MALTA COMMUNICATIONS AUTHORITY

Review of GO plc's application for funding of the net cost claimed to have been incurred to provide universal service obligations during 2014

Decision Notice

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Malta Communications Authority
Valletta Waterfront,
Pinto Wharf, Floriana,
FRN 1913, Malta

T + 356 2133 6840
F + 356 2133 6846

E info@mca.org.mt
W www.mca.org.mt

EXECUTIVE SUMMARY

In November 2017, the Malta Communication Authority (hereafter the “MCA” or the “Authority”) published a proposed decision for consultation on the review of GO plc’s (hereafter ''GO'') application for funding of the net cost claimed to be incurred by providing universal service obligations (hereafter the ''USO'') during financial year 2014[1].

In accordance with national law[2], the designated undertaking has the right to seek to receive funds for the net costs it believes to have incurred to provide part or all of the universal services and may submit a written request to the Authority. In December 2015, GO submitted its funding request for the unfair burden it claims it had suffered during 2014.

During that year, GO was designated to provide as universal services: access at a fixed location, directory enquiry services and directories, public payphones, specific measures for disabled users, reduced tariff options and control of expenditure. These services are intended to ensure that everyone, irrespective of the location and social standing can have access to electronic communications telecommunications services.

The MCA commissioned EY as an independent body to audit and verify the calculation of the net cost claimed by GO for the provision of the USOs, taking into account any market benefits. As established in the MCA decision *“Decision on Universal Service Obligations on Electronic Communications Services”* (hereafter referred to as “USO Decision”) of 2010, the universal service provider (hereafter referred to “USP”) is required to submit sufficient and detailed information supporting its claim. The information and the evidence of the net costs provided by GO serve as a basis for the calculation exercise to determine whether the provision of the USOs resulted in an unfair burden. GO’s funding application included the following components of the USOs namely, the Geographical Component in providing access at a fixed location; Public Payphones; Social Tariffs and Directory Enquiry Services. As part of its USO funding application, the intangible benefits were also included in order to calculate the net cost of the USOs. The evaluation process included two phases, namely:

- a Reasonability Phase to evaluate the reasoning behind GO's claim; and
- a Calculation Accuracy Phase to audit and verify the various calculations, including those used to quantify the intangible benefits.

Following the verifications and audit carried out by EY, it emerged that GO had suffered an element of unfair burden for providing the specified universal services, and after taking into account intangible

[1] GO’s financial year was from 1st January to 31st December 2014

[2] S.L 399.28 Regulation 30

benefits, it amounts to a net cost of €33,542. The results of the cost calculation and the conclusions of the audit on each USO component are being published and are found in Section 4 and Annex 1 below.

Following the consultation period on the proposed decision, the MCA received feedback from Melita Ltd (hereafter 'Melita') and the Authority wishes to thank this company for the interest shown in submitting its feedback.

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1. INTRODUCTION & BACKGROUND

The Electronic Communications (Regulation) Act (Cap. 399 of the Laws of Malta) specifies that one of the objectives of the Authority is to promote the interests and rights of users by ensuring that all users have access to universal services.[3] Universal services are defined as a minimum set of services of specified quality which are made available to all end-users irrespective of their geographical location, in the light of specific national conditions and at an affordable price.[4]

In April 2010, the Authority published a USO Decision which established a number of universal services that are to be provided by an entity, for a period of time as the Authority may specify, in part or in full, as the designated undertaking. The USO Decision stipulated that the MCA may designate different undertakings or a set of undertakings to provide different elements of universal services and to cover different parts of the Maltese islands, and that in default of an expression of interest from third parties, or if the established criteria failed to be satisfied, it is to designate an undertaking to be responsible for providing each of the universal services. As a result, given that there was no expression of interest, the Authority designated GO to provide the universal service/s in question.

During 2014, GO provided the following universal services:

- Provision of access at fixed location;
- Directory enquiry services and directories;
- Public Payphones;
- Specific measures for disabled users;
- Provision of reduced tariff options; and
- Ensuring users can control expenditure.

As outlined in the Electronic Communications Networks and Services (General) Regulations, SL 399.28 of the Laws of Malta (hereafter the "Regulations") and in the USO Decision, an undertaking designated to provide universal services has the right to apply to receive funds within a time period of eleven months following the end of the previous financial year for any net costs accrued in meeting these obligations. Such a request is required to be accompanied by supporting documentation to enable the MCA determine whether the provision of the universal service/s resulted in an unfair burden on the designated undertaking or not.[5]

On the 30th November 2015, GO submitted an application for the USO funding of the net costs it claimed to have incurred in providing universal services during 2014, accompanied by a detailed report on the

[3] Chapter 399, Regulation 4(1)(c)(i)

[4] SL 399.28 Regulation 21(1)

[5] SL 399.28 Regulation 30

methodology and calculations (including a cost model), for each of the USO components and was based on the following:

- the imbalance in the current tariff structure;
- individual geographic components;
- the provision of social tariffs;
- serving the territory with public payphones;
- the provision of universal directory enquiry services; and
- the deduction of the revenues derived from intangible benefits in providing universal services.

The MCA commissioned EY to undertake a review of the 2014 claim and to assist the Authority in assessing the funding application submitted by GO, and whether the information and the evidence provided was sufficient and detailed enough to support the claim. In order to expedite the process, the Authority requested GO's approval to make use of and refer to the information, explanations and documents provided by GO for previous USO claim reviews. GO did not raise any objection to the use of such information and documentation.

The process of the evaluation exercise is based on the one used for the previous USO claims, including two main review phases, namely a Reasoning Phase and a Calculation Accuracy Phase. Further detail and the outcome emanating from these work streams are described below.

1.1 Reasoning Phase

The goal of the Reasoning Phase was to analyse the validity of the reasoning GO used to support its claim. As part of this process, EY were asked to thoroughly investigate and assess the following elements on each universal service:

- the grounds on which the claim for funding are based;
- whether the claim is coherent with regulatory principles;
- the extent to which the claimed funding is attributed to universal service obligations; and
- the approach used to quantify the intangible benefit aspect of the claim.

During the Reasoning Phase, following some clarifications on the element of the Geographical component and the original claim, in March 2017 GO submitted a revised cost model which was also used in the Calculation Accuracy Phase described below. EY finalised the Reasoning Phase in May 2017 and the findings were included in a Report which was sent to GO. The findings emanating from this Phase can be found under the section "Assessment and Audit of the Net Cost" below.

1.2 Calculation Accuracy Phase

Specific universal services which were assessed as valid in the Reasoning Phase were analysed in detail in the Calculation Accuracy Phase. The objective of this phase was to audit and verify the various calculations, including those used to quantify the intangible benefits that GO provided in its claim. EY finalised the Calculation Accuracy Phase in October 2017.

The MCA requested EY to prepare a public version of the review report which is sufficient for the purpose of making the results of the cost calculation and conclusions of the audit publicly available, and at the same time protecting any financial information deemed to be of a commercially sensitive nature. This report is being made available in Annex 1 of this document. A summary of the findings emanating from this Report can also be found under section 4 "Assessment and Audit of the Net Cost" found below in this document.

2. LEGAL BASIS

The fundamental aspects of costing and financing of universal services are outlined in the Regulations and in the Directive 2002/22/EC (as amended) of the European Parliament and of the Council (hereafter the ''USO Directive'').

Regulation 30 of the Regulations stipulates that a universal service provider designated to provide all or parts of the universal service obligations outlined under regulations 21 to 28, may submit a written request to the Authority to fund the net costs it claims to have incurred in providing the universal service/s concerned. Such a request must be accompanied with detailed and supporting information to enable the Authority to determine whether the claim represents an unfair burden to the USP[6].

The Authority or an appointed independent body shall determine if the USO funding application submitted by the designated undertaking represents an unfair burden on that undertaking. The Regulations stipulate that an audit exercise shall verify the calculations of any net costs claimed on the basis of any market benefit which accrues to the designated undertaking and that the universal service obligations were provided in a cost effective manner[7]. If it is determined that the claimed components do not represent an unfair burden, the Authority shall inform the designated undertaking giving its reasons. Following the auditing exercise the results shall be made publicly available.

The financing of universal service obligations requires *a priori* that the Authority or an appointed independent body finds that an undertaking has suffered an unfair burden. Regulation 31 of the Regulations stipulates that the Authority shall compensate the designated undertaking from public funds with the approval of the Minister responsible for finance and, or from sharing the net cost between the providers of the electronic communications networks and services. The identification of the source of the USO funding, which could depend on the nature of the universal service in question, shall be treated by the MCA in a separate consultation.

[6] SL399.28, Regulation 30 (1) and (2)

[7] SL399.28 Regulation 30 (4) and (7)

3. ASSESSMENT AND AUDIT OF NET COST

As mentioned earlier, the Authority commissioned EY to evaluate the reasoning behind GO's claim and to audit and verify the various calculations of the net cost GO claimed it had suffered during 2014 in fulfilling its obligations and providing universal services on electronic communications services outside normal commercial conditions. The net cost is calculated as the difference between the cost a designated undertaking would suffer when operating with universal service obligations and that when operating without such obligations.[8] As also mentioned earlier, the specific objectives of the evaluation exercise consisted of two main review phases', namely the Reasoning Phase and Calculation Accuracy Phase. The MCA requested EY to prepare an abridged report which is sufficient for the purpose of making the results of the cost calculation and conclusions of the audit publicly available while protecting financial information of a commercially sensitive nature. The public version of EY's report entitled *"Review of GO plc's application for funding of the net cost claimed to have been incurred to provide universal service obligations during 2014"* is available in Annex 1 of this document.

For the financial year 2014, GO has claimed for the following USO components:

- Geographical Component;
- Payphones;
- Social Tariffs;
- Directory Enquiry Services; and
- Intangible Benefits.

As per previous claims, GO's cost model was based on two different scenarios, namely "Current net cost" which is based on actual line rental charged to their subscribers and a second scenario entitled "Current cost after rebalancing", based on a higher line rental tariff to cover the claimed line rental cost and return on capital. Nevertheless, in the covering letter attached to the 2014 claim, GO stated that although it still believes that before the introduction of competition in the fixed telephony market there was a non-completed rebalancing situation, it made its claim request in line with MCA's previous decisions on USO funding claim totalling €220,614.

Furthermore, although GO based the 2014 USO claim on the same methodology and cost model developed for its previous USO claims, the calculation for access deficit was not included as part of its submission. Access deficit can be described as a situation in which GO's overall revenues, emanating from connection services and line rental, fail to cover actual overall costs pertaining to the access line. GO took into consideration MCA's indications on the previous USO claims whereby access deficit should not form part of the USO claim.

[8] SL 399.28 the Sixth Schedule

As in previous USO claims, GO's cost model is based on a top-down model based on its operational data using a historical cost accounting methodology, taking a fully allocated cost approach. As part of its analysis during the Reasonability Phase and the Calculation Accuracy Phase, EY prepared an information request list to collect additional detail from GO. Following its initial feedback and clarifications on a number of items identified in the cost model, GO also submitted an updated version of the cost model which was analysed by EY during the calculation phase. Further detail is provided in Section 3.1 below and Annex 1.

In its submission for the net costs it incurred in providing universal services during 2014 GO did not include the following two USO components;

- the provision of broadband at a minimum speed of 4Mbps and 97% coverage which was included as a universal service in the USO Decision updated in June 2011; and
- the provision of a printed directory (since this service was not provided).

3.1 Geographical Component

The Geographical component is related to the net cost incurred in providing the Maltese territory with fixed telephony services irrespective of the location of the end-user. As in the case of previous USO claims, GO based its calculations on the basis of individual Main Distribution Frames (hereafter ''MDFs'') to determine unprofitable areas. The calculation on each MDF is based solely on active lines (both business and residential), since inactive lines should not be included for any potential compensation. EY's Reasoning Phase established that this was an acceptable approach and was also being used in other EU Member States. In the Reasoning Phase, EY established that, as in previous years, the geographical component should be calculated on the basis of net costs after rebalancing, as it was also stated by GO during the 2010 USO claim that it was because of competition that GO were not in a position to rebalance the line rental fee.

During the Reasonability Phase, a number of clarifications and information requests were made to GO in relation to this component. Following its feedback, GO provided an updated version of the USO cost model addressing these clarifications, and as a result it transpires that none of the MDFs suffered a net loss. The changes in the USO cost model included updated origination and termination rates established for the year 2014, in line with the relevant MCA decisions, and a rebalancing scenario with the exclusion of on-net traffic. This resulted that the net cost pertaining to the updated geographical component calculations recorded a positive margin in all zones and hence the original claim of €210,422 was revised, and as an effect no claim for the Geographical component was being made by GO.

As part of the EY review work during the Calculation Accuracy Phase, GO was requested to provide a reconciliation of revenues and costs used in the USO claim with the regulatory accounts. In order to avoid double counting, other USO components were excluded as was the case in previous claims, namely:

payphone lines, directory enquiry services and USO discounts in the case of social tariffs. EY reported that no exceptions were noted in arithmetical accuracies and allocation of the calculations carried out. Further information on this USO component is available in Annex 1.

In conclusion, since all MDFs resulted in a positive net margin for the Geographical component, it transpires that the USP did not suffer a net cost in providing this universal service during 2014.

3.2 Payphones

In accordance with the Regulations and USO Decision 2010, public payphones shall be made available to meet the needs of end-users in terms of geographical coverage, quantity, accessibility and quality of service.

The USO Decision established a minimum set of parameters of payphones required in each locality, depending on the population figures. In its 2010 USO claim, GO noted that it is reasonable to assume the minimum number of payphones as from 2011 onwards, given that the MCA USO decision was published in April of 2010 and it would have been logistically very difficult to remove a substantial amount of payphones in a short period of time. In the Reasonability Phase, EY reported that on the basis of the USO Directive and international practice, payphones could form part of the USO claim.

In its cost model, GO presented two scenarios; one with the total number of existing payphones, and another with the optimal number of payphones as set by the minimum requirements established in the MCA USO decision. Nonetheless, for claim purposes, GO decided to base its funding request on the current net cost pertaining to the optimal number of payphones, in line with the MCA's previous decisions on the USO funding claim.

The payphones installed around Malta and Gozo during 2014 amounted to a total of 713, out of which 674 were according to GO, unprofitable. Taking into account the minimum number of payphones requirement set by the MCA USO decision, GO is obliged to provide 184 payphones, out of which 145 were reported to be unprofitable.

As in the case of previous USO claims, GO provided revenues and costs information to arrive at the net cost of each unprofitable payphone. The estimation approach taken to calculate the net cost in the case of payphones is based on a net margin derived from revenues less costs per individual payphone, similar to the one undertaken to calculate the geographical component methodology using individual MDFs.

During the Calculation Accuracy Phase, GO confirmed that the same methodology was used as per previous USO claims and during the process of the review some data inaccuracies were identified and the calculation was adjusted to source the correct net margin for each unprofitable payphone.

Following the review, EY concluded that the payphone claim should be based on the optimal number of payphones in accordance with the USO Decision and the net cost of public payphones has been slightly adjusted from €36,907 to €36,356. More information on this USO component is available in Annex 1 of this document.

3.3 Social Tariffs

Another component which is claimed by GO, is the provision of social tariffs, to render the electronic communications service affordable to eligible end-users. As specified in the USO Decision, this component includes Telecare services and free line rental to low income earners, or to people with special social needs, included in a list specifically provided by the responsible Ministry or Government department.

During the Reasonability Phase, EY concluded that based on the USO Directive and on international practice, social tariffs could form part of the USO claim since it is a social obligation imposed on the designated undertaking. The same methodology as per previous claims was used by GO and was based on current net cost. This ensures that the eventual funding of the social tariff component is not overstated by including a charge higher than the actual charge applied to conventional GO's subscribers, due to a rebalancing tariff. The social tariff net cost has been calculated as the difference between the current retail price and the amount actually charged to subscribers.

GO claimed for two types of social services which were provided free of charge during 2014: Telecare service; and free line rental; these to the benefit of 2,469 and 2,691 subscribers respectively. During the Calculation Accuracy phase, the number of beneficiaries eligible for the social services were confirmed by the responsible Ministry which provides GO monthly updates of subscribers entitled to such services.

Following the Calculation Accuracy Phase, it was concluded that the claim on social tariffs based on the Current net cost scenario is justified. This amounted to a net cost of €63,108 for specific measures to disabled end-users and €163,559 for reduced tariff options totalling to a net-cost of €226,667. More information on this USO component is available in Annex 1 of this document.

3.4 Directory Enquiry Services

As in the case of past claims, the 2014 USO claim also included the provision of the directory enquiry services, which as per the USO decision had to be made available to all end-users at an affordable price. There is an agreement in place between local operators to provide GO, as the designated undertaking of the directory enquiry service, access to their subscribers' databases in order to be in a position to provide an updated comprehensive telephone directory enquiry service to all end-users.

Following the Reasonability Phase, EY concluded that directory enquiry services can form part of the USO claim, but further assessment was required to be carried out in the Calculation Accuracy Phase. Activities pertaining to dipping in the directory data (revenues and costs) are excluded from the calculation as they are outside the scope of the USO and therefore they should not be accounted for. The cost for the provision of the directory enquiry services was obtained from GO's management cost accounting system which included the variables used for the calculation of the net cost. During the Calculation phase, the arithmetical accuracy and the allocation of costs and revenues were considered, and it transpired that there were no exceptions.

EY concluded that the claim should remain as per GO's original claim amounting to €13,220. More information on this USO component is available in Annex 1 of this document.

3.5 Intangible Benefits

Regulation 30 and the Sixth Schedule of the Regulations establish that the Authority, or a third party approved by the same Authority, shall take into account any intangible benefits that arise from the provision of the universal services and deducted from the net costs.[9] In its USO claim, GO included information on ubiquity benefit and brand enhancement, as intangible benefits, which takes into consideration customer retention and influencing end-users' brand perception by offering universal services.

As in the case of previous USO claims, during the Reasonability phase EY concluded that intangible benefits should form part of the USO claim, and that although they are difficult to quantify, research shows that intangible benefits are included in a number of claims internationally. GO used the same approach and methodology of the previous claims to quantify ubiquity and brand enhancement not including life cycle and marketing benefits from the claim.

The methodology and computations were scrutinised in more detail during the Calculation Accuracy Phase to verify the workings of the intangible benefits components. In the cost model, although business

[9] SL 399.28, Regulation 30(4)

customers were included in the Geographic component, GO has once again excluded them from the ubiquity component. The workings and the calculations submitted by GO for ubiquity benefit were reviewed during the Calculation Accuracy Phase, and in response to the clarification requests relating to this component, unlike as in previous years, GO did not adjust the USO cost model to include business customers since it believes that the USO is aimed for residential users only although the scope of the universal service applies to all end-users including business customers. In addition, GO’s calculation did not include the percentage of subscribers` movement within the same zone. Nevertheless, GO’s position on these elements has not been accepted and the items mentioned above were adjusted in line with previous MCA Decisions. Following EY's calculation review and adjustments, the ubiquity element has been revised from €36,289 to €12,388. More information on this USO component is available in Annex 1 in this document.

As regard to brand enhancement which is associated with consumer brand loyalty allowing the designated undertaking to gain and retain its customers, GO based its calculation on 20% of the advertising costs applied on different media such as TV, fixed telephony and corporate branding. According to GO, there is no significant awareness by the end-users that GO is the universal service provider in Malta given that other service providers are providing similar offers. Following a work review, EY concluded that no exceptions were noted and the brand enhancement amount stated by GO in its claim remained unchanged at €230,313. More information on this USO component is available in Annex 1 in this document.

Estimating intangible benefits is a challenging exercise by its very nature, and different methodologies are generally used to assess them, nevertheless EY reported that the approach used by GO is reasonable and in line with international practice.

The value of the intangible benefits amounting to €242,701 would be deducted from the total of the USO components.

4. SUMMARY OF FEEDBACK RECEIVED AND FINAL ASSESSMENT OF THE NET COST PER COMPONENT

4.1 Feedback received

The consultation period for the proposed decision titled *'Review of GO plc's application for funding of the net cost claimed to be incurred to provide universal services during 2014'* ran from 22nd November 2017 until the 14th December 2017. The MCA received feedback solely from Melita Ltd (hereafter 'Melita') and would like to thank this company for the interest shown in submitting its responses.

4.1.1 Directory Enquiry Services

In its feedback, Melita included a comment on directory enquiry services stating that it does not concur with the funding of the directory enquiry services since calls to the 1182 number are not free of charge and are subject to a retail cost towards the end-user and a termination cost between the operators. However, the sharing of subscribers information (excluding ex-directory subscribers) to provide directory enquiry services falls outside the scope of the universal service obligations and therefore activities pertaining to dips in the directory data were correctly not included on GO's claim. The claimed net costs emanated from GO's management cost accounting system were reflected in GO's regulatory accounts.

Melita also mentioned that the universal service obligation for the provision of the directory enquiry services is enabling the designated undertaking to have access to a large database of potential customers which could be used to its advantage for marketing and promotion purposes. This concern is however already being addressed since as specified in the MCA decision titled *'Decision on the Wholesale Access to Data and the Provision of Publicly Available Directory Information Services'* the information provided by the subscriber to the publicly available telephone service provider shall be used solely for the purposes of directory information services and not for any other purposes, such as direct marketing[10].

4.1.2 Payphones

Melita is of the view that the USO funding should exclude expenses for the provision of public payphones due to the increased availability and accessibility of pre-paid services and IP based communications. Since the MCA Decision on *Universal Service Obligations on Electronic Communications Services* clearly established a required minimum number of payphones as a universal service subject to the number of

[10] Decision 7

population in each locality, the designated undertaking has every right to claim any net costs it incurred in providing this universal service.

4.1.3 Funding Mechanism

In its feedback, Melita also stated that the source of USO funding should emanate from public funds and not by means of a cost-sharing mechanism, even more so since the funding mechanism operates retrospectively given that financial planning and annual budgets cater for expenses in advance. The Authority will address this subject in a separate consultation specifically on the financing of the universal service obligations as in the case of previous USO claims.

4.2 Final Assessment

The table below shows a summary of the calculated cost and audited result for each element of the USO:

USO Components	Audited net cost €
Geographic component	(0)
Payphones	(36,356)
Social tariffs	(226,667)
Directory enquiry service	(13,220)
Intangible benefits:	
- Ubiquity	12,388
- Brand Enhancement	230,313
Total	**(33,542)**

5. SOURCE OF FUNDING

In the assessment process undertaken by EY it was established that GO, as the universal service provider, has suffered an unfair burden for the provision of the public payphones, social tariffs including Telecare and free line rental and directory enquiry services during 2014.

In accordance with regulation 31(1) of the Regulations, when the Authority establishes that a designated undertaking had suffered an unfair burden to provide a universal service, it shall be compensated by one or a combination of the following:

- from public funds with the approval of the government; and/ or
- by means of a sharing mechanism between providers of electronic communications networks and services[11].

More detail on the allocation of the source of funding on GO's claim for the financial year 2014 would be dealt with by means of a separate consultation document earmarked for publishing following the publication of this decision.

[11] SL399.28, Regulation 31 (1)

ANNEX 1

Malta Communications Authority

Review of GO plc's application for funding of the net cost claimed to have been incurred to provide universal service obligations during 2014

Calculation Accuracy Phase

Abridged Version of Full Report

09 October 2017

Building a better working world

Disclaimer notice

This report was prepared by Ernst & Young Ltd. ("EY") for the Malta Communications Authority ("MCA"), under the MCA's instructions. This report is an abridged version of the full report addressed to the MCA which was prepared for MCA's internal use only and is not suitable to be relied on by any other party or for any other purpose.

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Contents

Introduction and background information

Introduction (1)

This report relates to the review of GO plc's (GO) application for funding of the net cost claimed to have been incurred to provide Universal Service Obligations (USO) during 2014.

The Malta Communications Authority (MCA), as the National Regulatory Authority of the electronic communications sector in Malta, is responsible for the regulation of a minimum set of electronic communication services essential for the general public to participate in society, and those which are already available to the great majority of citizens. These universal services need to be available at just, reasonable and affordable rates ensuring persons on low income, those residing in geographically distant areas, persons with disabilities, and other vulnerable groups, have access to these services at reasonable prices.

Based on an MCA Decision dated July 2003, as updated by the decision entitled "Universal service obligations on Electronic Communication Services" (dated April 2010, updated September 2011; hereafter referred to as the "MCA USO Decision"), GO was designated as the Universal Services Provider ("USP") for a number of USO's, including:

- the provision of access at a fixed location,
- directory enquiry services and directories,
- public payphones,
- specific measures for disabled users,
- reduced tariff options, and
- measures ensuring users can control expenditure.

In June 21 2011 the MCA issued a decision obliging GO to provide a broadband universal service at a minimum of 4Mbps for 97% coverage. As explained in GO's USO claim, the cost of broadband provision is not evaluated for the purposes of this claim.

Introduction (2)

- As per the provisions of EC Directive 2002/22/EC ("EC USO Directive") and the Electronic Communications Networks and Services (General) Regulations (July 2011; hereafter referred to as "SL 399.28"), the USP can submit a claim related to USO funding. The MCA USO Decision delineates the key guiding principles and criteria for the evaluation of USO, the list of USO undertakings, the financing options and the designation processes. As per the EC USO Directive, article 12, and as per SL 399.28, regulation 30, the MCA or a body independent of the relevant parties appointed by the MCA shall verify the accounts and/ or other information serving as the basis for the calculation of the net cost of USO provided by the operator, with the results of the cost calculation and the conclusions of the audit being made publicly available.

- In 2012, GO submitted its first request to the MCA for the funding of the net cost claimed to have been incurred to provide USO for the year 2010. GO has since submitted USO claim requests for the years 2012 and 2013 prior to the claim for the year 2014 being reviewed in this report. These previous USO claims were reviewed by EY under the commission of MCA.

- GO's claim for the year 2014 was submitted on 30 November 2015, with a funding request of €220,614. As explained in pgs. 8 and 11 of this report, during 2017-Q1 GO have provided a revised USO claim submission and model with a funding request of €8,463. The scope of this engagement is to assist the MCA in its assessment of this (revised) funding application, and to assess whether the evidence provided is sufficient and detailed enough to support this claim.

Scope

Scope of our work

In accordance with the contract terms, EY has been requested by the MCA to assist in the review of GO's USO claim for the year 2014, submitted by GO in November 2015 (and subsequently updated).

The assignment is split into two phases:

- ***Reasoning Phase***: assessment of the grounds on which the claim is based, whether it is coherent with regulatory principles, the extent to which the claimed funding can be attributed to USO, and the approach used to quantify the intangible benefit aspect.
- ***Calculation Accuracy Phase***: verify the various calculations GO provided in their submissions.

This Calculation Phase follows on the conclusions of the Reasoning Phase which was finalised in April 2017. An overview of the conclusions of the Reasoning Phase is provided on pgs. 13-14 of this report.

Use of report

This report provides a summarised overview of the Reasoning Phase, and details of the Calculation Accuracy Phase review of GO's application for funding of the net cost claimed to have been incurred to provide USO during 2014. This report is an abridged version of the full report addressed to the MCA. This abridged report forms part of a public communication process to be undertaken by the MCA with stakeholders, including a public consultation document which is scheduled to be issued following the completion of both the Reasoning Phase and the Calculation Accuracy Phase. The public consultation document shall provide stakeholders with the opportunity to comment on the conclusions of the Reasoning and Calculation Phases.

Sources of information/ data (1)

Throughout the course of this engagement we have been provided with a number of information sources and documents, for both the Reasoning and Calculation Accuracy phases, as described below:

Reasoning Phase

For the Reasoning Phase we have been provided with the following information and documents dated 30 November 2015 and received by EY on 13 January 2017:

- Covering e-mail related to GO's 2014 USO funding application
- Evaluation of Universal Service Obligations costs in Malta in 2014: Methodology and Results ("USO Methodology and Results")
- Cost Evaluation of 2014 Universal Service Obligation for GO: Cost Model ("USO Model")

Following a number of clarification requests forwarded by the MCA to GO during 2017-Q1 in relation to the element of the "geographic component" of the original USO Model and claim, GO has provided a revised USO Model. The updates made to the USO model and claim amounts are explained on pg. 11, and any further reference to the "USO Model" in this report refers to this updated cost model. Furthermore, the USO Methodology and Results provided by GO will also be considered in light of this updated model.

Calculation Accuracy Phase

Following the submission of the Reasoning Phase report, a number of questions have been forwarded by the MCA/ EY to GO in order to prepare for the Calculation Phase.

Hence, in the preparation of this report we have referred to the below information sources besides those already provided in the Reasoning Phase:

- GO's replies to the MCA/ EY's first request of information and clarifications received on 21 June 2017
- GO's replies to the MCA/ EY's additional clarification requests, received on 24 July 2017.
- Confirmation from the Ministry for the Family, Children's Rights and Social Solidarity (Ministry responsible for social benefits and telecare services) on the number of subscribers that benefitted from social tariffs during 2014, received on 01 August 2017.

Sources of information/ data (2)

- During the compilation of this report reference has and will be made to information, discussions, principles and decisions related to previous USO claims. The MCA has requested the approval of GO to make use and refer to information, explanations and documents already provided by GO for the exercises undertaken for the previous USO claims, and GO has found no objection to such a request.

- An overview of the key decisions included in the previous MCA claim decisions are presented on the next page. The three previous MCA claim decisions are:
  - MCA-OPS/tf/14-2006 for the claim for the year 2010 (“2010 USO Claim Decision Notice”)
  - MCA-OPS/tf/15-2450 for the claim for the year 2012 (“2012 USO Claim Decision Notice”)
  - MCA-OPS/tf/16-2719 for the claim for the year 2013 (“2013 USO Claim Decision Notice”)

Overview of previous MCA USO Claim Decision Notices

The previous MCA USO Claim Decision Notices for the years 2010, 2012 and 2013 established key conclusions on what should, and should not, form part of the USO claim based on the universal service obligations set in the MCA USO Decision and EC USO Directive. The main conclusions from the 2010 USO Claim Decision Notice were re-iterated in the Decision Notices for the 2012 and 2013 claims. The key points emanating from these decision notices are listed below:

- In view of the 1996 EC Communication, Access Deficit should not form part of the total USO claim. As a result:
  - The Geographical Component should be based on the Rebalancing scenario.
  - The Social Tariffs claim should be based on current line rental charges (i.e. excluding charge for access deficit). If access deficit were taken into account to compute the social tariff cost, the entities providing the source of funding would be financing a higher line rental rate than that actually paid by regular end-users. Hence, social tariffs should be computed as the difference between the current retail tariff and the amount actually charged to subscribers.

- The Geographical Component should not include on-net traffic losses. Given that there are no price control on retail tariffs, on-net tariffs are set as a result of pricing decisions taken by GO rather than as a consequence to imposed regulatory measures. Hence, any arising on-net traffic losses are the result of pricing decisions taken by GO and should not form part of the USO claim.

- The public payphones claim should not be based on the total number of existing payphones but rather on the minimum number of payphones per locality as established in the 2010 MCA USO Decision. The USO Decision established parameters for the minimum number of payphones required in each locality depending on the population figures.

- Directory Enquiry services can form part of the USO claim.

- Intangible benefits related to ubiquity (for both residential and business customers; and based on rebalanced tariffs and excluding on-net calls) and brand enhancement were also included in the previous USO Claim Decision Notices as deductions against the USO costs.

Overview of GO's 2014 claim (1)

- GO's 2014 claim includes the same components included in previous claims. However, as noted below, while the net cost for the Geographical Component has been calculated in the USO Model, this resulted to be nil (all zones resulted to be profitable). The USO Model calculations of this component were still reviewed in this Calculation Accuracy Phase.

- As noted in its Decision Notices on the previous USO claims, MCA decided that (a) access deficit should not form part of the USO claim, (b) the geographical component should not include the access deficit element, and should be based on the rebalanced scenario and excluding on-net calls, and (c) social tariffs should be based on what is actually being paid, that is, the current cost scenario.

- In its covering e-mail accompanying the 2014 claim, GO states that, even though they still believe that they should be compensated for non-completed rebalancing before the introduction of competition, they have not included this in their request for 2014 in line with the MCA's decision on the 2010 claim.

- As explained earlier, following the clarification and information requests forwarded by the MCA during 2017-Q1, GO has provided an updated version of the USO Model addressing clarifications requested in relation to the Geographical Component calculation, as well as confirmations on the updated figures that should be considered for claim purposes. The updated Geographical Component calculation being considered for claim purposes is based on:
    - a rebalancing scenario with the exclusion of on-net traffic, and
    - origination and termination rates in place for 2014 as per relevant MCA decisions.

  Based on the above, all zones record positive net operating margins and hence no claim for the Geographical Component is being made by GO.

  As a result, the original total funding request of €220,614 submitted in November 2015 was revised to €8,463 (as reported in the Reasoning Phase Report) in this updated claim.

- The USO claim components and the associated funding requests are summarised in the table overleaf.

Overview of GO's 2014 claim (2)

- The adjacent table compares the funding request by USO claim component for the:
  - 2013 claim accepted by the MCA in its Decision Notice, and;
  - the 2014 claim following the conclusions of this Calculation Accuracy Phase review - more information on the reasoning behind these changes is provided throughout the 'Analysis by component' section of this report which documents our review and verifications of the calculations in GO's 2014 USO Model.

(in €)	2013	2014
	Final outcome (following review)	Final outcome (following review)
Geographical component	(7,257)	-
Payphones	(33,166)	(36,356)
Social tariffs	(245,659)	(226,667)
Directory enquiry services	(46,419)	(13,220)
Intangible benefits	230,936	242,701
Total	**(101,538)**	**(33,542)**

Summary of Reasoning Phase conclusions (1)

The Reasoning Phase dealt with the following areas:

- the grounds on which the claims for funding are based;
- whether the claim/s is/are coherent with regulatory principles;
- the extent to which the claimed funding can be attributed to USO; and
- the approach used to quantify the intangible benefit aspect.

The conclusions from the Reasoning Phase for each component of the claim were as follows:

Component	Initial reasonability assessment
Geographical component	• Based on international practice and the provisions of the EC USO Directive, the geographical component can form part of the USO claim. • The use of Main Distribution Frame (MDF) areas as a basis to determine the unprofitable areas is an acceptable approach, and is being used in other countries. • In line with MCA Decision Notices on previous USO claims, the geographical component claim to be considered is based on net costs after rebalancing and excluding on-net traffic.
Public payphones	• On the basis of the EC USO Directive and international practice, payphones can form part of the USO claim. • The 2012 and 2013 MCA USO Claim Decision Notice concluded that the claim for public payphones should be based on the optimal number of payphones, and not the existing number of payphones. The parameters for the calculation of the optimal/ minimum number of payphones per locality depends on locality population figures, as established by the MCA USO Decision (2011 update). • GO's 2014 submission has been based on the optimal number of payphones.

Summary of Reasoning Phase conclusions (2)

Component	Initial reasonability assessment
Social tariffs	• Based on the EC USO Directive social tariffs can form part of the USO claim, given that they represent a social obligation imposed on GO by the regulator. • In view of the previous MCA Decisions, wherein it was decided that access deficit should not form part of the USO claim, then it follows that the social tariff computation should be based on the current tariffs to ensure that those funding the social benefits are not burdened by higher cost than "normal" consumers. • GO have based their claim on current tariffs.
Directory enquiry services (DES)	• DES can form part of the USO claim. • As was the case for previous claims, justifications need to be sought for the losses being claimed, and whether the costs being included represent unavoidable net costs incurred by an efficient operator. • Furthermore, due consideration needs to be made to the fact that despite GO's argument that DES are offered at a loss, no requests have been made for an increase in the tariffs charged. This could be the case to retain their competitiveness with the other telecommunication firms and hence such a cost would not qualify as refundable.
Intangible benefit	• Intangible benefits should form part of the USO computation. Though inherently difficult to quantify, international research shows that a number of claims in other countries have also included intangible benefits, with the main benefits relating to ubiquity, brand enhancement, life-cycle and marketing. • In their USO application for funding, GO claim to have insufficient data to estimate the lifecycle benefit, and they claim that the marketing benefit is irrelevant locally since pay phones are not commonly used by consumers and advertising on payphones is uneconomic given the high costs involved. • Going forward, the approach GO has adopted to compute the intangibles benefits needs to be scrutinized in more detail in the Calculation Accuracy Phase to assess the methodology adopted and computation undertaken in quantifying ubiquity and brand enhancement.

Summary of Reasoning Phase Conclusions (3)

- Having completed the Reasoning Phase which sought to address the methodological issues (i.e. grounds on which the claim is based, whether it is coherent with regulatory principles, and the extent to which the claimed funding can be attributed to USO), the next step was to consider the calculation actually undertaken and verify the various calculations GO provided in their submissions. An overview of GO’s approach and methodology, as well as the main conclusions of the Calculation Phase are presented on the next pages.

GO's approach and methodology

GO's approach and methodology (1)

- GO has submitted a written request to receive funding for the net costs of meeting the USO for the year 2014. The claim was prepared by GO based on Marpij's methodology developed for the 2010 claim. An overview of the approach and main assumptions adopted in the 2014 claim is provided in the following pages.

Cost accounting basis

- The claim is based on historic cost accounting (HCA), taking a fully allocated cost (FAC) approach.

Approach and data sources

- Net costs have been calculated on the basis of a top-down model based on GO operational data. Specifically, the following sources have been used:
  - Accounting data: GO's management accounts and regulatory accounts
  - Technical data: GO's Technical Department reporting
  - Revenues and traffic: Data warehouse IT

- Although inevitable given the nature of the exercise and the various data sources used, it remains difficult to reconcile revenues and costs included in the USO claim to the audited regulatory accounts and statutory financial statements. In their USO model, GO have taken into consideration figures emanating from the regulatory accounts to ensure revenue reconciliation between the two. On the basis of these workings, no net costs resulted for the geographical component.
- GO was requested to provide separate reconciliations of revenues, costs and capital employed included in the USO claim to the 2014 audited regulatory accounts, to account for the remaining reconciling differences.
- On the basis of the reconciliations and explanations provided by GO, only immaterial differences between USO model and regulatory accounts revenues, costs and capital employed remain unexplained.

GO's approach and methodology (2)

Data approximation

- GO's management systems are aimed at providing information for their statutory financial statements and the regulatory accounts. In previous claims, GO indicated that a certain element of data approximation needs to be undertaken for the purposes of the USO claim. Main areas of approximation relate to particular points in time chosen to determine:
  - Data from GO's billing systems as at June 2014 to work out revenue / traffic per subscriber
  - If a service was inactive as at June 2014, GO identified the earliest service active between 30 March and 31 December.
  - Technical data (tel. number/ active lines/ local loop length/ max broadband speed)

- For the 2010 claim, GO had also explained that since customers can change their tariff plan at any time during the year, theoretically GO should have based their computation on monthly data (in terms of number of subscribers and tariff plans). For practical reasons, however, GO opted for the mid-year (i.e. 30 June referred to above) as an approximation.

- As mentioned already, GO have provided a reconciliation of revenues, costs and capital employed included in the USO claim to the 2014 audited regulatory accounts, explaining the reasons for the discrepancies between the two.

Access deficit

- Although the USO Methodology and Results document describes the calculation of access deficit, the USO Model and the formal claim put forward by GO do not take into account access deficit, in line with MCA Decisions on previous claims.

Return on Capital Employed (ROCE)

- The calculation includes a Return on Capital Employed ("ROCE"), which is based on the MCA's Decision (MCA/D/12-1416, dated 20 November 2012) on the Weighted Average Cost of Capital ("WACC") of 9.65% for regulatory accounting periods ending on or after 31 December 2012.

GO's approach and methodology (3)

Efficiency factor

- When asked whether an efficiency factor has been included in the USO calculations, GO confirmed that similar to previous claims, no efficiency factor has been included. In the 2013 claim GO had explained that "GO is subject to intense competition in the markets that encompass USO and as such cannot afford not to be efficient. In fact, in the past years it shed a considerable number of employees and has revised many of its procedures and operational practices. All these have for a time been at levels commensurate to a company subject to competition in the market".
  - Had an efficiency factor been included, this could have possibly resulted in a lower cost and a lower claim particularly in the directory enquiry and payphones components. This however needs to be considered in the context of the size of the claim of these components.
  - Furthermore, certain revenues and costs are estimated on the basis of traffic volumes. In particular, interconnection costs are based on traffic volume data, and origination/ termination rates for 2014 as set by the MCA decision notice MCA/D/12-1420 on the new Bottom-up Cost Model (BUCM2) for fixed networks and fixed interconnection prices, dated 21 December 2012. The origination and termination rates set by the decision are based on long-run incremental cost and are modelled on "the services of a hypothetical efficient operator with a view to set efficient regulated wholesale charges for fixed interconnection".

Fibre Lines

- For the geographical component, net costs are based on revenues and costs of residential and business consumers using copper line. According to the MCA's 2010 USO Claim Decision Notice, "any connection must be capable of allowing end-users to make and receive local and international calls, facsimile communications and data communications at data rates that are sufficient to permit functional internet access…. This must be done taking into account prevailing technologies used by the majority of subscribers, and technological feasibility." (2010 DN, pg. 10)
- While the decision does not specify the type of technology to be used to provide access, in practice copper lines are being used to provide the minimum required services including access. GO has been increasingly deploying fibre lines with plans for a national fibre rollout (Fibre-To-The-Home), however at this stage business customers requiring more sophisticated services and higher speeds tend to have fibre. Accordingly, and as was the case in the previous claims, the costs and revenues of fibre lines are not included in GO's claim as they are considered to be outside the scope of USO.

Analysis by component
Geographical component

The Geographical Component (1) GO's methodology

- The ***geographical component*** relates to the cost of providing telephony services across the entire country, so that all subscribers, irrespective of location, have access to a telephone at the same price anywhere in the country, including potentially areas that could lead to losses.
- Based on GO's USO Model all geographical zones resulted to be profitable for 2014. As part of our review work, we have reviewed the methodology and calculations utilised in the calculations of this component.
- GO uses MDF areas as the basis to assess the geographical component and identify unprofitable areas. GO's network includes 22 MDF areas covering the whole of Malta and Gozo. The computation is based on active lines only and includes both business and residential customers. In the Reasoning Phase it was concluded that the inclusion of active lines only in the geographical component calculation represents normal practice since inactive lines cannot be included as part of any potential compensations.
- In GO's USO Model, net margins were determined through a P&L approach by MDF, as shown in the adjacent table. All MDFs record positive net margins, and hence there is no funding pertaining to the Geographical Component.
- In order to avoid double counting, the other USO components which have been separately identified were excluded:
  - Payphones lines
  - Directory enquiry services
  - USO discounts (social tariffs) – in the case of social tariffs, lines eligible to social tariffs were treated as normal lines, with the discount portion being then considered separately (discussed as a separate component in pgs. 32-33 of this report)

Revenue and cost by MDF as per GO's claim	
Line rental revenue (including rebalanced line rental from both residential and business subscribers)	
Traffic revenue (international, fixed to mobile, off -net, broadband, telecare, OTC, international incoming and other revenue)	
Less:	Technical line cost (local loop cost + subscriber based costs)
	Other line cost (commercial and corporate costs)
	Traffic cost
	Broadband cost
	Other costs
Net revenue / (cost) by MDF	

The Geographical Component (2)
GO's methodology

- GO's Geographical Component calculation for the year 2014 is based on rebalanced tariffs and excludes on-net traffic.
  - The use of rebalanced tariffs is in line with the conclusion of past MCA Decision Notices where it was decided that access deficit should not form part of the USO claim.
  - The exclusion of on-net traffic conforms with the MCA decision in its 2010 Decision Notice that "on-net calls" should be excluded from the geographical component calculation.

- In their USO model, GO have taken into consideration figures emanating from the regulatory accounts to ensure revenue reconciliation between the two.

- In the model, all MDFs resulted to be profitable with no associated funding request for the Geographical Component.

- GO confirmed that the same methodology and assumptions with regards to revenues and costs applied in previous claims were applied in the USO Model calculation for the 2014 clam. This includes the process used in previous claims of extracting data from the billing system as at end June and matching it by MDF. The June cut-off point was chosen as a proxy for the entire year (instead of working out monthly details per subscriber given such data is not readily available). This estimation resulted in certain differences in the revenues and costs of broadband and line rental compared to the regulatory accounts and the audited financial statements. GO provided explanations for these differences.

- The following pages explain in further detail the revenue and cost assumptions used in the USO Model calculation of the geographical component.

The Geographical Component (3)
Key assumptions – revenues

Revenue by MDF	Assumption
Line rental revenue – residential	• Number of residential lines x average rebalanced line rental • As was the case in previous claims, the number of residential lines was extracted from GO's data warehouse IT database and includes all active residential lines as at June 2014, including those with bundle offers and Easyline and subsidised lines, but excluding lines with no telephone and no broadband revenues, and excluding payphone lines. • The rebalanced line rental was estimated by adding the monthly technical cost/ line and the monthly commercial & corporate cost/ line (described under the Cost assumptions)
Line rental revenue – business	• Number of business lines x average rebalanced line rental. • The number of business lines was extracted from GO's data warehouse IT database as at June 2014 and includes all active lines as at this date. • The rebalanced line rental was estimated by adding the monthly technical cost/ line and the monthly commercial & corporate cost/ line (described under the Cost assumptions)
Call revenue - on-net	• Has not been included in line with MCA's Decision on the 2010 claim
Call revenue - international outgoing, fixed-to-mobile, broadband, and other revenue ("OTC")	• The sources of these figures were not provided. However, we understand that these are based on information which has been extracted from the billing data and are based on actual revenues for 2014.
Call revenue - International Incoming	• International incoming traffic x average revenue • International incoming traffic has been based on total incoming traffic volume (hard-coded, and based on traffic statistics as per regulatory accounts) and has been apportioned by MDF on the basis of outgoing international traffic. In previous claim reviews, GO explained that it does not have statistics on terminating international calls by MDF, and as a result international incoming revenue was split by MDF on this basis. • Average revenue per minute is based on total related revenues divided by related volumes (both hard-coded, and based on traffic statistics and revenue as per regulatory accounts).
Other revenue	• Other revenue related to supplementary services and remaining activities (obtained from the regulatory accounts), allocated to MDFs on the basis of MDF revenue (line rental and traffic revenue) as a percentage of total revenue.

The Geographical Component (4)
Key assumptions – costs

- The following table presents the cost assumptions as explained by GO or presented in GO's USO Model.

- It is pertinent to note that the termination rates for 2014 are significantly lower than previous years'. The origination and termination rates used in the cost model's net margin calculations are based on the regulated termination rates pertaining to 2014 as set by the MCA in decision MCA/D/12-1420 – "The MCA's New Bottom-up Cost Model for Fixed Networks and Fixed Interconnection Prices". The decision dated 21 December 2012 established significantly lower termination rates which were gradually phased in over 2013 (reductions in Jan 2013 and July 2013) with the lower rates set as from 01 July 2013 remaining applicable throughout 2014. The mobile termination rate has also been significantly reduced as from 01 April 2014, when it was set on the basis of a Bottom-Up Long Run Incremental Cost model. The lower termination fees for 2014 have reduced the traffic costs calculated in the geographical component.

Cost by MDF	Assumption
Technical Line Cost	• Number of active lines x sum of operating cost/line and cost of capital/ line + line length x sum of operating cost/line length and cost of capital/line length • The operating cost per active line relates to the cost of line cards, FMUX transmitting equipment, other activities, corporate costs and the licence fee, and is divided by the total number of active lines. This data has been obtained from the regulatory accounts model (not provided) • The cost of capital per active line is based on the product of (a) a WACC rate of 9.65% (MCA Decision on WACC for regulatory accounting periods ending on or after 31 Dec 2012, ECS WACC Review 2012, p. 18); and (b) the Net Book Value of line cards, FMUX transmitting equipment, and other assets. This is then divided by the total number of active lines. This data has been obtained from the regulatory accounts model (not provided) • The operating cost per copper line length relates to the cost of the copper only, and is divided by the total copper line length. • The cost of capital per copper line was determined by multiplying the 9.65% WACC by the NBV of the copper line, and subsequently divided by the total copper line length. Again, this data was obtained from the regulatory accounts model
Other Line Cost	• Number of residential lines x residential commercial & corporate cost/ line • Number of business lines x business commercial & corporate cost/ line • This data has been obtained from the regulatory accounts model • The residential commercial & corporate costs relate to Talk 200, Free Nights and Weekends scheme, Talk Anytime, and general residential line rental. The business commercial & corporate costs relate to Talk 500 and the Access Business package • The retail cost (commercial and corporate LAN costs) per regulated retail service was extracted from the regulatory accounts, which includes detailed retail costs split by service/ bundle.

The Geographical Component (5)
Key assumptions – costs

<table>
<tr><th>Cost by MDF</th><th>Assumption</th></tr>
<tr><td>Traffic Costs</td><td>

Traffic volumes (outgoing international, fixed-to-mobile, off-net, international incoming) x unitary cost/minute
Traffic volumes were extracted from billing data (and therefore include all traffic including free minutes in bundles)
Unitary costs/ minute have been based on the applicable origination and termination rates, and the commercial cost/ minute
The commercial cost has been derived from the regulatory accounts model

</td></tr>
<tr><td>Termination rates included in traffic costs</td><td>

Origination and termination rates have been based on the 2014 rates applicable to all operators having been designated with an SMP status in the provision of mobile termination services market, as per the MCA’s Decisions, including:

A fixed-line termination rate of €0.000443/ minute based on the MCA’s New Bottom-up Cost Model for Fixed Networks and Fixed Interconnection Prices, MCA/D/12-1420. This MCA decision dated December 2012, established lower fixed line termination rates which were gradually phased in during 2013 (reductions in January and July 2013). The fixed line termination rate pertaining to 2014 is of €0.000443/ minute applicable from 01 July 2013. No further revisions in relation to the rate for 2014 were effected.
A fixed-line origination rate of €0.002643/ minute which is also based on the rate set by the MCA’s New Bottom-up Cost Model (decision MCA/D/12-1420). This is the rate which became applicable as from 01 July 2013 and also pertains to 2014 as no further revisions to this rate have been made since.
An average mobile termination rate of €0.009159/ minute based on:

A rate of €0.0245/ minute as per MCA/D/14-1840, applicable for the period January-March 2014
A rate of €0.004045/ minute applicable as from 01 April 2014 as set in the MCA’s decision on mobile interconnection pricing based on a Bottom-up Cost Model for mobile networks dated 14 March 2014 (MCA/D/14-1802)

In view of the above, the rates applicable for 2014 as set by the MCA Decisions are lower than those applicable for previous years.
An international termination rate has been applied in GO’s USO Model. This was derived by GO through their 2014 regulatory accounts.

</td></tr>
<tr><td>Broadband Cost</td><td>

Broadband revenue generated by each MDF (which is hard-coded) x (1 – ADSL net margin).
This ADSL margin is estimated on the basis of information included in the regulatory accounts, and taking into account (a) revenues, (b) operating costs, and (c) the cost of capital employed at 9.65% on ADSL Capital Employed, a breakdown of which is also provided in the model.
The same ADSL margin is applied across all MDFs. In previous claims GO explained that this approach is adopted since the cost of providing ADSL is not dependent on line length but the equipment utilised in the MDFs. GO believes that the adopted approach provides the best estimate for broadband cost per MDF.

</td></tr>
<tr><td>Other costs</td><td>

Other costs include operating costs of supplementary services and remaining retail activities. These costs are not traffic-based and are not related to line rental costs. These costs include operating costs which are specific to retail and transfer charges from core network. Other operating costs, are allocated to MDFs on the basis of total MDF revenue (line rental and traffic) as a percentage of total revenue (same basis for allocation of supplementary revenues).

</td></tr>
</table>

The Geographical Component (6)
Review work & conclusion

- The Geographical Component, calculated under the previously described methodology and assumptions, yielded positive net margins for all MDFs and hence there is no funding request for the Geographical Component.

- As part of our review work, a reconciliation of revenues and costs used in the USO claim with the regulatory accounts was requested from GO, in view of the use of different sources to estimate the revenue and costs by MDF and the resulting timing issues. Reconciliations and explanations of the arising differences were provided by GO on 21 June 2017. Following these reconciliations, marginal differences in revenue and costs remained unexplained.

- We have considered the arithmetical accuracy and allocation calculations carried out, and report that no exceptions were noted.

Analysis by component
Public payphones

Public payphones (1)
GO’s methodology

- The ***public payphones*** claim relates to the net cost of serving the territory with public payphones.
- The estimation approach is similar to the geographical component methodology, and derives a net margin based on revenues less costs (as per the table below), with a claim being made on an individual payphone basis. In reply to clarification requests, GO has confirmed that the same methodology used in previous claims for the calculation of the net payphone cost based on the optimal number of payphones has been used for this 2014 claim. The key assumptions of this methodology are described in the below table.

Revenue and cost by individual payphone	Assumption
Revenue from calls	• Billing data for on-net calls, outgoing international, mobile calls, and off-net calls sourced from GO’s Data warehouse.
Less:	
Line cost	• Number of active lines x sum of operating cost/line and cost of capital/ line + line length x sum of operating cost/line length and cost of capital/line length • Previously described under the “geographical component” section
Traffic cost	• Traffic volumes (on-net, outgoing international, fixed-to-mobile, and off-net) x unitary cost/minute • Traffic volumes were extracted from billing data • Previously described under the “geographical component” section)

Direct operating costs	• Equal allocation of operating costs (derived from actual invoices), including:
	  • Cost of sales - cards
	  • Commissions paid to distributors of payphone cards (both easyline and telecards)
	  • Share of corporate
	  • Electricity
	  • Hire of premises
	  • R&M - Cardphones
	  • Metering cost

Depreciation & Amortisation	• Equal allocation of depreciation obtained from the regulatory accounts model.
Cost of capital	• Regulatory cost of capital based on the net book value referring to payphones (both card and coin) • Cost of capital of 9.65% (previously discussed)
Net revenue / (cost) by payphone	

Public payphones (2)
GO’s methodology – Number of payphones

- The MCA USO Decision establishes the parameters for the minimum number of payphones required in each locality based on the locality population. Previous MCA Decision Notices established that the public payphone claim should be based on this optimal number of payphones. In their feedback on the 2010 USO claim dated 30 May 2014, when arguing for the number of payphones to be included in the 2010 claim, GO pointed out that “it is reasonable to assume the minimum number of payphones from 2011 onwards”. In view of the above, the payphone claim should be based on the optimal number of payphones in accordance with the USO Decision.

- In the USO model for the 2014 claim, GO present the net payphone cost based on both the total existing number of payphones (713), and the optimal number of payphones as set by the minimum requirements as established in the MCA USO Decision. GO’s funding request for 2014 is however based on the optimal number of payphones, in line with the MCA USO Decision and previous MCA USO Decision Notices. In previous USO Decision Notices, the MCA concluded that the USO claim should be based on the optimal number of payphones as set in the MCA USO Decision.

- With the minimum payphone requirement set by the MCA USO Decision, the optimal number of payphones for the whole of Malta is 184. Based on GO’s USO Methodology and Results, 145 payphones (out of the optimal number of 184 payphones) in 62 localities (out of 68) generate a negative margin, leading to a claimed net cost of €36,907.

Public payphones (3)
Review Work & Conclusion

Review Work

- In the process of our review work, some data sourcing inaccuracies were identified in the component's calculation based on the optimal number of payphones. The payphone calculation was adjusted so as to source the correct net margin figures for each individual payphone, and to source the least unprofitable payphones in each locality in line with the payphone distribution rule. As a result of these adjustments, the net cost for the payphone component decreased slightly from €36,907 to €36,356.

Conclusion

- In line with previous MCA Decision Notices, GO's calculation of the public payphones component is based on the optimal number of payphones as calculated through the 2010 Decision Notice's mechanism.

- On the basis of our review work explained above, the public payphone claim results in a total net cost of €36,356.

Analysis by component
Social tariffs

Social tariffs (1)
GO's methodology

- Under its current USP status, GO is required to provide social tariff options to a number of users. In turn, GO can claim back the net cost of providing such services, similar to what is done in a number of other European countries.

- GO provides two types of social services free of charge: free line rental and free Telecare service. The users eligible for such social tariffs are identified by the Ministry for the Family, Children's Rights and Social Solidarity (formerly the Ministry for the Family and Social Solidarity in 2014), which provides GO with a monthly update of consumers entitled to benefit from social tariff. As part of the review, the MCA have obtained the Ministry's confirmation on the number of subscribers that benefitted from social tariffs during 2014.

- The social tariffs net cost has been computed as the difference between the discounted rate amount actually charged to subscribers, which in this case is free, and the current line retail price. This calculation, based on the current net cost scenario, is aligned with the MCA's decisions of previous claims that access deficit should not form part of the USO claim.

- In order to avoid double counting, beneficiaries have been included in the geographical component claim with the standard rental fee (i.e. not discounted), while the discount is highlighted solely in this social tariff component.

Social tariffs (2)
GO's methodology and conclusion

- The table across summarises the 2014 social tariffs claim totalling €226,667 (i.e. €163,559 for reduced tariff options; and €63,108 for specific disability measures) as submitted by GO.

Conclusion

- The social tariff component has been calculated by GO as the difference between the current retail tariffs and the amount actually charged to subscribers, which in this case is free. This net cost calculation, based on the current net cost scenario, is aligned with the MCA's decisions of previous claims that access deficit should not form part of the USO claim.

- The social tariff claim, on the basis of current costs and subscriber numbers, results in a net cost of €226,667.

GO's claim	Reduced Tariff Options for Users	Specific Measures for Disabled Users
	€	€
DUO PACK		
Free Rent and Charged Telecare	2	n/a
Charged Rent and Charged Telecare	n/a	n/a
Charged Rent and Free Telecare	n/a	46
HOME PACK		
Free Rent and Charged Telecare	9	n/a
Charged Rent and Charged Telecare	n/a	n/a
Charged Rent and Free Telecare	n/a	169
Free Rent and Free Telecare	1	1
NO PACK		
Charged Rent and Charged Telecare	n/a	n/a
Charged Rent and Free Telecare	n/a	1,240
Charged Rent No Telecare	n/a	n/a
Free Rent and Charged Telecare	338	n/a
Free Rent and Free Telecare	1,013	1,013
Free Rent No Telecare	1,328	n/a
Total	**2,691**	**2,469**
Line rental (€/ month)	5.065	2.13
Total annual cost	**163,559**	**63,108**

Analysis by component
Directory enquiry services (DES)

Directory enquiry services (1) GO's methodology and conclusion

- The Directory Enquiry Services (DES) component relates to the net cost of providing directory enquiry services to all end-users at an affordable rate. As per previous MCA decision notices, DES can form part of the USO claim.
- The net cost of the provision of DES was obtained from the management cost accounting system (costs used in the regulatory accounts), and includes:
  - Call revenues from the 1182 enquiry service
  - Operating cost of the call centre
  - Transfer charges from core and LAN network
  - Cost of capital with 9.65% WACC

  The adjacent table summarises these components making up GO's DES claim, which it claims that have generated a net cost of €13,220.

Directory Enquiry Services
Revenue from call charges (business and residential)
Less:
Operating costs specific to retail
Transfer charges from Core Network
Cost of capital
= Total Costs
Net Margin/ Cost

- GO have confirmed in their clarification replies, that no changes were made in 2014 to the agreement between the operators to share their respective directory data in order to provide telephone numbers of other operators. This access is provided on an individual search basis rather than the operators providing GO with access to their entire database. This electronic system carries a charge for every dip into the directory data of a respective operator. This arrangement was made with the direct involvement of the MCA in discussions held at the time among the operators.
  - Following the 2010 USO Claim Decision Notice, the sharing of subscribers information between operators (excluding ex-directory subscribers) to provide DES falls outside the scope of USO. Therefore, activities (and income/ costs) pertaining to dips in directory data are not to be included in the claim. GO confirmed that the income and cost rates used in the net cost calculation for the 2014 claim are exclusive of dipping charges.

Conclusion

- Based on our review work, the DES claim should be equal to the claimed amount of €13,220.

Analysis by component
Intangible benefits

Intangible benefits (1)
GO's methodology

- Revenues related to intangible benefits that the operator derives from the provision of the USO need to be deducted from the costs of the USO components in order to arrive at the final net USO cost.

- GO provided estimates for the following two intangible benefits:
  - ***Ubiquity***: the benefit associated with the comparatively lower cost of the USO operator compared to the competitors in extending its network to new customers.
  - ***Brand enhancement***: the benefit associated with the enhancement of the USP brand through the fulfillment of the USO. This affects the customer perception (of its own and other operators' brands), thereby impacting on the provider's overall profitability.

  GO adopted the same approach and methodology used in previous claims to quantify the above intangible benefits. The methodologies adopted in the calculation of these benefit, are reviewed and analysed in detail on the next pages.

- Other intangible benefits which were not considered by GO include:
  - ***Life cycle***: evaluation in terms of the evolution of the average telephone bill, and the increase of the telephone bill through the evolution of the familial structure.
  - ***Marketing/ access to customers' database***: benefit associated with the savings in acquisition costs and operational costs of a customer's database.

Intangible benefits (2)
Ubiquity benefit

Ubiquity

- In their USO Model, GO estimated a ubiquity benefit of €38,017.
- In our review work we have assessed the ubiquity benefit calculation in light of past MCA USO Decision Notices. Accordingly, we have adjusted the ubiquity benefit calculation with the following:
  - The benefit calculation was adjusted so as to include business customers' moves (in addition to residential customers' moves). The calculation in the USO Model was based on residential customer moves only. The adjustment has been made in view of the following:
    - In reply to clarification requests on this 2014 calculation, GO have again expressed their view that they do not believe that business customers should be included in the calculation of USO intangible benefits. GO claim that USO is clearly aimed at residential customers which would otherwise not be served due to non-economic feasibility of providing a service. The same argument had been put forward by GO in previous claims to which the MCA had replied and decided that businesses should be included in this calculation as they were also included in the calculation of the geographical component.
    - In line with the above, MCA decisions on the 2010, 2012 and 2013 USO claims had been concluded on the basis of a working including both residential and business customers' moves.

    In view of the above, the ubiquity benefit calculation was adjusted to include business customers' moves in line with past MCA decisions.
  - GO's calculation did not consider the percentage of moves (business and residential) within the same geographical zone. Since the non-consideration of moves within the same zone would lead to an overstatement of the ubiquity benefit, the calculation was adjusted with the rate of moves within the same zone set in previous claims submitted by GO.

Intangible benefits (3)
Ubiquity benefit

Ubiquity

- The value of this intangible benefit, based on GO's methodology presented in the below table, and following the adjustments to include business customers' moves and percentage of moves within the same zone (described in previous page), amounts to €12,388.

	Item
a	Moves/year
b	of which residential (adjusted to include business customer moves)
c	of which in the same zone (adjusted to include moves within the same zone)
d=a*b*c	Moves outside zone
f	# of zones
g	# of unprofitable zones
h=d/f	Moves outside zone
i=(f-g)*h	Moves to profitable zones
j	Competition market share in acquisition
k=(1-j)*i	Loyal customers thanks to the USP position
l	Net annual margin/customer (€)
m=k*l	**Ubiquity benefit (€)**

Intangible benefits (4)
GO's methodology

Brand enhancement

- Brand enhancement relates to any improvement in the UPS' brand image when offering its services.

- There is no standard methodology to estimate this benefit. In its 2014 claim, GO again decided to follow the UK regulator's approach, basing its calculations on the below assumptions/ methodology:
  - Brand image benefit was assumed to be approximately equal to 20% of the combined cost of related marketing expenditure, including advertising campaigns related to fixed telephone, TV packages, and general corporate branding.
    - The 20% factor used in this calculation is the same as the one used in previous claims where, in relation the choice of this factor, GO had explained that in view of the costs involved in a market study to assess this intangible benefit, a benchmark with international experience is more than adequate.
    - GO has provided a list of the campaigns related to fixed line whose costs have been used in the calculation of this intangible benefit.

- Based on the above methodology, the brand enhancement benefit was valued at **€230,313.**

Intangible benefits (5)
Conclusion

- Based on our review, the value of the intangible benefits to be deducted from the cost of the other components should be equal to:
  - Ubiquity: €12,388
  - Brand enhancement: €230,313

- The calculation of intangible benefits is difficult due to their very nature, but the approaches applied by GO appear reasonable and in line with international precedent.

Summary of conclusions

Calculation Phase: summary of conclusions

Based on the considerations contained in this report, the following table summarises the conclusions of the Calculation phase.

Component	€	Summary of conclusion
Geographical component	-	As per GO USO Model/ claim
Payphones	(36,356)	After slight adjustment for data sourcing inaccuracies (pg. 30)
Social tariffs	(226,667)	As per GO USO Model/ claim
DES	(13,220)	As per GO USO Model/ claim
Ubiquity	12,388	After adjustment to include business customers' moves and percentage of moves within the same zone, in line with MCA USO Decision Notices on previous claims (pgs. 38-39)
Brand enhancement	230,313	As per GO USO Model/ claim
Total	**(33,542)**	

- The resulting USO net cost amounts to **€33,542**.