern about peak demand on the network that local calls would not have been priced at a flat rate.

Currently, the DG is minded to adopt a flat rate approach and hence there would no longer be a need to align wholesale and retail charging structures.

The DG proposes to adopt a flat rate for interconnection services from April 2010 onwards.

6.2 The charging for interconnection link services

Of the three respondents, one OLO clearly favoured the current approach, one OLO favoured the alternative approach and C&WG pointed out that both approaches have their advantages and disadvantages. However, it felt there was a risk that the alternative approach would more likely to give rise to disputes.

The key advantages of the current approach are that it provides cost certainty to the OLO seeking to procure a joining link and reduces the likelihood of disputes. Arguably, a pure time and materials based approach might be more cost reflective. However, the DG accepts that in theory there might be less incentive for C&WG to tightly control its costs under such an approach although he is less convinced that in practice such behaviour would incur, given the wholesale arrangements currently in place.

Having considered these various points of view, the DG considers that on balance it is preferable to maintain the current approach.

The DG proposes not to change the approach for charging for interconnection link services.

6.3 Other issues raised in the consultation

6.3.1 Reasonableness of other charges: cost of the 'Time' product

It is the DG's understanding that this cost increase results from this product no longer being provided on-island but instead being provided for C&WG by BT. Although in percentage terms the increase is indeed very significant, in practice there seems to be little demand for this product. Indeed, the DG understands that in 2007-08, OLOs did not use this interconnection product. Therefore, the DG considers that the overall impact on customers is likely to be small.

The OUR's review of C&WG's proposed interconnection charges and regulatory accounts for 2007/08 concluded that C&WG's regulatory accounting system (on which the proposed charges were based) did allocate costs appropriately to products. The DG is

therefore satisfied that the charge is likely to be cost oriented. The DG would not, however, expect to see further significant increases in this charge. He would also remind C&WG that it should ensure all its services are provided as efficiently as possible.

6.3.2 Increasing transparency going forward

The DG welcomes C&WG efforts in restructuring its model to give greater visibility of how costs and revenues are associated with the services.

6.4 Other issues raised by respondents

6.4.1 Removal of TOD gradients from the regulatory accounts

The DG agrees with C&WG that it would be appropriate not to include the TOD gradients in the 2008/09 regulatory accounts for the reasons mentioned in the consultation document and C&WG's response to the consultation.

6.4.2 Rental charges for on-going interconnection link services

The DG considers that rental charges should be set in line with the following principles:

- The charges should enable C&WG to recover efficiently incurred costs in the provision of interconnection link services;
- Both C&WG and the OLOs should have certainty over the level of charges, which should be set in a transparent manner;
- Where charges are split between ongoing rental and upfront charges, C&WG should ensure that the initial charges do not act as a barrier to OLOs entering the market, whilst also ensuring that C&WG is able to recover its costs;
- Where asset costs are recovered upfront, C&WG should not continue to charge an ongoing rental charge associated with these assets, other than to cover maintenance; and
- Costs associated with interconnection link services should be clearly separated in C&WG's costing system, so to ensure that these costs are not also allocated to other regulated services.

A further objective when setting prices for interconnection conveyance services relates to setting prices such that they provide efficient pricing (build or buy) signals to new entrants. This objective is, however, less relevant for interconnect joining services, given the sunk nature of these services. The DG therefore considers that enabling C&WG to recover efficiently incurred costs (without over-recovering these costs) should be the key objective for setting these charges. Furthermore, the DG is aware that for those joining

services it has already provisioned, C&WG recovered the majority of its capital cost through an upfront charge. It would therefore expect ongoing rental charges for these links to be relatively limited.

Given the objectives set by the DG, he believes that rental charges for existing links should remain at their current levels. For new links, the DG considers that C&WG should ensure that rental charges reflect the specific costs of those links. Based on practice elsewhere, the DG considers that these costs would include:

- charges for material and maintenance associated with the transmission equipment used in the link service (both link and length dependent costs); and
- a reasonable share of corporate overhead costs.

6.4.3 Proposed increase in termination rates – impact on the OLOs

Currently, the charge for on-island call origination is much higher than the charge for on-island call termination. C&WG's proposals in effect include a rebalancing of these charges, with an increase in the charge for on-island call termination and a reduction in the charge for call origination. Indeed, the DG agrees with the respondent that call origination and termination rates should be similar, given that the services use the same network infrastructure and notes that the proposed charges will result in the rates for these services converging.

On-island termination rates have historically been below origination rates as a result of the approach taken to calculate these charges. For both services charges have been based on the unit costs of the network components used by call origination and termination and the relative usage of each component by calls originating and terminating on C&WG's network (i.e. routing factors). These routing factors have taken account of both the call origination and termination services C&WG provides to OLOs and the services it provides to its own downstream businesses (such as C&WG Mobile).

Calls terminating on C&WG's fixed network from OLOs typically use more of C&WG's fixed network than calls which terminate from its own mobile business. This is because each of the OLOs only interconnects with the C&WG network at one exchange and hence has to use more of C&WG network.

C&WG's Mobile network interconnects with its fixed network at *both* exchanges. Therefore mobile to fixed calls which are originated on C&WG's mobile network are carried relatively more on its mobile network than mobile to fixed calls originated on OLO networks are carried on their respective mobile networks. As a result these calls use less of C&WG fixed network.

As a result, the routing factors for calls terminating on C&WG's fixed network from OLO mobile networks are higher than the routing factors for calls terminating on C&WG's fixed network from its own mobile network.

This means that as OLOs' market share of mobile traffic has increased, so has the average routing factor for on-island termination on C&WG's fixed network. This has led to the proposed increase in call termination rates.

The OUR has reviewed the information provided by C&WG on its call termination tariff, including the routing factors used to calculate tariffs and the derivation of these tariffs. The DG is satisfied that the approach followed by C&WG to determine these is reasonable and reflects the usage of its network.

It is true that mobile termination rates have seen significant reductions this year. However, the DG considers that it is not appropriate to directly compare reductions in mobile termination rates with the proposed increases in fixed termination rates given the starting point for MTRs was less reflective of actual costs than other interconnect charges.

The increase in the emergency call tariff is driven by an increase in costs for the customer support centre. Although volumes for this service are low, the charges are much higher than for on-island termination, because of the staff costs associated with the customer service centre, which handles emergency calls (as well as other services). This increase has been driven both by an increase in the costs of the customer support centre (which primarily relates to staff costs) and a reduction in the volume of traffic handled by the centre. Given that the centre must maintain a minimum level of service (for example given its role in handling emergency calls) it seems reasonable that unit costs may increase as volumes decline. However, going forward, the DG would expect C&WG to ensure that it provides these services on an efficient basis.

6.4.4 NGN

The DG considers that it is very important for C&WG to involve all OLOs, as its main customers, in the planning of its NGN.

7. Next Steps

The DG has formulated his position based on the best information available to him at this time. Subject to any comments that interested parties may wish to make on these proposals the DG intends to publish his final decision on the methodology to be used to set interconnection and access rates from April 2010 onwards by the end of this year.

The actual rates to be included in the Reference Offer will need to be calculated in accordance with the DG's final decision on the methodology to be used and need to be based on the information provided by C&WG in its latest regulatory accounts. OLOs may wish to consider C&WG's regulatory accounts, which will be published later this month, before submitting any response to this draft decision.

Interested parties are requested to provide responses to this draft decision by 6th November 2009. Subject to the consideration of any responses received the DG intends to finalise his decision in December 2009.

ENDS