



Review of GO plc's application for funding of the net cost claimed to have been incurred to provide universal service obligations during 2015

Proposed Decision

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EXECUTIVE SUMMARY

During 2015, the Malta Communications Authority (hereafter "MCA" or the "Authority") published a revised decision for the provision of universal services on the electronic communication services entitled "*Decision on Universal Service Obligations on Electronic Communications Services*" (hereafter "2015 USO Decision"). Following a consultation process it was decided that certain components of the universal services had to be updated and/or revoked in light of technological advancements and services available to all end-users. These services are intended to ensure that every member of society, irrespective of location and social standing, can have access to electronic communications services.

As a result of the 2015 USO decision, the provision of universal service components were updated as follows (applicable from the latter part of 2015):

Access at a fixed location

This universal service is only applicable in the case when no other public communications networks provide connection at a fixed location at an affordable price;

Directory enquiry services and directories

The obligation for the directory enquiry service was revoked and, in addition to the provision of the comprehensive electronic telephone directory, the designated undertaking is required to also make available a free of charge smartphone telephone directory 'app';

Public payphones

No changes from the 2010 USO Decision (except for some reduction in administrative processes during the removal of payphones).

Specific measures for disabled users including Telecare type of service

No changes from the 2010 USO Decision

Reduced tariff options and control of expenditure

No changes from the 2010 USO Decision

As allowed by the above Decision, the MCA received a written request by GO plc (hereafter "GO"), the designated undertaking, claiming the net costs it believes it incurred during the financial year 2015¹, taking into account in its calculations that the 2015 USO Decision came into force as from 1st July 2015.

¹ GO's financial year was from 1st January to 31st December 2015

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 universal service obligations, taking into account any market benefits. As established in the MCA 2015 USO Decision, the universal service provider (hereafter referred to as "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: Public Payphones, Social Tariffs and in the case of Directory Enquiry Services for the first six months of the year since as stated in the afore mentioned decision this universal service was withdrawn as from 1st July 2015. As part of its USO funding application, the intangible benefits were also included in the claim.

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 incurred an element of unfair burden for providing the specified universal services, which after taking into account the intangible benefits, amounts to a net cost of €122,644. The results of the cost calculation and the conclusions of the audit on each USO component are being published and are found in Section 3 and Annex 1 below.

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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.² 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.³

In April 2010, the Authority published a USO Decision, which was updated in May 2015 establishing 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.

Given that the 2015 USO Decision came into force on the 1st July 2015, the USO claim is taking into account the USO Decision published in April 2010 for the first half of 2015 and the USO Decision published in May 2015 for the latter half.

During 2015, GO provided the following universal services:

- Provision of access at fixed location (from 1 July 2015, applicable only in areas where no other public communications network was in a position to provide such a service to the end-user at an affordable price);
- Directory enquiry services and directories (only applicable until 30 June 2015);
- 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 2015 USO Decision, an undertaking designated

² Chapter 399, Regulation 4(1)(c)(i)

³ SL 399.28 Regulation 21(1)

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 to determine whether the provision of the universal service/s resulted in an unfair burden on the designated undertaking or not.⁴

On the 30th November 2016, GO submitted an application for the USO funding of the net costs it claimed to have incurred in providing universal services during 2015, accompanied by a report on the methodology and calculations (including a cost model), for each of the USO components.

The MCA commissioned EY to undertake a review of the 2015 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 a few questions on some elements of the claimed USO components, in April 2018 GO submitted a revised cost model which was used in the Calculation Accuracy Phase described below. EY finalised the Reasoning Phase in June 2018 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.

⁴ SL 399.28, regulation 30.

1.2 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. During this phase, information and clarification requests were made to GO, and as a result a revised cost model was submitted to the MCA in quarter two of 2018. EY finalised the Calculation Accuracy Phase in December 2018.

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 3 “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 of the Regulations, 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 USP⁵.

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 manner⁶. If it is determined that the claimed components do not represent an unfair burden, the Authority shall inform the designated undertaking accordingly, giving its reasons therefor. 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.

⁵ SL399.28, regulation 30 (1) and (2).

⁶ 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 incurred during 2015 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.⁷ As 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 2015*" is available in Annex 1 of this document.

For the financial year 2015, GO included the following USO components in its claim:

- Payphones;
- Social Tariffs;
- Directory Enquiry Services (for the first half of the year); and
- Intangible Benefits.

GO's cost model was based on the "Current net cost" which is based on actual line rental charged to their subscribers and unlike previous claims GO correctly did not include the second scenario "Current cost after rebalancing", which used to be based on a higher line rental tariff to cover the claimed line rental cost and return on capital. In its cost model, GO included the current net cost for a full year adjusted in line with the revised 2015 USO Decision which came into effect on the 1st July 2015. As a result, the total claim amounted to a net cost of €206,009. Following a number of clarifications that took place during in the Reasonability Phase in the second quarter of 2018, GO submitted a revised cost model totalling €169,045.

GO based the 2015 USO claim on the same cost model developed for its previous USO claims. Furthermore, although GO based the majority of the components on the same methodology used in previous claims, the Directory Enquiry Services was initially based on a different cost allocation methodology which is further explained in Section 3.3 below.

⁷ SL 399.28 the Sixth Schedule

As in previous USO claims, GO's 2015 USO claim is based on a fully allocated cost approach by means of a top-down cost model factoring in its operational data using a historical cost accounting methodology. 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. Supplementary questions were sent to GO during the review work for clarifications and justification purposes and as a result GO sent updated figures in relation to Payphone and Directory Enquiry Services cost elements. 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 2015, 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).

The following sub-sections include further explanation of the review work carried on each USO component claimed by GO for funding.

3.1 PAYPHONES

In accordance with the Regulations and the MCA USO Decision published in 2010 (as updated in the USO Decision published in 2015), 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 2010 USO Decision established a minimum set of parameters of payphones required in each locality, based on the population figures. These parameters were maintained in the 2015 USO Decision with the exception that whenever GO intended to remove a public payphone, it was only required to notify the MCA of such a removal and its exact location, and not ask for its authorisation, subject that the minimum number of payphones required as established in the aforesaid Decision was maintained. The minimum number of payphones in all localities of the Maltese islands amounted to a total of 184 payphones.

In its cost model, as per previous claims, 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 2015 USO decision. Nonetheless, for purpose of the claim, 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 decisions on the previous USO funding claims. In the Reasonability

Phase report, EY stated that, on the basis of the USO Directive and of international practice, payphones could form part of the USO claim.

The number of payphones around Malta and Gozo during 2015 amounted to a total of 522, out of which 503 were according to GO, unprofitable. Taking into account the minimum number of payphones requirement set by the MCA Decision, GO was obliged to provide 184 payphones, out of which 165 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 approach taken to calculate the net cost in the case of payphones was 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 Main Distributor Frame (MDFs).

During the Calculation Accuracy Phase, further clarifications were sought from GO on a number of aspects, including the data sourcing and allocation methodologies of cost elements related to Repairs & Maintenance and Share of Corporate costs, reason/s for the main changes to cost items, and the sourcing of the net margin for each unprofitable payphone. Following these discussions, the calculation was adjusted accordingly.

Following the review, EY concluded that the payphone claim should be based on the optimal number of payphones in accordance with the 2015 USO Decision and the net cost of public payphones has been adjusted from €63,998 to €39,733. More information on this USO component is available in Annex 1 of this document.

3.2 SOCIAL TARIFFS

The Social Tariff USO component is related to the provision of reduced tariffs which render the electronic communications service affordable to eligible end-users. As specified in the USO Decision, this component includes a Telecare type of service and free line rental to low income earners, or to people with special social needs, included in a list specifically provided by the competent 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 a current net cost approach. 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. The social tariff net cost has been calculated as the difference between the current retail price and the amount actually charged to the eligible subscribers.

As in previous years GO claimed for two types of social tariffs which were provided free of charge during 2015, namely the *Telecare* service and the free line rental, benefiting 2,297 and 3,227 subscribers respectively. During the Calculation Accuracy Phase, the number of beneficiaries eligible for the social services were revised by GO and were confirmed by the responsible Ministry which provides GO with monthly updates of the subscribers' entitled for such services.

Following the Calculation Accuracy Phase, it was concluded that the claim on social tariffs based on the Current net cost scenario amounting to a net cost of €207,302 for specific measures to disabled end-users, and €58,711 for reduced tariff options, totalling to a net-cost of €266,014, was justified. More information on this USO component is available in Annex 1 of this document.

3.3 DIRECTORY ENQUIRY SERVICES

The universal service obligation for the provision of a comprehensive directory enquiry services was withdrawn in the revised USO decision published in 2015. To this effect, GO's claim included the net cost believed to be incurred for the provision of this USO component for the first half of the financial year providing that its withdrawal came into effect as from 1st July 2015. 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, and underlying variables, were provided by GO.

During the Calculation Accuracy Phase, following the submission of queries to GO, amendments were undertaken to the original claim in relation to the cost of capital and the allocation of operating costs (to be in line with previous USO claims). As a result of these adjustments, EY concluded that the net cost for the directory enquiry services for the first half of 2015 amounted to €10,033 (GO's claim amounted to €29,610). More information on this USO component is available in Annex 1 of this document.

3.4 INTANGIBLE BENEFITS

Regulation 30 and the Sixth Schedule of the Regulations establishes 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.⁸ In its claim GO included ubiquity and brand enhancement elements as components of intangible benefits. The ubiquity benefits take into consideration the comparatively lower cost the USO operator undertakes compared to the competitors when extending its network to new customers, and on the other hand, the brand enhancement benefit refers to the enhancement of the universal service provider brand by offering universal services and its influence on end-users' perception which might impact the overall profitability.

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, and did not include life cycle and marketing benefits in 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, GO took into consideration business customers in the ubiquity component in line with the previous MCA Decisions. The workings and the calculations submitted by GO for ubiquity benefit were reviewed during the Calculation Accuracy Phase, and it was noted that in its calculation GO included the ubiquity benefit on one unprofitable zone. Given that all MDFs in the Geographical component resulted profitable, the ubiquity calculation was updated accordingly. Following EY's calculation review and adjustments, the ubiquity element was revised from €53,751 to €56,311. 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 which allows the designated undertaking to gain and retain its customers, as in previous claims GO based its calculation on 20% of the advertising costs applied on different media such as TV, fixed telephony and corporate branding. During the review work, GO was requested to provide further breakdown on the advertising campaign and its costs which were used for this calculation. EY concluded that based on this, the brand enhancement amount stated by GO in its claim should remain unchanged at €136,825. More information on this USO component is available in Annex 1 in this document.

Estimating intangible benefits is a challenging exercise in its very nature, and a number of different methodologies have been used for assessment purposes, 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 €193,136 would be deducted from the total of the USO components.

⁸ SL 399.28, Regulation 30(4)

3.5 SUMMARY

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

USO Components	Audited net cost €
Payphones	(39,733)
Social tariffs	(266,014)
Directory enquiry service	(10,033)
Intangible benefits:	
- Ubiquity	56,311
- Brand Enhancement	136,825
Total	(122,644)

4. 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, free line rental, and directory enquiry services during 2015.

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 services⁹.

More detail on the allocation of the source of funding on GO's claim for the financial year 2015 would be dealt with by means of a separate consultation document earmarked for publishing following the publication of this decision.

⁹ SL399.28, Regulation 31 (1)

5. SUBMISSION OF RESPONSES

In accordance with its obligations under article 4A of the Malta Communications Authority Act [Cap. 418 of the Laws of Malta], the Authority welcomes written comments and representations from interested parties and stakeholders during the national consultation period which shall run from the 11/02/2019 to the 04/03/2019.

The Authority appreciates that respondents may provide confidential information in their feedback to this consultation document. This information is to be included in a separate annex and should be clearly marked as confidential. Respondents are also requested to state the reasons why the information should be treated as confidential.

For the sake of openness and transparency, the MCA will publish a list of respondents to this consultation. The Authority will take the necessary steps to protect the confidentiality of such material as soon as it is received at the MCA offices in accordance with the MCA's confidentiality guidelines and procedures¹⁰. Respondents are however encouraged to avoid confidential markings wherever possible.

All responses should be submitted to the Authority, in writing by no later than 12:00 04/03/2019 and be addressed to:

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Extensions to the consultation deadline will only be permitted in exceptional circumstances and where the Authority deems fit. The MCA reserves the right to grant or refuse any such request at its discretion. Requests for extensions are to be made in writing within the first ten (10) working days of the consultation period.

¹⁰ http://www.mca.org.mt/sites/default/files/articles/confidentialityguidelinesFINAL_0.pdf

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 2015

Calculation Accuracy Phase

Abridged Version of Full Report

04 December 2018

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.

EY has consented that, subject to conditions, MCA may publish this Report, solely for information purposes, to assist others in understanding the basis upon which the MCA meets its duties as a regulator.

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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 2015.

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 of specified quality which are to be made available to all end-users in the Maltese islands ("universal services"). As per the provisions of EC Directive 2002/22/EC ("EC Directive"), these universal services are to be made available at affordable prices with the objective of promoting social inclusion of electronic communication services. Universal Services Provider/s ("USP") designated by the MCA have Universal Service Obligations (USOs) to provide a minimum set of services to all end-users, including persons on low income, residents of rural or high installation cost areas, persons with disabilities and other vulnerable groups.

As the entity responsible for the regulation of the local electronic communications sector, the MCA is required to decide at reasonable intervals, which electronic communications services are to be classified as universal services, and which undertaking/s should be designated as the USP. During the year in review (2015) following a consultation process, the MCA published a decision revising the elements of the universal service obligations. This decision entitled "Universal Service Obligations on Electronic Communication Services" Decision and Response to Consultation has come into force on 1st July 2015, therefore for the scope of this exercise, the first half of the year was regulated by the MCA USO Decision published in April 2010 and updated in March 2011 ("2010 MCA USO Decision"), while the second half of the year was regulated by the decision published in May 2015 ("2015 MCA USO Decision"). The revisions made to the MCA USO Decision 2015 are explained in further detail on the next page.

Under both decisions, GO plc ("GO") was designated as the USP for a number of USO, 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.

Introduction (2)

As explained on the previous page, the 2015 MCA USO Decision put into force (as from 1 July 2015) a number of USO revisions which updated the obligations previously in place. Of most relevance to the USO claim under review, the updated decision specifically allows for:

- ▶ the fixed telephone line obligation to be only applicable in areas where no other undertakings offer such a service to the end-user at an affordable price;
- ▶ the retention and integration of the USO that, in case of market failure, the designated undertaking is to provide functional internet access with a line speed of at least 4Mbps;
- ▶ the withdrawal of the USO for the provision of a comprehensive telephone directory enquiry service (DES), with the exception of the DES provision to visually impaired persons;
- ▶ the withdrawal of the printed telephone directory as a USO while maintaining the comprehensive electronic directory which established the requirement of a smartphone app allowing users to look up both fixed and mobile telephone numbers; and
- ▶ formal MCA approval for the removal of a public payphone to be no longer required as long as the minimum number established for a given locality is satisfied.

In relation to the above obligations it is noted that:

- ▶ GO has launched the free telephone directory app in December 2016.
- ▶ As explained in GO's USO claim submission, the cost of broadband provision is not evaluated for the purposes of this claim.

Introduction (3)

- ▶ As per the provisions of the EC Directive and the Electronic Communications Networks and Services (General) Regulations (hereafter referred to as “the Regulations”), 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 Directive, article 12, and as per the Regulations (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 review 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 a USO claim request annually including the claim for the year 2015 being reviewed in this report. These previous USO claims were reviewed by EY under the commission of the MCA.
- ▶ GO’s claim for the year 2015 was submitted on 30 November 2016, with a funding request of €206,009. As further explained on pg. 9 of this report, following confirmations requested from GO in the Reasoning Phase, GO have provided a revised USO Model during 2018-Q2 with the revised total funding request being of €169,045.
- ▶ 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 2015, submitted by GO in November 2016 (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 2018. 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 2015. 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/ referred to a number of information sources/ documents:

Reasoning Phase

For the Reasoning Phase we have been provided with the following information and documents received on 01 March 2018:

- ▶ Covering e-mail related to GO's 2015 USO funding application submitted on 30 November 2016
- ▶ Evaluation of Universal Service Obligations costs in Malta in 2015: Methodology and Results ("USO Methodology and Results")
- ▶ Cost Evaluation of 2015 Universal Service Obligation for GO: Cost Model ("USO Model")
- ▶ Revised Decision on Universal Service Obligations on Electronic Communication Services published in May 2015

In preparation for the Reasoning Phase, confirmations have been requested from GO in relation to the operating cost values included in the USO claim and the social tariff subscriber numbers included in the social tariff component calculation. In reply to these requests GO provided a revised USO Model on 17 April 2018 updating the DES operating costs and social tariff subscribers reported for the year 2015. The updated total funding request amounted to €169,045. The claim review reported in this report has been based upon this updated USO Model, and any further reference to "USO Model" relates to this updated model.

Calculation Accuracy Phase

Following the submission of the Reasoning Phase report, sets of questions have been forwarded by the MCA/ EY to GO during the Calculation Phase review.

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 clarification received on 25 July 2018
- ▶ GO's replies to the MCA/ EY's additional clarification requests, received on 05 September 2018 and 13 October 2018.
- ▶ 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 over 2015, received on 30 October 2018.

Sources of information/ data (2)

- ▶ As previously noted, 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 four 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”)
 - ▶ MCA/D/18-3076 related to the 2014 claim (“2014 USO Claim Decision Notice”)

Previous MCA USO Claim Decision Notices – key points

The MCA USO Claim Decision Notices listed on the previous page established key conclusions on what should (and should not) form part of the USO claim based on the USOs set in the MCA USO Decision and EC Directive. The main conclusions from the 2010 USO Claim Decision Notice were re-iterated in the Decision Notices for the subsequent claims. The key points emanating from these decision notices (and any associated considerations arising from the 2015 MCA USO Decision) 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 calculation of the Geographical Component (where applicable) should be based on the Rebalancing scenario.
 - ▶ The Social Tariffs claim should be based on standard 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 the regular end-users. Hence, social tariffs should be computed as the difference between the standard retail tariff and the amount actually charged to subscribers.
- ▶ 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. This Decision established parameters for the minimum number of payphones required in each locality depending on the population figures. The same parameters were maintained in the 2015 MCA USO Decision.
- ▶ On the basis of the conclusions of the 2010 MCA USO Decision, previous USO Claim Decision Notices had concluded that DES can form part of the USO claim. In these previous claims, GO had submitted a request for the funding of the net USO cost of providing a telephone directory enquiry service. The 2015 MCA USO Decision, however, has withdrawn the USO for the provision of a comprehensive telephone directory enquiry service with effect as from 1 July 2015. In view of this, GO's 2015 USO claim has been submitted on the basis of half a year's net cost of providing the telephone DES.
- ▶ 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 2015 claim

- ▶ GO's 2015 claim includes the same components included in previous claims, with the exception of the Geographical Component for which no USO claim is being submitted by GO for 2015 due to the following reasons:
 - ▶ In the Geographical Component calculation, all geographical zones resulted to be profitable and hence no claim for this component has been submitted by GO. While a claim for the Geographical Component had originally been submitted by GO in the preceding 2014 claim, following the claim's review, all geographical zones had resulted to have been profitable in 2014 as well.
 - ▶ Also, following the 2015 MCA USO Decision (effective as from 1 July 2015), the USO for the provision of access at a fixed location in any given area remained only applicable in the case when there are no other public communications networks in a position to provide connection at a fixed location to the end-user at an affordable price.
- ▶ The provision of the telephone DES was withdrawn from a USO by the 2015 MCA USO Decision (as from 1 July). In view of this, GO's 2015 claim for DES has been based on the calculation of half a year's net costs of providing the telephone DES.
- ▶ The adjacent table compares the funding request by USO claim component for the:
 - ▶ GO's claim for 2015 as per the updated USO Model and claim confirmations provided by GO (as reported in the Reasoning Phase Report); and
 - ▶ the 2015 claim following the conclusions of this Calculation Accuracy phase review. The 'Analysis by component' section of this report documents our review and verifications of the calculations in GO's 2015 USO model.

(in €)	GO's claim as per USO Model*	Final outcome (following review)
Payphones	(63,998)	(39,733)
Social tariffs	(266,014)	(266,014)
Directory enquiry services	(29,610)**	(10,033)**
Intangible benefits	190,576	193,135
Total	(169,045)	(122,644)

* Based upon the updated USO Model provided by GO, as explained on pg. 9.

** Based on half a year's DES net cost calculation

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
Public payphones	<ul style="list-style-type: none">• On the basis of the EC Directive, the 2015 MCA USO Decision and international practice, payphones can form part of the USO claim.• The 2015 MCA USO Decision and previous USO claim decision notices 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 2010 MCA USO Decision (2011 update) and confirmed by the 2015 MCA USO Decision.• GO's 2015 submission has been based on the optimal number of payphones.
Social tariffs	<ul style="list-style-type: none">• Based on the EC Directive and the 2015 MCA USO Decision, 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 standard tariffs to ensure that those funding the social benefits are not burdened by higher cost than "normal" consumers.• GO have based their claim on standard tariffs.

Summary of Reasoning Phase conclusions (2)

Component	Initial reasonability assessment
Directory enquiry services (DES)	<ul style="list-style-type: none"> • The 2015 MCA USO Decision (effective from 1 July 2015) updated the services which are to form part of DES USO. The decision concluded that the obligation for the provision of a comprehensive telephone DES shall be withdrawn from USO. In previous USO claims, the net USO cost of providing this telephone service had been calculated and claimed by GO in the DES component. • In line with the obligation withdrawal as from July 2015, GO's 2015 DES claim component is based on the calculation of the net USO costs for half a year. • As was the case for previous claims, justifications also need to be sought in the Calculation Accuracy phase for the losses being claimed, and whether the costs being included represent unavoidable net costs incurred by an efficient operator.
Intangible benefits	<ul style="list-style-type: none"> • 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.

- ▶ 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 2015 based on the methodology developed by Marpij LLC for the 2010 claim. This section provides an overview of the approach and main assumptions adopted in the 2015 claim methodology.

Cost accounting basis

- ▶ The 2015 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.
- ▶ GO was requested to provide reconciliations of revenues, costs and capital employed recorded in the USO claim components, to the 2015 audited regulatory accounts. In their replies, GO have provided the required reconciliation calculations/ explanations and on the basis of the reconciliations provided only immaterial differences between USO model and regulatory account 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 2015 to work out revenue / traffic per subscriber
 - ▶ If a service was inactive as at June 2015, GO identified the earliest service active between 30 March and 31 December.
 - ▶ Technical data (tel. number/ active lines/ local loop length)
- ▶ 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.

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 2015 claim. 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 2015 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".

GO's approach and methodology (3)

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.

Fibre Lines

- ▶ Net costs included in the claim 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 as part of a national fibre rollout plan (Fibre-To-The-Home), however over the period for which the claim is being made business customers requiring more sophisticated services and higher speeds tended 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.

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.

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 public payphone cost estimation adopted by GO derives a net margin based on revenues less costs (as per table across), with a claim being made on an individual payphone basis.

Revenue and costs	Assumption
Revenue	<ul style="list-style-type: none"> • Billing data for on-net calls, outgoing international, mobile calls, and off-net calls sourced from GO's Data warehouse.
Technical Line costs	<ul style="list-style-type: none"> • 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 • 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. This was also obtained from the regulatory accounts model
Traffic costs	<ul style="list-style-type: none"> • Traffic volumes (on-net, outgoing international, fixed-to-mobile, and off-net) x unitary cost/minute • Traffic volumes were extracted from billing data • 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
Direct OPEX	<ul style="list-style-type: none"> • Equal allocation of operating costs (derived from actual invoices) : <ul style="list-style-type: none"> • Electricity • Hire of premises • R&M - Cardphones • Metering cost • Payphone share of corporate costs
Depreciation and Amortisation	<ul style="list-style-type: none"> • Equal allocation of depreciation of obtained from the regulatory accounts model.
Cost of Capital	<ul style="list-style-type: none"> • 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)

Public payphones (2)

GO's methodology

- ▶ 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 view of this, the payphone claim should be based on the optimal number of payphones in accordance with the USO Decision.
- ▶ GO's USO model presents the net payphone cost based on both the total existing number of payphones, and the optimal number of payphones as set by the minimum requirements as established in the MCA USO Decision. GO's funding request for 2015 is however based on the optimal number of payphones, in line with the MCA USO Decision and previous MCA USO Decision Notices.
- ▶ 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 claim submission, 165 payphones (out of the minimum payphone requirement) in 65 localities (out of 68) were recorded to generate a negative margin, leading a net cost of €63,998.

Public payphones (3)

Review Work

Review Work

- ▶ In order to review and assess the methodology employed in the Payphone calculation, clarifications were requested from GO on the data sourcing and allocation methodologies of the payphone revenue and costs underlying the claim, and the reasons behind the observed substantial increase in Payphone repairs and maintenance costs and in Payphone share of corporate costs over the prior year claim. GO was also requested to provide a detailed breakdown and description of the repair times on each individual payphone indicating the ones which have been considered as forming part of the minimum requirement as per MCA USO Decision, and a reconciliation with the figures in the USO Model.
 - ▶ In reply, GO has confirmed that the same data sources and methodologies used in previous claims for the calculation of the net payphone cost has been used for this 2015 claim. The key assumptions of this methodology have been described on pg. 20.
 - ▶ In relation to repairs and maintenance costs, GO explained that it does not compile information on an individual payphone basis/ by type of repairs required as the administrative effort and costs required to keep this information exceeds the potential benefits and hence is not viable in a commercial environment. In the absence of such information, in GO's calculations the average operating cost per payphone (total cost / total payphones) is equally allocated over all payphones, including the minimum requirement payphones which are ultimately considered for the net cost claim.

Following the requested clarifications on the nature and volume of payphone repairs and maintenance costs, GO have revisited and adjusted the figures for repairs and maintenance costs substantially downwards. Based on this adjustment, the payphone component's share of corporate costs have also been adjusted given the updated repairs and maintenance costs.

Public payphones (4)

Review work and conclusion

Review work (cont.)

- ▶ In the process of our review work, some data sourcing inaccuracies in the payphone margin were identified in the component's calculation based on the optimal number of payphones.
 - ▶ As in the previous claim review, the 2015 payphone calculation was also 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.
- ▶ Following these adjustments and the updated repairs and maintenance costs provided by GO (as explained on preceding page), the net cost for the payphone component decreases from €63,998 to €39,733.

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, the public payphone claim results in a total net cost of €39,733.

Analysis by component

Social tariffs

Social tariffs (1)

GO's methodology

- ▶ Under its current USP status, GO provides social tariff options to a number of users identified by the responsible Ministry. 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.
- ▶ As the designated USP, GO claimed for two types of social services provided free of charge to the end user: free line rental and free Telecare service. In the revised USO Model provided by GO during the Reasoning Phase review (as explained on pg. 9), GO has provided an updated social tariff calculation with revised number of subscribers for 2015, and with a revised claim of €266,014.
- ▶ The users eligible for such social tariffs are identified by the responsible Ministry, that is, the Ministry for the Family, Children's Rights and Social Solidarity, 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 2015 which were found to be in line with those recorded in GO's USO Model.
- ▶ The cost of social tariffs has been computed as the difference between the discounted rate, which in this case is free, and the standard line retail price. This calculation is aligned with MCA's previous USO claim decisions that access deficit should not form part of the USO claim.

Social tariffs (2)

GO's methodology and conclusion

- ▶ The table across summarises the 2015 social tariffs claim submitted by GO totalling €266,014 (i.e. €207,302 for reduced tariff options; and €58,711 for specific disability measures) as submitted by GO.

Review 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 €266,014.

GO's claim	Reduced Tariff Options for Users (free line rental)	Specific Measures for Disabled Users (free Telecare)
DUO PACK		
Free Rent and Charged Telecare	387	n/a
Free Rent and Free Telecare	75	75
HOME PACK		
Free Rent and Charged Telecare	933	n/a
Charged Rent and Charged Telecare	n/a	n/a
Charged Rent and Free Telecare	n/a	-
Free Rent and Free Telecare	167	167
NO PACK		
Charged Rent and Charged Telecare	n/a	n/a
Charged Rent and Free Telecare	n/a	1,423
Charged Rent No Telecare	n/a	n/a
Free Rent and Charged Telecare	192	n/a
Free Rent and Free Telecare	632	632
Free Rent No Telecare	841	n/a
Total numbers of users	3,227	2,297
Annual Charge per user		
Line rental at €5.353 per user per month		
Telecare at €2.13 per user per month	€64.24	€25.56
Total annual cost	€207,302	€58,711

Analysis by component

Directory enquiry services (DES)

Directory enquiry services (1)

GO's methodology

- ▶ The Directory Enquiry Services (DES) component relates to the net cost of providing this service to all end-users at an affordable rate. Article 24 of the Regulations establishes that the designated USP shall ensure that a comprehensive directory is made available to all end-users and that a comprehensive telephone directory enquiry service is made available to all end-users including users of public payphones. In relation to this USO, the 2015 MCA Decision Notice concluded that:
 - ▶ The obligation for the provision of a comprehensive telephone directory enquiry service shall be withdrawn from USO.
 - ▶ The universal service shall include the provision of a comprehensive electronic telephone directory free of charge and updated in real-time whenever technically possible. This electronic directory shall be web-based and include an interface that caters specifically for smartphone-based users. It is noted that, in relation to this new obligation, GO has launched a free telephone directory app in December 2016.
- ▶ In previous USO claims, GO had calculated and included in the DES claim component the net USO cost incurred in the provision of the telephone DES. In view of the withdrawal of this service from USO following the 2015 MCA USO Decision (effective as from 1 July 2015), GO's 2015 DES claim submission is based on the calculation of half a year's net costs incurred in providing the telephone DES. In their USO Model, GO presents the calculation of the whole year's net costs incurred in providing this service, of which half is then claimed in the 2015 USO claim submission.
- ▶ Following clarification requests, GO explained that DES calls and costs are generally evenly distributed over the year (48% of total DES calls in 2015 were made in the first six months of the year), and that is why total net DES costs for 2015 were halved to arrive to the half-yearly net cost.
- ▶ The associated DES revenue and cost components making up GO's DES net cost claim are summarised in the adjacent table.

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

Directory enquiry services (2)

Review work and conclusion

Review work

- ▶ In reply to review clarification replies, GO confirmed that no changes were made in 2015 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.
 - ▶ The sharing of subscribers information between operators (excluding ex-directory subscribers) to provide DES falls outside the scope of USO. Therefore, activities (and income) pertaining to dips in directory data are not to be included in the claim. In this regard, GO also confirmed that dipping charges are excluded from the DES claim calculation.
- ▶ During the calculation accuracy review, it was observed that the USO Model's cost of capital calculation was not being calculated on the basis of 2015 regulatory accounts' assets and liabilities figures. This was noted to GO in the sets of queries forwarded to them, who in this regard provided an updated DES calculation based on 2015 cost of capital figures.
- ▶ Explanations and justifications have been requested from GO regarding a substantial increase in DES operating costs recorded over the prior year's claim. In this regard, following clarification requests, GO explained that this was a result of a different allocation basis for Retail Group expenses adopted in 2015. Retail Group expenses had been allocated over retail products on an equal allocation basis as opposed to a revenue-based allocation as in previous years. In view of this, GO has provided a separate DES working on a revenue allocation basis as in previous claims. The latter calculation was taken into consideration for the purposes of this Calculation Phase review.
- ▶ As a result of the above adjustments, the DES revised claim submitted by GO (based on half-yearly cost as earlier explained) of €29,610 was further revised to €10,033.

Conclusion

- ▶ Based on the above described review work, the net DES USO cost should amount to €10,033.

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 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)

GO's methodology

Ubiquity

- ▶ In their USO Model, GO estimated a ubiquity benefit value of €53,751.
- ▶ The ubiquity benefit calculation in the USO Model is based on both residential and business customers in line with the conclusions of previous MCA Decision Notices.
- ▶ During review, it was noted GO's ubiquity benefit calculation is based on the number of unprofitable MDF zones being one. This was adjusted to zero unprofitable MDF zones in line with the results of the Geographical Component calculation which records all MDF zones as being profitable.
- ▶ The value of this intangible benefit, based on GO's methodology presented in the below table, and following the adjustment to the number of unprofitable zones referred to above, amounts to €56,311.

Item	
a	Moves/year
b	of which residential
$c=a*b$	Residential moves outside zone
d	# of zones
e	# of unprofitable zones (adjusted to 0 as per Geographical component calculation)
$f=c/d$	Res moves outside zone
$g=(d-e)*f$	Moves to profitable zones
h	Competition market share in acquisition
$i=(1-h)*g$	Loyal customers thanks to the USP position
j	Net annual margin/customer (€)
$k=i*j$	Ubiquity benefit (€)

Intangible benefits (3)

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 2015 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, as well as the associated cost data.
- ▶ Based on the above methodology, the brand enhancement benefit was valued at €136,825.

Intangible benefits (4)

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: €56,311
 - ▶ Brand enhancement: €136,825
- ▶ 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 review work/ conclusion
Payphones	(39,733)	Updated with revised repairs and maintenance costs provided by GO (pg. 22) Slight calculation adjustments correcting data sourcing inaccuracies (pg. 23)
Social tariffs	(266,014)	As per GO USO Model/ claim
DES	(10,033)	Calculation with revenue-based allocation of Retail group expenses (as in previous claims) has been selected following review (pg. 29).
Ubiquity	56,311	Number of unprofitable MDF zones in GO's calculation adjusted to 0, in line with the results recorded in the Geographical component (pg. 32).
Brand enhancement	136,825	As per GO USO Model/ claim
Total	(122,644)	

- ▶ The resulting net USO cost amounts to **€122,644**.