

Fair Trading Commission



TERMS OF REFERENCE

**Engagement of Consultants for Review of the
Price Cap Plan 2008
for Cable & Wireless (Barbados) Ltd.**

Dated: 27 July, 2011

1. INTRODUCTION

The Terms of Reference presented in this document relate to the engagement of consultants to provide technical assistance to the Fair Trading Commission (the Commission) for the review of the Price Cap Plan 2008 for Cable & Wireless (Barbados) Ltd (C&W).

2. BACKGROUND

The Commission is a statutory body established by the Fair Trading Commission Act CAP. 326B. The Commission is responsible for, *inter alia*, regulating utility services, safeguarding the interests of consumers, and promoting and maintaining effective competition in the Barbados economy.

The Commission currently regulates domestic and international telecommunications services as well as electricity.

Telecommunications services in Barbados are provided by C&W and include domestic, mobile and international telephony services. Other providers also offer fixed wireless, mobile and internet services. From 2005 C&W has operated under a Price Cap Plan which was reviewed in 2008. The new Price Cap Plan 2008 (PCP 2008) was implemented to govern the adjustment of rates of the regulated telecommunications services for the period August 1, 2008 to March 31, 2012. A copy of the PCP 2008 Decision can be obtained from the Commission's website. www.ftc.gov.bb.

The Objectives of the 2008 Price Cap Plan were to:

- a. Provide the economic incentive to reduce operating cost;
- b. Provide the company with an incentive to be innovative and replace plant in an efficient manner;
- c. Provide the company with a reasonable opportunity to earn a fair return on its investment;
- d. Allow efficiency gains to be passed on to consumers through reduced prices of telecommunication services;
- e. Foster competition within the telecommunications market;
- f. Streamline regulatory procedures relating to rates;
- g. Facilitate price flexibility and responsiveness to evolving technological, legal and market conditions.

Price Cap Formula

The main price cap formula that governs the Price Cap Plan is expressed in the equation below. The formula accommodates a degree of pricing flexibility. The Company is permitted to increase and decrease its prices over the year without regulatory intervention. These price increases and decreases by the Company are measured as the Actual Price Index (API). The pricing flexibility is however constrained as the API is not allowed to exceed the Price Cap Index (PCI). So:

$$API_t^k \leq PCI_t^k$$

The Price Cap Index is calculated as follows

$$PCI_{t-1}^k (1 + I_t - X_t^k) = PCI_t^k$$

Where

PCI_{t-1}^k Price Cap Index for basket k in year $t-1$

I_t Computed Inflation rate for year t (expressed in decimal form)

X_t^k X-factor for basket k , in year t (expressed in decimal form)

The PCI for Basket 2 is reset by the Commission on August 1st of each year of the Price Cap Plan.

Inflation Factor (I)

The inflation factor as included in the price cap formula accounts for changes in the input costs of the operator during the price cap period.

The Commission determined that the Barbados Retail Price Index (RPI) will be used to measure the Inflation Factor. The Barbados RPI is computed on a monthly basis by the Barbados Statistical Service. It is calculated based on changes in the prices of those goods and services most commonly purchased by Barbadian consumers.

Price Cap Model

The PCP 2008 utilises a price cap financial model which has been designed to take into account the Company's forecasted year-over-year earnings as well as an earnings constraint on price capped services. The price cap model was designed with the assistance of consultants hired by the Commission and input from the company and is designed to provide the company with a reasonable opportunity to earn a fair return on its price capped services over the course of the second price cap period. The model also takes into account actual company data and the forecast of market developments. The model aims to capture all factors that will impact the company's earnings during its term. These include the Company's cost of capital, expected price elasticity of demand, expected price and volume changes driven by competition and expected rate of inflation.

Baskets

The services regulated under the PCP 2008 were divided into three baskets. The baskets have been established as follows:

Basket 1- Domestic Residential Access

This basket includes domestic residential line access and the residential installation service. Pricing in Basket 1 was implemented in two phases as below:

- *Phase I – first 17 months of second price cap (August 1, 2008 to December 31, 2009)*

The X factor was set to equal the I-factor so there was a rate freeze from August 1, 2008 until December 31, 2009. This means that prices for residential line rental were unchanged from August 2007.

- *Phase II – for the remaining 27 months of the second price cap (January 1, 2010 to March 31, 2012)*

The Company is allowed to adjust rates in line with the Inflation factor up to a maximum of 4.5%. This means that when the I-factor is less than 4.5%, the X-factor will equal 0% but if the I-factor is greater than or equal to 4.5%, the rate increases are capped at 4.5% and thus the rate can only be increased to a maximum of 4.5%.

Basket 2 - Domestic Voice Telecommunication Services

This basket includes business access, business installation, payphone access, domestic leased circuits and value added services. The Commission determined that this basket includes Domestic Private Leased Circuits (DPLC) and Voicemail. The Commission determined that the productivity X-factor for Basket 2 is 7.12% which is an increase over the last price cap plan.

Basket 3 - International Telecommunication Services and Other Retail Telecommunication Services

This basket includes fixed international outgoing, payphone international, international operator assistance and international leased circuits and all other retail services not accounted for in the other two baskets. The Commission determined that, in view of the existing or emerging competition in these services, no price cap constraint would be placed on these services. The Company however should not increase the price of the services in this basket.

Review

The Company must file documents to facilitate the Commission's review of the Plan. These include:

- a) A report submitted by C&W which to outline:
 - The extent to which competition, technological developments, economic factors and social developments in the industry have materially impacted the Company's performance throughout the Price Cap Plan, and the likelihood of them continuing to do so;
 - The Company's quantifiable data, disaggregated into separate services as presented in its Enhanced Allocation Model.

- b) C&W Financial Reports in summary form, showing:
 - Revenues;
 - Expenses;
 - Net investment rate base;
 - Capital structure; and
 - Rate of return on utility common equity.

This review is expected to be completed in February 2012.

3. LEGISLATIVE FRAMEWORK

Under Section 4 (3) of the Fair Trading Commission Act Cap. 326B the Commission is charged with responsibility to, *inter alia*, “establish principles for arriving at the rates to be charged by service providers.”

The Commission is also charged with this responsibility under section 3 (1) of the Utilities Regulation Act Cap. 282. Further in section 6 (1) (d) of the Telecommunications Act CAP. 282B it states that the Commission shall:

“Establish and administer mechanisms for the regulation of prices in accordance with this Act, the Fair Trading Commission Act and the Utilities Regulation Act.”

The Telecommunications Act also states in Section 39 (2) that the rates should facilitate the policy of market liberalisation and competitive pricing.

In changing any principles of rate setting the Commission is obligated to consult with interested parties in accordance with Section 4 (4) of the Fair Trading Commission Act CAP. 326B which states that:

“The Commission shall, in performing its functions under subsection (3) (a), (b), (d) and (f) consult with the service providers, representatives of consumer interest groups and other parties that have an interest in the matter before it.”

4. OBJECTIVES

The Consultants shall be engaged to review the PCP 2008 to ascertain whether it has achieved the objective for which it was originally designed. The Consultants are also expected to assess whether there is a need to make changes to the PCP 2008 in consideration of the performance of C&W and the developments in the telecommunications sector.

This review will enable the Commission to determine whether there is a need to modify the principles, indices or rules of the PCP 2008.

5. SCOPE OF WORK

The Consultants shall assess the efficiency and effectiveness of the Price Cap Plan 2008 and the Company's performance.

In performing this review the Consultant shall:

- Assess the Company's regulatory and financial performance, its productivity achievements, and
- Consider the overall market developments that have impacted and may continue to impact the Company's performance.
- Take into consideration the perceived level of competition and the liberalisation of the industry and will be guided by any revision of policy issued by the Ministry responsible for Telecommunications.

1. The Consultant shall evaluate:

- a) A report submitted by C&W which is expected to outline:
 - The extent to which competition, technological developments, economic factors and social developments in the industry have materially impacted the Company's performance throughout the Price Cap Plan, and the likelihood of them continuing to do so;
 - The Company's quantifiable data, disaggregated into separate services as presented in the Enhanced Allocation Model.

- b) C&W Financial Reports in summary form, showing:
 - revenues;
 - expenses;

- net investment rate base;
 - capital structure; and
 - rate of return on utility common equity.
2. The Consultants shall also assist the Commission in preparing the public consultation document. This document will be used to invite members of the public to submit their comments on the operation of the price cap regime. The consultants shall take into consideration the responses to the consultation in regard to whether there is a need to modify the principles, indices or rules of the Price Cap Plan.
 3. The Consultants shall provide advice and make recommendations as well as identify, evaluate and provide feedback on critical issues that could impact on the timelines or quality of the output of the project.
 4. The Consultants are expected to provide the opportunity for an effective transfer of knowledge and expertise to Commission staff, by facilitating their involvement throughout the duration of the project.

6. DURATION

The Commission is seeking to formally engage the services of the Consultants with effect from **October 7, 2011**.

The Price Cap review is required to be completed no later than **February 03, 2012**.

7. CLIENT MEETINGS

Meetings with the Commission, the Company and other interested parties will be facilitated as required during the project.

The Consultants would be expected to identify, evaluate and give feedback on critical issues that could impact on the timeliness or quality of the output and to liaise with the Commission's Director of Utility Regulation regarding the progress of the project on an on-going basis.

8. REPORTS

The Consultants shall submit to the Commission, two (2) copies of the following:

- ◆ An Interim Report indicating any areas of difficulty that could impact on progress of the project and identify issues which should be included in the public consultation within four (4) weeks.
- ◆ Reports on the status of the project as necessary
- ◆ A Draft Final Report within two weeks of the scheduled end of the project, providing a detailed assessment of the Price Cap Plan 2008 with recommendations for modification of the model or specifications for a new model as warranted.
- ◆ Final Report

9. PROPOSALS

Consultants will be required to submit a proposal which should at least include:

- ◆ A schedule of fees, the time each Consultant is expected to spend on the project, the stages of payment, travel and accommodation and other expenses directly related to the project.
- ◆ A project plan detailing the approach, methodology and dates for completion of tasks to meet the specified deadlines. Any event which may affect the Consultants' ability to meet specified deadlines may be discussed with the Commission.
- ◆ A list of the individual Consultants that will be involved in the project along with details of their expertise. The Consultants should demonstrate expertise and experience in the areas of regulatory matters and Price Cap

development. Previous work in the Caribbean or other developing countries would be considered an asset.

Any matters which are considered pertinent to the work to be performed but which have not been included under the "Scope of Work" should be included in the proposal.

The deadline for the receipt of proposals is **August 26, 2011**.

10. EVALUATION OF PROPOSALS

Proposals will be evaluated based on Consultants' experience, qualifications, and the quality of the proposals. The Commission is not bound to accept the lowest or any offer. Proposals and/or queries should be submitted by **4:00 p.m. on August 26, 2011 to:**

**Chief Executive Officer
Fair Trading Commission
"Good Hope"
Green Hill
St. Michael
Barbados,
BB12003**

An electronic copy should also be submitted to the Fair Trading Commission to:
info@ftc.gov.bb.

11. PROVISION OF FACILITIES

The Commission will provide physical office accommodation.

12. SUMMARY OF KEY DATES

The Consultant should be aware of the following key dates/deadlines when submitting proposals.

<u>TASK</u>	<u>DATES</u>
Submission of Proposals	August 26, 2011
Selection of Consultants	September 23, 2011
Start of Project	October 07, 2011
Interim Report	November 4, 2011
Draft Final Report	January 20, 2012
Final Report	February 03, 2012

FAIR TRADING COMMISSION

"GOOD HOPE"

GREEN HILL

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