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 2013

Proposed Decision

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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 accordance with national law, the designated undertaking providing universal services 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 in line with its obligations and may submit a written request to the Malta Communications Authority (hereafter the ''MCA" or the ''Authority''). Universal services are defined as a minimum set of services of specified quality which are to be made available to all end-users regardless of their geographical location and, in the light of specific national conditions, at an affordable price[1]. During 2013, GO plc (hereafter ''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. In December 2014, GO submitted its funding application for the unfair burden it claims it had suffered in providing these universal services during the financial year 2013[2].

GO’s funding application included the following components of the universal service obligations (hereafter the ''USO''); 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 MCA commissioned EY as the independent body to audit and verify the accuracy of the workings of GO’s claim for USO funding for the year 2013. The assignment 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 has suffered an element of unfair burden for providing the specified universal services and after taking into account intangible benefits it amounts to a net cost of €101,538. 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.

[1] Electronic Communications (Regulation) Act (Cap. 399 of the Laws of Malta), article 2 thereof

[2] GO's financial year was from 1st January to 31st December 2013

CONTENTS

1. INTRODUCTION

The Electronic Communications (Regulation) Act (Cap. 399) specifies that one of the objectives of the Authority is to promote the interest of end-users by ensuring that all users have access to universal services.[3] Universal services are a minimum set of services of specified quality which are made available to all 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 decision entitled *'Universal Service Obligations on Electronic Communication Services'*[5] (hereafter the ''USO Decision'') which established a number of universal services 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 the Authority designated GO to provide the universal service/s in question.

During 2013, 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 (hereafter the "Regulations"), an undertaking designated to provide universal services has the right to apply to receive funds for any net costs accrued in meeting these obligations[6]. On the 31st December 2014, the MCA received GO's written request for the USO funding of the unfair burden it claimed to have incurred during the financial year 2013.

GO's USO funding claim for 2013 was based on the same methodology adopted for the 2010 and 2012 USO claims. The MCA once again engaged EY as the independent body to evaluate the reasoning behind this claim and to audit and verify the various calculations used and where necessary to review the workings.

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

[4] SL 399.28 Regulation 21(1)

[5] Updated in September 2011

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

2. BACKGROUND

As specified in the USO decision, the universal service provider designated to provide all or parts of the universal services has the right to submit in writing an application to the Authority for USO funding within a time period of eleven months following the end of the previous financial year. Such a request is required to be accompanied by supporting documentation needed to enable the MCA determine whether the provision of the universal service/s resulted in an unfair burden on the designated undertaking or not.[7] The net cost is calculated as the difference between the cost for a designated undertaking of operating with universal service obligations and operating without universal service obligations.[8]

In December 2014, GO submitted an application for USO funding for the net costs it claimed to have incurred in providing universal services during 2013, accompanied by a detailed report on the methodology and calculations (including a cost model), for each of the USO components. The costs of the universal service components included in the claim are the following:

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

In April 2015, EY were commissioned by the MCA to undertake a review of the 2013 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 the exercise undertaken for the previous USO claims. GO showed no objection to the use of such information and documentation.

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

[7] SL 399.28 Regulation 30

[8] SL 399.28 Sixth schedule

2.1 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.

EY finalised the Reasoning Phase in March 2016 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.

2.2 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 2016.

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.

3. LEGAL BASIS

The fundamental aspects of costing and financing of universal services are outlined in the Regulations and in the Directive 2002/22/EC 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[9].

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[10]. 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 is subject 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.

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

[10] SL399.28 Regulation 30 (4), (7)

4. 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 2013 in fulfilling its obligations as the undertaking designated to provide universal service obligations. As mentioned earlier, the specific objectives of the evaluation exercise consisted of two main outputs, 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 2013"* is available in Annex 1 of this document.

For the financial year 2013, GO has claimed for the following USO components:

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

As in the case of previous USO claims, GO included two different scenarios in its claim for the net costs claimed to have been incurred during 2013, 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. In its covering letter attached to the 2013 claim, GO stated that although they still believe that before the introduction of competition in the fixed telephony market there was a non-completed rebalancing situation, it is believed by GO that it should still be subject of compensation, nevertheless, their funding request was made on the basis of MCA’s decisions of previous claims.

The table below shows the totals pertaining to each category as specified in GO's original USO claim:

USO Components	Current Net Cost €	Current Cost after Rebalancing €
Geographic component	(26,682)	(1,024,043)
Payphones	(242,225)	(242,225)
Social tariffs	(396,818)	(245,659)
Directory enquiry service	(45,220)	(45,220)
Intangible benefits	253,699	250,243
Total	**(457,245)**	**(1,306,904)**

Although GO based the 2013 USO claim on the same methodology and cost model developed for the 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.

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 their analysis, during the Reasonability Phase and the Calculation Accuracy Phase, EY prepared an information request list to collect additional detail from GO. Following its feedback and clarifications on a number of items identified in the cost model during the Calculation Accuracy Phase, GO submitted an updated version of the cost model and as a result of these modifications the updated outcome resulted in €206K less than the original claim.

In its submission for the net costs it incurred in providing universal services during 2013 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).

4.1 GEOGRAPHICAL COMPONENT

This 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 Member States. Besides the different variables used for the current net-cost and rebalancing scenarios as stated earlier, GO also included different scenarios including and excluding on-net traffic. In the original claim, from a total of twenty two MDFs, two were identified as unprofitable during 2013.

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.

In GO's original claim, the cost model was calculated using erroneous wholesale rates pertaining to the previous year. This was rectified by GO in its updated model during the Calculation Accuracy Phase. GO's updated model was based on rebalancing scenario and including on-net traffic. Whilst the inclusion of rebalancing tariffs is in line with previous MCA's Decisions, the inclusion of on-net traffic does not reflect the conclusions of previous decisions and should be excluded from the geographical component calculation. As was established in previous claims, EY concluded that given no price control measures were taken by the Authority during the year in question, on-net tariffs were set as a result of pricing decisions taken by GO rather than as a consequence to imposed regulatory measures.

To estimate the net cost based on the rebalanced tariffs and excluding on-net traffic, a profit and loss approach by MDF was adopted. Given that different sources were used to estimate the revenues and the costs by MDF, GO was requested to provide a reconciliation of revenues and costs used in the USO claim with the regulatory accounts. More information on this USO component is available in Annex 1 of this document.

In conclusion, it was established that the Geographical component should be based on the current net cost after rebalancing scenario, excluding on-net traffic, and amounting to a net cost of €7,257 pertaining to only one MDF.

4.2 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 the 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. Nevertheless, as was the case during the 2012 claim, the 2013 USO claim was once again based on the total number of payphones installed rather than on the optimal number of payphones. The payphones installed around Malta and Gozo during 2013 amounted to a total of 762, out of which 731 were according to GO, unprofitable payphones. Had GO based its claim on the mentioned MCA parameters, the unprofitable number of payphones would have decreased to 158.

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. 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 cost model apart from providing the figures of the net cots based on the total number of public payphones, gives also visibility of the net cost based on the optimal number of public payphones as established in the USO Decision. During the Calculation Accuracy Phase, GO agreed that the claim on public payphones should be based on the optimal number of payphones and this is reflected in the updated cost model submitted to the MCA during the Calculation Accuracy Phase.

Following the review, EY also 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 amounts to €33,166. More information on this USO component is available in Annex 1 of this document.

4.3 SOCIAL TARIFFS

Another component 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 GO. In the original claim, although GO indicated that the cost of social tariffs is calculated as the difference between the discounted rate, which in this case is free, and the current line retail price, the net cost claimed was based on the rebalancing scenario. The updated cost model submitted by GO to the Authority during the Calculation Accuracy Phase was then based on the Current net cost as per MCA's decisions of previous claims.

GO claimed for two types of social services which were provided free of charge during 2013: Telecare service; and free line rental; to the benefit of 2,570 and 2,961 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 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 €65,689 for specific measures to disabled end-users and €179,970 for reduced tariff options totalling to a net-cost of €245,659. More information on this USO component is available in Annex 1 of this document.

4.4 DIRECTORY ENQUIRY SERVICES

The 2013 USO claim also includes 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 access to their subscriber 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. The difference between the amount claimed in the original claim and in the updated claim is the calculation of the cost of capital which was based on 2012 figures. 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. 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. The arithmetical accuracy and 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 updated cost model amounting to €46,419. More information on this USO component is available in Annex 1 of this document.

4.5 INTANGIBLE BENEFITS

In accordance with article 30(4) of the Regulations, the Authority or a third party shall also assess and calculate any intangible benefits accrued by the designated undertaking for providing universal services.[11] In their USO claim, GO included information on the ubiquity benefit which arises when end-users move from uneconomic areas to economic areas and the brand enhancement benefit which can be defined as the enhancement of the USP 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, international 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 and to identify the reasons why life cycle and marketing benefits were not included in the claim. The workings and the calculations submitted by GO for ubiquity benefit were reviewed during the Calculation Accuracy Phase and in response to the resulting clarification requests, GO adjusted the cost model to reflect the scenario adopted for the geographical component. This includes the rebalancing of line rental tariffs, the inclusion of business customers, exclusion of on-net calls and the inclusion of the percentage number of subscribers' moves per year of which in the same zone. These adjustments are all in line with previous MCA Decisions. Following EY's calculation review and adjustments, the ubiquity element has been revised to €11,825. More information on this USO component is available in Annex 1 in this document.

As regard to brand enhancement, GO based their calculation on a 20% of their brand image 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 the review of work EY concluded that no exceptions were noted and the brand enhancement amount stated by GO in its claim remained unchanged at €219,138. 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 €230,963 would be deducted from the total of the USO components.

[11] SL 399.28 Regulation 30(4)

4.6 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 €
Geographic component	(7,257)
Payphones	(33,166)
Social tariffs	(245,659)
Directory enquiry service	(46,419)
Intangible benefits:	
- Ubiquity	11,825
- Brand Enhancement	219,138
Total	**(101,538)**

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 geographical component, public payphones, social tariffs including Telecare and free line rental and directory enquiry services during 2013.

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[12].

More detail on the allocation of the source of funding on GO's claim for the financial year 2013 would be dealt with by means of a separate consultation document earmarked for publishing following the publication of this decision.

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

6. 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 31/10/2016 to the 21/11/2016.

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 all respondents to this consultation on its website, up to three days following the deadline for responses. The Authority will take the necessary steps to protect the confidentiality of all such material as soon as it is received at the MCA offices in accordance with the MCA's confidentiality guidelines and procedures[13]. 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 on 21/11/2016 and be addressed to:

Chief of Operations
Malta Communications Authority
Valletta Waterfront, Pinto Wharf,
Floriana, FRN1913
Malta.
Tel: +356 21 336 840 Fax: +356 21 336 846
Email: coo.mca@mca.org.mt

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.

[13] http://www.mca.org.mt/sites/default/files/articles/confidentialityguidelinesFINAL_0.pdf

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 2013

Calculation Accuracy Phase

Abridged Version of Full Report

17 October 2016

EY

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.

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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EY has not been instructed by its client, MCA, to respond to queries or requests for information from any Third Parties. Any queries or requests should be directed to the MCA. Further, EY is not instructed by the MCA to update the Report for subsequent events (if any). Accordingly, without prejudice to the generality of the foregoing, EY accepts no responsibility to any Third Party to update the Report for such matters.

EY reserves all rights in the Report.

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 2013.

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 21 June 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)

Following a public consultation exercise, on 12 May 2015 the MCA published a decision updating USO obligations (MCA-OPS/tf/15-2265). Specifically, it allows for (a) 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; (b) the withdrawal of the printed telephone directory as a USO while at the same time establishing that a smartphone app shall be made available allowing users to look up both fixed and mobile telephone numbers; and (c) formal MCA approval for the removal of a public payphone is not required as long as the minimum number established for a given locality is satisfied. This decision came into effect as from 1 July 2015 and does not apply retrospectively. Hence, while this decision is noted, it does not in any way influence this review of GO's USO Claim for 2013.

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 verification being made publicly available.

The first USO claim by GO was submitted for the year 2010. For this first claim, the MCA commissioned EY to review this claim in 2012, with the final decision being published by the MCA on 14 October 2014 (MCA-OPS/tf/14-2006). GO also submitted a USO claim for the year 2012, which was reviewed by EY in 2015 under the commission of MCA. The MCA published its final decision on the 2012 claim in January 2016 (MCA-OPS/tf/15-2450).

In December 2014, GO submitted a request in relation to the USO net cost for the year 2013, with a funding request of c. €457k Following the Reasoning Phase, and in preparation for the Calculation Phase, GO have clarified and revised their funding request to c. €251k (explained in further detail later on in this Report). In the above context this assignment was aimed at assisting 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 2013, submitted by GO in December 2014 (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***: verification of the various calculations provided by GO in their submissions

This Calculation Phase report follows on the conclusions of the Reasoning Phase which was concluded in April 2016. An overview of the conclusions of the Reasoning Phase is provided on pgs. 14-16 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 2013. 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 31 December 2014 and received by EY on 3 February 2016:

- Covering e-mail related to GO's 2013 USO funding application
- Evaluation of Universal Service Obligations costs in Malta: Methodology and Results ("USO Methodology and Results"). The methodology and results are based on a model prepared by Marpij Associates (GO's external consultants).
- Cost Evaluation of 2013 Universal Service Obligation for GO based: Cost Model ("USO Model")

Calculation Accuracy Phase

Following the submission of the Reasoning Phase report, sets of questions have been forwarded by the MCA/ EY to GO in order to prepare for the Calculation Phase. In reply to these information and clarification requests, GO have effected revisions to their USO Model. The revisions applied, and their effects on the USO funding request, are described in further detail on pgs. 12-13 of this report.

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

- GO's replies to the MCA/ EY's first request for information and clarification received on 03 May 2016
- GO's replies to the MCA/ EY's additional clarification requests, received on 08 July 2016 and 01 August 2016.
- Updated USO Model, received on 01 August 2016.
- Confirmation from the Ministry for the Family and Social Solidarity (Ministry responsible for social benefits and telecare services) on the terms for subsidized line rentals under social tariffs, received by the MCA and sent to EY on 29 August 2016.

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 the 2010 and the 2012 claims. The MCA has requested GO’s approval to make use of such information discussions, principles and decisions related to the previous claims for the exercise being undertaken, and GO has found no objection to such a request.
- An overview of the key decisions included in the 2010 and 2012 MCA claim decisions are presented on the next pages. The two previous MCA claim decisions are:
  - MCA-OPS/tf/14-2006 for the claim for the year 2010 (“2010 Decision Notice”)
  - MCA-OPS/tf/15-2450 for the claim for the year 2012 (“2012 Decision Notice”)

Overview of MCA Decision Notice on 2012 USO Claim

The 2012 USO Claim Decision Notice reiterates points established in the 2010 USO Claim Decision Notice. It is pertinent to note that GO submitted the funding claim for 2012 prior to the publication of the 2010 USO Claim Decision Notice. The key points emanating from the MCA's 2012 USO Claim Decision Notice 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 the regular end-users. Hence, social tariffs should be computed as the difference between the current retail tariff and the amount actually charged to subscribers, if any.

- The Geographical Component should not include on-net traffic. See next page for further background related to this Decision.

- GO's public payphones claim for 2012 was based on 670 payphones, being the unprofitable payphones out of the total existing 762 payphones. However, the MCA's 2012 USO Claim Decision Notice was based on 184 payphones, being the minimum number of payphones per locality as established in the 2010 USO Decision.

- 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 (and accepted) in the 2012 USO Claim Decision Notice as deductions against the USO costs.

Overview of MCA Decision Notice on 2012 USO Claim – on-net traffic

The 2012 USO Claim Decision Notice (based on the 2010 USO Claim Decision Notice) reiterates that the Geographical Component should not include on-net traffic. This Decision was based on the following rationale:

- Given that there was no price control on retail tariffs, any on-net traffic losses in prior claims had to be the result of GO's own pricing decisions.
- Further clarifications were sought to understand the reason why on-net traffic was being provided at a loss, whether the computation based on current cost after rebalancing considered the increase in retail call tariffs to cover full cost, the impact of bundle offerings (deemed to be a commercial decision) on the geographical component claim, and the number of free calls and free minutes on on-net calls of loss-making MDFs.
- GO's replies did not rule out that there may be some element of cross-subsidisation taking place between the different revenue streams, and this may be due to the Talk Anytime and bundle offers. In fact, from GO's replies, it would appear that costs included in the geographical component are not restricted only to the minutes which are charged as part of the tariff plan, but include also those minutes which are "free" as a result of the tariff plan chosen.
- The methodology adopted in the geographical component calculation (prepared on an MDF basis) does not allow visibility with respect to how bundles have been included. It was therefore not possible to determine whether on-net calls from bundles were being provided at a loss or whether bundle offerings in certain areas were in fact resulting in a loss which was being included in the geographic component.
- GO were not able to provide the number and minutes of free calls per MDF. Based on the above, it was not possible to conclude whether bundle offerings are in fact resulting in losses which are featuring in the geographical component. Therefore in the absence of any evidence to the contrary being submitted by GO and bearing in mind that there is no price control on call tariffs, it was decided that the USO should not be used to compensate for losses arising due to pricing / competition issues, and GO should be computing their USO claim on the basis of a scenario where call tariffs are rebalanced, or where the costs related to minutes which are provided free to customers (due to bundle offer) are not included in the geographic component (given that there is no related revenue to such calls).
- In the absence of such a calculation, the assessment of the geographic component was based on a scenario without on-net traffic as in the case of previous claims

Overview of GO's claim (1)

- GO's 2013 claim includes the same components included in the 2012 claim. 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 (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 2013 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 2013 in line with the MCA's decision on the 2010 claim. Accordingly, the USO Model accompanying the claim is based on net costs after rebalancing, where applicable.

- Following the clarification and information requests forwarded by the MCA/ EY, GO has provided clarifications on the figures that should be considered for claim purposes as well as an updated version of the USO Model which addressed some issues identified in the clarification requests. Namely, the following changes have been applied by GO to the claim originally submitted (and as reported in the Reasoning Phase Report):
  - On-net traffic revenues are included in the updated USO Model, which were not included in the original claim submission. The model provides the flexibility to include or remove on-net traffic through a modelling "switch".
  - The origination and termination rates were updated to the rates in place for 2013 as per the relevant MCA decisions.
  - As indicated in the Reasoning Phase Report (pg. 20), GO's original funding request for the public payphones component was based on the total number of payphones. However, as per the MCA USO Decision, the claim for public payphones should be based on the optimal number of payphones. In their replies to the clarification requests, GO confirmed that the figure based on the optimal number of payphones should be considered for claim purposes.
  - The cost of capital calculation in the DES component was updated with asset and liability figures reported for 2013 (original claim request was based on 2012 figures).
  - The ubiquity benefit calculation was adjusted so as to include business customers, and to account for customer movements which occur within the same geographical area, in line with previous claims.

Overview of GO’s claim (1)

- As a result of these modifications, the claim figure in the updated USO model is c. €206k less than the original claim submission (as reported in the Reasoning Phase report). The key difference resulted from the claim for the payphone component which was revised downwards by c. €209k (refer to table below).

- The adjacent table compares the funding request by USO claim component for the:
  - 2012 claim accepted by the MCA in its Decision Notice .
  - GO’s claim for 2013 as per the USO Model submitted in the initial claim (as reported in the Reasoning Phase Report) and;
  - the claim figures for 2013 as per the updated USO Model and clarifications from GO.
  - the 2013 claim following the conclusions of this Calculation Accuracy Phase review

(in €)	2012	2013		
	Final outcome (following review)*	GO’s claim as per original USO Model	GO’s claim as per updated USO Model	**Final outcome (following review)**
Geographical component	**(23,736)**	(26,682)	(4,916)	**(7,257)**
Payphones	**(32,897)**	(242,225)	(33,166)	**(33,166)**
Social tariffs	**(278,499)**	(396,818)	(396,818)	**(245,659)**
Directory enquiry services	**(21,220)**	(45,220)	(47,343)	**(46,419)**
Intangible benefits	**231,242**	253,699	230,936	**230,936**
Total	**(125,110)**	**(457,245)**	**(251,279)**	**(101,538)**

- The rest of this Calculation Phase report verifies the calculations as provided in the updated USO Model (column entitled “GO’s claim as per updated USO Model” and totaling €251,279). Any further reference in this report to the “USO Model” refers to this updated model.

**GO’s claim for 2012 was based on a current cost scenario, but the accompanying model allowed for the option to view the USO net cost after rebalancing. The scenario presented in the table above is the one accepted by the MCA in its Decision Notice.*

Reasoning Phase: Conclusions (1)

This section present the key conclusions of the Reasoning Phase which dealt with the following areas:

- the grounds on which the claims for funding are based;
- whether the claims 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 Distributor Frames (MDF) 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 should be calculated on the basis of 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 MCA 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 2013 submission is still based on the existing number of payphones, rather than the optimal number of payphones. As in previous claims, GO will be informed that the claim to be considered will be based on the optimal number of payphones, not the existing number of payphones (GO submitted an amended claim on the basis of the optimal number of payphones in the Calculation Accuracy phase)

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 MCA Decision on the 2010 and 2012 claims, 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 (GO's claim is based on the rebalancing scenario) to ensure that those funding the social benefits are not burdened by higher cost than "normal" consumers. • As in previous claims, GO will be informed that the claim to be considered will be based on the current tariffs, not the rebalanced scenario.
Directory enquiry services (DES)	• DES can form part of the USO claim. • As was the case for the 2012 claim, 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 claiming that DES are offered at a loss, no requests have been made for an increase in the tariffs charged. Further analysis of the allocated costs and revenues will be scrutinized during the Calculation Phase to understand the losses made.
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 payphones are not commonly used by consumers and advertising on payphones is uneconomic given the high costs involved. • The approach adopted by GO to compute the intangibles benefits will be scrutinized in more detail in the Calculation Accuracy Phase to assess the methodology adopted and computation undertaken in quantifying ubiquity and brand enhancement.

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 2013. 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 2013 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 this regard, GO have provided a reconciliation of revenues, costs and capital employed included in the USO claim to the 2013 audited regulatory accounts.

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 2013 to work out revenue / traffic per subscriber
  - If a service was inactive as at June 2013, 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 2013 audited regulatory accounts, explaining the reasons for the discrepancies between the two.

GO's approach and methodology (3)

Efficiency factor

- When asked whether an efficiency factor (input vs. output ratio) has been included in the USO calculations, GO replied that *"GO is subject to intense competition in the markets that encompass USO and as such cannot afford not to be efficient".* GO explained that its procedures and operational practices in the past years have "*been at levels commensurate to a company subject to competition in the market".* Consequently, no efficiency factor has been included in the USO calculations.
  - Had an efficiency factor been included, this could have possibly resulted in a lower cost and a lower claim particularly in the geographical component, 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 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".

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.

Methodology and approach (5)

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. Even though GO is increasingly deploying fibre lines, 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.***

Access deficit

- Although by the Cost Model provided by GO includes the calculation of access deficit, the formal claim put forward by GO does not take into account access deficit, in line with MCA Decisions on previous claims.

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.

- GO uses Main Distributor Frames (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.

- GO have based their claim on the total net margin of the unprofitable MDFs, which has been calculated as shown in the table below:

Revenue and cost by MDF	
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

- In its USO Model for the year 2013, GO’ calculation of the geographical component was based on rebalanced tariffs and including 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 inclusion of on-net traffic, however, does not conform with the MCA decision in its 2010 Decision Notice that “on-net calls” should be excluded from the geographical component calculation.

- The USO Model allows for the option to view the geographical component without on-net calls. When on-net calls are excluded, in line with previous MCA decisions, the net costs for the geographical area rise from €4,916 to €7,257.

- The following pages explain the assumptions used in the derivation of the geographical component (based on rebalanced tariffs and excluding on-net calls) in further detail.

The Geographical Component (3)
Key assumptions – revenues

- GO confirmed that the same methodology and assumptions with regards to revenues and costs applied in the previous claims were used for this 2013 claim.

- 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.

- 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. 35-37 of this report)

Revenue by MDF	Assumption
Line rental revenue - residential	• Number of residential lines x average rebalanced line rental instead of the current monthly 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 2013, 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 2013 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 below)
Call revenue - on-net	• Not to be included as per MCA's Decision on the 2010 claim

The Geographical Component (4)
Key assumptions – revenues

Revenue by MDF	Assumption
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 2013.
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 (5)
Key assumptions – costs

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

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 • 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.
Traffic Costs	• 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

Termination rates included in traffic costs	• Origination and termination rates have been based on the 2013 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:
	  • An average fixed-line termination rate of €0.002123/ minute. This is based on the MCA's New Bottom-up Cost Model for Fixed Networks and Fixed Interconnection Prices, MCA/D/12-1420, which established the following fixed line termination rates for 2013:
	    • €0.003803/ minute from 01 January 2013 to 01 July 2013, and
	    • €0.000443/ minute from 01 July to 31 December 2013
	  • An average fixed-line origination rate of €0.003373 based on the following origination rates for 2013 set by the MCA in decision MCA/D/12-1420:
	    • €0.004903/ minute from 01 January 2013 to 01 July 2013, and
	    • €0.002643/ minute from 01 July to 31 December 2013
	  • Mobile termination rate: €0.0207/ minute as per MCA/D/14-1840, pg. 11
	The rates applicable for 2013 as set by the MCA Decisions are significantly higher than those applicable for previous years.
	• An international termination rate has been applied by GO in their USO Model. This was derived through their regulatory accounts.

The Geographical Component (6)
Key assumptions – costs

Cost by MDF	Assumption
Broadband Cost	• Broadband revenue generated by each MDF (which is hard-coded) x (1 – ADSL net margin of 7.84%) • 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 across all MDFs has been applied by GO. In response to clarification requests, GO asserted that the application of the same ADSL margin across all MDFs is justified 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.
Other costs	• Other costs include operating costs of supplementary services and remaining retail activities which 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).

The Geographical Component (7)
Review work and conclusion

Review work

- As part of our review work, we have considered the arithmetical accuracy and allocation calculations carried out, and report that no exceptions were noted.

- Due to the use of different sources to estimate the revenue and costs by MDF, we have requested GO to provide a reconciliation of revenues and costs used in the USO claim with the regulatory accounts. GO provided reconciliations and explanations of the arising differences on 01 August 2016. According to GO, the main differences are due to the different data sources used and resulting timing issues. To this effect no adjustment claim taking into account these reconciling differences was received by the MCA.

Conclusion

- The Geographical Component claim should be based on a scenario with rebalanced tariffs and excluding on-net traffic. **This results in a net cost of €7,257** related to the one MDF only. The USO Model provided by GO refers to an amount of €4,916, but this was inclusive of on-net traffic revenues and costs, which as per previous MCA decisions should be excluded from the USO claim.

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 table below), with a claim being made on an individual payphone basis.

Revenue and cost by individual payphone	
Revenue from calls	
Less:	
Line cost	
Traffic cost	
Direct operating costs	Cost of sales (cards) Commissions paid to distributors Share of corporate costs Hire of Premises Electricity Repairs & Maintenance – Card phones Metering Cost
Depreciation & Amortisation	
Cost of capital	
Net revenue / (cost) by payphone	

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 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.

- As reported in the Reasoning Phase report, GO's original submission was based on the total number of payphones, with 731 out of the total 762 being loss-making, and generating total losses of €242,225. This original submission was not consistent with the USO Decision. The USO Model submitted by GO provides, however, the option to view net USO cost for public payphones based on the optimal number of payphones as set in the MCA USO Decision, besides the net USO cost based on the total number of payphones. In response to clarification requests sent in preparation for this Calculation Accuracy phase, GO clarified that the methodology/ calculation based on the optimal number of payphones should be considered for claim purposes.

- According to the USO Model provided by GO, the optimal number of payphones as per USO Decision (i.e. taking into account population per locality) is of 184 payphones. Based on the methodology described in the previous page, 158 of these 184 payphones are unprofitable, leading to a net cost of unprofitable payphones of €33,166.

Public payphones (3)
Key assumptions

- The following table summarises the key assumptions used by GO to arrive at the payphone net cost.

Revenue and costs	Assumption
Revenue	• Billing data for on-net calls, outgoing international, mobile calls, and off-net calls sourced from GO's Data warehouse.
Technical Line costs (same as per geographical component)	• 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 costs (same as per geographical component)	• 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 OPEX	• 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 and 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)

Public payphones (4) Conclusion

Conclusion

- As per previous MCA's Decision Notices the USO claim for public payphones should be based on the optimal number of payphones as calculated through the 2010 Decision Notice's mechanism.

- The public payphone claim, on the basis of the optimal number of payphones, results in a **total net cost of €33,166**.

Analysis by component

Social tariffs

Social tariffs (1)
GO's methodology

- The social tariffs claim relates to the cost of providing service to certain categories of people (e.g. low income).

- 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 responsible Ministry, the Ministry for the Family 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 2013.

- While in the original formal claim GO indicated that the cost of social tariffs has been computed as the difference between the discounted rate (i.e. free of charge) and the current line retail tariffs, the claimed net cost (€396,818) is actually based on the difference with the rebalanced line rental fee, and not the current tariff. This is not in line with the 2010 and 2012 Decision Notices, that is, that access deficit should not form part of the USO claim. Social tariffs should be computed as the difference between the current retail tariffs and the amount actually charged to subscribers, which in this case is free.

Social tariffs (2)
Review work and conclusion

Review work

- The table across summarises the 2013 social tariffs claim totalling €396,818 (i.e. €331,128 for reduced tariff options; and €65,689 for specific disability measures) as submitted by GO.
- GO's claim has been based on the rebalanced line rental fee of €9.32/ month. If the current line rental fee of €5.07/ month is applied, in line with conclusions of previous MCA Decision Notices, the social tariffs claim totals €245,659 (i.e. €179,970 for reduced tariff options; and €65,689 for specific disability measures).

Conclusion

- The social tariff claim, on the basis of current costs and subscriber numbers approved by the Ministry, **results in a net cost of €245,659.**

GO's claim	Reduced Tariff Options for Users	Specific Measures for Disabled Users
	€	€
DUO PACK		
Free Rent and Charged Telecare	23	n/a
Charged Rent and Charged Telecare	n/a	n/a
Charged Rent and Free Telecare	n/a	2
HOME PACK		
Free Rent and Charged Telecare	1	n/a
Charged Rent and Charged Telecare	n/a	n/a
Charged Rent and Free Telecare	n/a	142
Free Rent and Free Telecare	0	0
NO PACK		
Charged Rent and Charged Telecare	n/a	n/a
Charged Rent and Free Telecare	n/a	1,338
Charged Rent No Telecare	n/a	n/a
Free Rent and Charged Telecare	359	n/a
Free Rent and Free Telecare	1,088	1,088
Free Rent No Telecare	1,490	n/a
Total	**2,961**	**2,570**
Line rental* (€/ month)	9.32*	2.13
Total annual cost	**331,128**	**65,689**
Line rental (€/month)	5.07*	2.13
Total annual cost	**179,970**	**65,689**

* GO's claim has been based on the rebalanced line rental fee. The MCA's Decision Notices concluded that the current tariffs should be used.

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 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 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 (derived from retail charge)
  - Operating cost of the call centre
  - Transfer charges from core and LAN network
  - Cost of capital with 9.65% WACC

- The table below summarises the components making up GO's DES claim.

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

- As per the updated USO Model, GO claims that DES have generated a net cost of €47,343. This net cost of €47,343 differs from the cost of €45,220 reported in the original claim and in the Reasoning Phase Report. This is because the calculation of the cost of capital in the original submission was still based on 2012 asset and liability figures. In preparation for this Calculation Accuracy Phase, GO was asked to provide an updated calculation with figures for 2013. This was provided on 01 August 2016, and resulted in a net claimed DES cost of €47,343.

Directory enquiry services (2)
GO's methodology and conclusion

- GO have confirmed in their clarification replies, that no changes were made in 2013 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. GO explained that dipping charges are included in their net cost calculation and provided the associated costs and revenues.

- 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.

Review work and conclusion

- When dipping revenues and costs are netted out from GO's DES net cost calculation, in line with the 2010 Decision Notice, net cost fall from €47,343 to €46,419.

- Based on our review work, the DES claim should be equal to the claimed **amount of €46,419**, following the netting out of dipping revenues and costs from GO's calculation.

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.

- 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

Ubiquity

- The 'ubiquity' benefit is the advantage the USP has over its competitors in extending the network of customers.

- Using the methodology presented in the below table, GO estimated a ubiquity benefit of €11,825. In their claim, GO argue that this figure is on the higher end as it is likely that customer loyalty is attributable to marketing efforts rather than because of GO's USP position.

- The ubiquity benefit submitted in the original claim (and reported in the Reasoning Phase Report) was of €34,561. In response to clarification requests, GO have adjusted the ubiquity benefit calculation in the USO Model 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 original submission was based on residential customer moves only. In its Decision Notices on the 2010 and 2012 claims, the MCA had included an adjusted working based on both residential and business customers. In the 2012 claim the MCA decided that businesses should be included in this calculation as they were also included in the calculation of the geographical component. The adjustment related to the inclusion of businesses in the calculation is thus consistent with this MCA decision.
  - The calculation was adjusted to account for customer movements which occur within the same geographical area, in line with previous claims

- The value of this intangible benefit, following the above described adjustments, **amounted to €11,825**, as previously mentioned.

	Item
a	Moves/year
b	of which residential
c	of which in the same zone
d=a*b*c	Moves outside zone
f	# of zones
g	# of unprofitable zones
h=f/d	Moves outside zone
i=(f-g)*h	Moves from unprofitable zones 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 (3)
GO's methodology – Brand enhancement

Brand enhancement

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

- There is no standard methodology to estimate this benefit. In its 2013 claim, GO again decided to follow the UK regulator's approach (as in previous claims), basing its calculations on the below assumption/ 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 the 2012 claim, which was based on Ofcom/ BT's approach of allocating 20% of related market expenses to the brand image benefit.

- 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 **€219,138.**

Intangible benefits (4)
Review work and conclusion

Review work

- GO was asked to justify why other intangible benefits were not quantified.
  - According to GO, the lifecycle benefit was not assessed because:
    - Benchmarking shows that this benefit is not evaluated in USO funding claim processes, except for Belgium in 2003.
    - GO has no figures or studies to estimate a forecast of ARPU according to household consumption
    - The use of telephony by children increases as they grow up, but it is likely that these children will adopt the mobile phone rather than increase their use of the fixed phone in the next 5 years. This argument can be reversed: what happens when children leave the household?
  - According to GO, the marketing benefit was not assessed because it considers this intangible benefit to be insignificant in view of the nature of Maltese payphones, which make any advertising uneconomic given their low usage and the material difficulty of exposing any advertising on them.

- As part of our review work, we have considered the arithmetical accuracy and allocation calculations carried out, and report that no exceptions were noted.

Conclusion

- The value of the intangible benefits to be deducted from the cost of the other components should be equal to:
  - **Ubiquity: €11,825**
  - **Brand enhancement: €219,138**

- 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	(7,257)	Adjusted with the exclusion of on net calls
Payphones	(33,166)	As per the updated GO USO Model/ claim
Social tariffs	(245,659)	Re-based on current tariffs
DES	(46,419)	Adjusted to exclude dipping revenues and costs
Ubiquity	11,825	As per the updated GO USO Model/ claim
Brand enhancement	219,138	As per the updated GO USO Model/ claim
Total	**(101,538)**	

- The resulting USO net cost amounts to **€101,538**.