

Price Cap Consultation

Printed in Business Monday Newspaper on March 5, 2012

On February 10, 2012 the Fair Trading Commission issued a consultation paper on the review of the Cable & Wireless (Barbados) Ltd.'s (C&W) Price Cap Plan 2008 (PCP2008). The Consultation paper seeks the input of stakeholders and members of the general public on whether the PCP 2008 has achieved the objectives for which it was designed and on the proposed changes to the current Price Cap which is coming to an end on March 31, 2012. The PCP2008 governs the regulated services of C&W and this review also consists of an examination of the financial and operational performance of C&W, and changes to the market conditions over the past three-and-three-quarter (3¾) years.

So how does price cap regulation function? Price Cap regulation began in the United Kingdom during the 1980s and was introduced in Barbados in 2005. It is a forward-looking regulatory mechanism that is designed as a surrogate for competition in the marketplace. Price Cap regulation is meant to provide the incentive for the operator to improve productivity and pass the gains on to the customer through the use of a formula to determine the allowable price changes. This type of regulation also allows flexibility in pricing, provided that the average change in prices charged by the company and measured by the Actual Price Index (API), does not exceed the Price Cap Index (PCI). The PCI is expressed as Inflation (I) minus Productivity (X). As a secondary objective, the design of the Price Cap aims to not unduly constrain C&W's pricing flexibility on individual services.

In designing the price cap model to derive the appropriate productivity factor, the Commission has indicated that the company would be given the opportunity to earn a fair rate of return. This is however not guaranteed but is just one of the several elements considered in the design of the model. Forecast of market developments, productivity improvements, inflation rates, price elasticity, and international prices are some of the other elements that have been factored into the development of the price cap model and the productivity factor.

Depending on the value of the productivity factor and the inflation for a particular period the company may be required to have an overall decrease or increase in prices. Under PCP2008 the prices of the "Call Waiting" and "Caller ID" services were decreased. Business customers also saw a decrease in the monthly cost of some leased circuits and residential customers had a rate freeze followed by an increase.

The current PCP 2008 covers the period from August 2008 to March 2012. The price cap structure (in particular, the number of baskets and distribution of the services within these baskets) will play an important part in meeting its objectives. Generally, the basket structure of a price cap regime determines the pricing flexibility provided to the regulated company. Within an individual basket, changes in the price of one service can be offset by changes in the prices of other services as long as the overall cap is met. The narrower a basket is defined, the less pricing flexibility the company will retain for individual services within that basket. For example, under a single basket structure covering all regulated services, C&W would retain full pricing flexibility on individual services, as long as it meets the overall cap across the entire basket. Further, introducing sub-caps on specific services within a basket allows the price changes for those services to be specifically capped thus limiting excessive rate increases.

With the revised structure, the Commission is proposing to have two baskets instead of three. One basket covers most of the regulated telecommunications services including residential and business access, installation, voice mail, leased

circuits and price changes would be governed by a price cap formula. It is also proposed to have a sub-cap on the residential access service while international “competitive” services are placed in the second basket which would be uncapped.

The Commission is also seeking public response to a number of questions posed in the consultation paper on issues such as the proposed number of baskets and the proposed price cap formula. In addition the Commission is examining the parameters within the Price Cap formula as well as the duration of the Price Cap period. The responses to these questions will assist the Commission in making its final determination in respect of the Price Cap 2012.

It is the Commission’s policy to fully ventilate such issues so that opinions on matters that affect members of society can be considered prior to making a final decision. The views and analyses set out by the Commission in a consultative document are intended to invite comments which may help to inform the Commission as it reviews the Price Cap Plan 2008. The Commission encourages the widest possible participation in this consultation process for the new Price Cap plan.

The Consultation period began on February 10, 2012 and ended on March 9, 2012.