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 2017

Decision Notice

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EXECUTIVE SUMMARY

In September 2021, the Malta Communications Authority (hereinafter referred to as "MCA" or the “Authority”) published a consultation and proposed decision on the review of GO plc’s application for funding of the net cost claimed to be incurred for providing universal service obligations (hereafter the ''USO'') during financial year 2017[1].

In accordance with the MCA Decision of 2015 entitled *“Decision on Universal Service Obligations on Electronic Communications Services”* (hereinafter referred to as "2015 USO Decision"), the designated undertaking has the right to seek to receive funds for the net costs that it claims it incurred to provide part or all of the universal services and consequently may submit a written request to the Authority. In 2018, GO plc (hereinafter referred to as ''GO'') submitted its funding request for the unfair burden it claims it suffered during 2017.

The MCA commissioned Ernst & Young Limited (hereinafter referred to as “EY”) as an independent body to audit and verify the calculation of the net cost claimed by GO taking into account any market benefits. As established in the MCA 2015 USO Decision, the universal service provider (hereafter “USP”) is required to submit sufficient and detailed information supporting its claim. The information and the evidence of the net costs provided by GO serve as a basis for the evaluation exercise to determine whether the provision of the USOs resulted in an unfair burden. GO’s funding application included the following components of the USOs namely: public payphones, social tariffs and a comprehensive electronic directory. As part of its USO funding application, GO also included an intangible benefit in its claim, namely the brand enhancement element as described in Section 3 below.

The evaluation process included two phases, namely:

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

Following the verifications and audit carried out by EY, it emerged that during 2017 GO had incurred an element of unfair burden for providing the specified universal services, which after taking into account the intangible benefits, amounts to a net cost of €76,659. The results of the cost calculation and the conclusions of the audit on each USO component are being published and are found in Section 3 and Annex 1 below.

The consultation period ran between the 2nd and 27th September 2021. The MCA received feedback to the consultation and proposed decision from Melita Ltd (hereinafter referred to as ‘Melita’). The Authority wishes to thank this undertaking for the interest shown in submitting its response.

[1] GO’s financial year was from 1st January to 31st December 2017.

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1. INTRODUCTION & BACKGROUND

In April 2010 the Authority published a USO Decision, which was updated in May 2015, specifying that one of the objectives of the Authority is to promote social inclusion of electronic communications services and ensure the provision of a minimum set of services to all end-users, including vulnerable groups. Vulnerable groups include persons on low income, residents of rural or high installation cost areas, and persons with disabilities. Universal services are the minimum set of services of specified quality which are made available at an affordable price to all end-users irrespective of their geographical location and in the light of specific national conditions.

The MCA 2015 USO Decision established a number of universal services to be provided, in part or in full, by an entity as the designated undertaking, for a period of time as the Authority may specify. The USO Decision stipulated that the MCA may designate different undertakings or sets of undertakings to provide different elements of universal services and/or 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 are not satisfied, the MCA was required to designate an undertaking to be responsible for providing each of the universal services. As a result, given that there was no expression of interest, the Authority designated GO to provide the universal services in question.

During 2017, GO provided the following universal services:

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

Comprehensive Electronic Directory:
In addition to the provision of the comprehensive electronic telephone directory the designated undertaking is required to make available a free of charge web-based interface for smartphone users;

Public payphones:
The USO Decision establishes a minimum set of parameters of number of payphones to be available in each locality according to the number of population;

Specific measures for disabled users including 'Telecare' type of service:
The provision of a service that allows easy access to emergency/assistance services;

Reduced tariff options:
The provision of a reduced tariff option to render the universal service affordable to eligible consumers, especially vulnerable users on low incomes or with special social needs.

Chronology of the current claim:

As outlined in the MCA 2015 USO Decision, an undertaking designated to provide universal services has the right to apply to receive funds within eleven months following the end of the previous financial year for any net costs accrued in meeting these obligations. Such a request must be accompanied by supporting documentation to enable the MCA determine whether or not the provision of the universal service/s resulted in an unfair burden on the designated undertaking.

In 2018, GO submitted an application for the USO funding of the net costs it claimed to have incurred in providing universal services during 2017, accompanied by a report on the methodology and calculations (including a cost model), for each of the USO components.

The MCA commissioned EY to undertake a review of the 2017 claim and to assist the Authority in assessing the funding application submitted by GO, and whether the information and the evidence provided was sufficient and detailed enough to support the claim. In order to expedite the process, the Authority requested GO's approval to make use of and refer to the information, explanations and documents provided by GO for previous USO claim reviews. GO did not raise any objection to the use of such information and documentation.

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

1.1 REASONING PHASE

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

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

EY finalised the Reasoning Phase in December 2020 and the findings were included in a Report which was sent to GO. The findings emanating from this Phase can be found under Section 3 “Assessment and Audit of the Net Cost” below.

1.2 CALCULATION ACCURACY PHASE

The objective of this review phase was to audit and verify the various calculations, including those used to quantify the intangible benefits that GO provided in its claim. Following a number of information and clarification requests on specific aspects of the claim, GO submitted a revised cost model in March of 2021. In the meantime, the responsible Ministry confirmed that the number of subscribers that benefitted from social tariffs during 2017 as specified in the claim is correct. EY finalised the Calculation Accuracy Phase in June 2021.

The MCA requested EY to submit an abridged version of the review report on the cost calculation and conclusions of the audit to be made publicly available, without revealing any financial information which could be commercially sensitive. This report is made available in Annex 1 of this document and a summary of its findings can also be found under Section 3 further below in this document.

2. LEGAL BASIS

The fundamental aspects of costing and financing of universal services applicable to 2017 were outlined in SL 399.28 of the Laws of Malta (hereinafter referred to as the "Regulations") and in Directive 2002/22/EC (as amended) of the European Parliament and of the Council (hereinafter referred to as the ''USO Directive'')[2].

Regulation 30 of the Regulations stipulated that a universal service provider designated to provide all or parts of the universal service obligations outlined under regulations 21 to 28 of the Regulations, may submit a written request to the Authority to fund the net costs it claims to have incurred in providing the universal service/s concerned. Such a request must be accompanied with detailed and supporting information to enable the Authority to determine whether the claim represents an unfair burden to the USP[3].

The Authority or an independent body approved by the Authority, 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. If it is determined that the claimed components do not represent an unfair burden, the Authority shall inform the designated undertaking accordingly, giving its reasons therefor. Following the audit exercise, the results shall be made publicly available.

The financing of universal service obligations requires *a priori* that the Authority or an independent body approved by the Authority finds that an undertaking has suffered an unfair burden. Regulation 31 of the Regulations[4] stipulated 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, or services. The identification of the source of the USO funding, which could depend on the nature of the universal service in question, shall be considered and dealt with by the MCA in a separate consultation.

[2] As a result of the transposition of the European Electronic Communications Code, Cap. 399 was amended by Act Number LII of 2021, and S.L. 399.28 was repealed by LN379 of 2021 and replaced by S.L. 399.48 with effect from 1st October 2021**. The references to the legislation prior to the amendments to the applicable laws that came into force as on the 1st October 2021 have been retained in this Decision Notice since the claims are related to a period (2017) which is prior to the coming into force of the amended legislation.** The provisions enabling the publication of this Decision Notice which were previously included in Regulation 30 of S.L. 399.28 have been substantively retained in Regulation 76 of S.L. 399.48.

[3] The provisions in Regulation 30 (1) and (2) of S.L. 399.28 referred to in the proposed decision were substantively retained in Regulation 76 (3) of S.L. 399.48 which became effective from 1 October 2021 after S.L. 399.28 was repealed by LN379 of 2021.

[4] The provisions in Regulation 31 of S.L. 399.28 referred to in the proposed decision were substantively retained in Regulation 77 of S.L. 399.48 which became effective from 1 October 2021 after S.L. 399.28 was repealed by LN379 of 2021 and replaced by S.L. 399.48.

3. ASSESSMENT AND AUDIT OF NET COST

As mentioned earlier, the Authority commissioned EY to evaluate the reasoning behind GO's claim and to audit and verify the various calculations of the net cost GO claimed it had incurred during 2017 in fulfilling its obligations by providing universal services in relation to electronic communications services outside normal commercial conditions. In accordance with the MCA 2015 USO Decision, the net cost is calculated as the difference between the cost a designated undertaking would incur when operating with universal service obligations and that when operating without such obligations. As mentioned earlier, the specific objectives of the evaluation exercise consisted of two main review phases, namely the Reasoning Phase and the 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 without revealing 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 2017"* is available in Annex 1 of this document.

For the financial year 2017, GO included the following USO components in its claim:

- Payphones;
- Social Tariffs;
- Comprehensive electronic directory; and
- Intangible Benefits.

GO's cost model was based on the "current net cost" approach which is based on actual line rental charged to their subscribers. GO also included a second scenario – the "Current cost after rebalancing" – which was also included in some previous USO claims and is based on a higher line rental tariff to cover the claimed line rental cost and return on capital. Nevertheless, GO made its 2017 claim request, in line with MCA's previous decisions on USO funding, on the "current net cost" scenario totalling €321,596. Following a number of clarifications that took place during the Calculation Accuracy Phase and a revised cost model submitted by GO in March 2021, the net USO cost amounted to €154,979.

GO based the 2017 USO claim on the same cost model developed for its previous USO claims.

As in previous USO claims, GO's 2017 USO claim is based on a fully allocated cost approach by means of a top-down cost model factoring its operational data using a historical cost accounting methodology. As part of its analysis during the Reasonability Phase and the Calculation Accuracy Phase, EY prepared an information request list to collect additional details from GO. Following its initial feedback and clarifications on a number of items identified in the cost model, GO also submitted an updated version of the cost model, including adjustments to some elements, which was then analysed by EY during the Calculation Accuracy Phase. Changes were made in figures in relation to standard line rental, social tariffs and comprehensive electronic directory components. Further detail on each universal service component is found below and in Annex 1.

During the Calculation Accuracy Phase, GO were requested to adjust the standard line rental since there was a mathematical error in its calculation which impacted the claim of two universal service components, namely the public payphones and social tariffs.

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

3.1 PAYPHONES

In accordance with the MCA 2015 USO Decision, public payphones were to be made available to meet the needs of end-users in terms of geographical coverage, quantity, accessibility and quality of service. The 2010 USO Decision established a minimum set of parameters of payphones required in each locality, based on population figures. These parameters were maintained in the MCA 2015 USO Decision with the exception that whenever GO intended to remove a public payphone it was only required to notify the MCA of such a removal and its exact location, subject that the minimum number of payphones as established in the aforesaid Decision was maintained. The minimum number of payphones in all localities of the Maltese islands according to the 2015 USO Decision amounted to a total of 184 payphones.

In its cost model, as per previous claims, GO presented two scenarios: one with the total number of existing payphones; and another with the optimal number of payphones as set by the minimum requirements established in the MCA 2015 USO Decision. For the purpose of this claim, GO correctly based its funding request on the current net cost pertaining to the optimal number of payphones, in line with the MCA's decisions on the previous USO funding claims.

The number of payphones around Malta and Gozo during 2017 amounted to a total of 371, out of which 368 were according to GO, unprofitable. Taking into account the minimum number of payphones requirement set by the MCA 2015 USO Decision, GO was obliged to provide 184 payphones, out of which 181 were reported to be unprofitable.

As in the case of previous USO claims, GO provided revenues and costs information to arrive at the net cost of each unprofitable payphone. The approach taken to calculate the net cost in the case of payphones was based on a net margin derived from revenues less costs per individual payphone, similar to the methodology that had been undertaken in past claims to calculate the geographical component cost on the basis of individual Main Distributor Frames (MDFs).

During the Reasonability Phase, EY confirmed that on the basis of the USO Directive and of international practice, the inclusion of payphones as part of the USO claim could be justifiable.

During the Calculation Accuracy Phase, clarifications were sought from GO on certain inputs underlying the 2017 claim specifically on local access network (LAN) operating costs. It was observed that there were some increases from the previous claims and GO has provided its reasons and explanations outlining the associated technical factors driving an increase in costs.

The calculation also included sub-contracting costs which GO based on the same reasoning used in the 2016 USO claim. GO explained that as from 2016 it started to shift maintenance to sub-contractors, and concluded that such costs should in effect be treated as direct payphone costs.

EY noted that GO's USO Model records lower operating electricity costs than in the previous 2016 claim, which is consistent with the reduction in the number of operative payphones being claimed for.

During this Phase, GO made corrections to origination and termination rates in the cost model to be aligned with those applicable for 2017 as set in the MCA Decision on the Bottom-up Cost Model for Fixed Networks and Fixed Interconnection Prices, leading to a slight reduction in the original claimed cost for public payphones[5].

Following the review of the payphone USO component, EY concluded that the payphone claim should be based on the optimal number of payphones in accordance with the MCA 2015 USO Decision, and the net cost of public payphones has been slightly reduced to €50,023. More information on this USO component is available in Annex 1 of this document.

3.2 SOCIAL TARIFFS

The Social Tariff USO component is related to the provision of reduced tariffs which render the respective electronic communications service affordable to certain eligible end-users. As specified in the MCA 2015 USO Decision, this component includes a Telecare type of service and free line rental to qualifying low income earners, or to people with special social needs, included in a list specifically provided by the competent Ministry or public entity.

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

[5] https://www.mca.org.mt/sites/default/files/decisions/decision-on-bucm-2-ftr-2012.pdf

As in previous years GO claimed for two types of social tariffs which were provided free of charge during 2017, namely the *Telecare* service and the free line rental. During the Calculation Accuracy Phase, clarifications were sought from GO on the number of subscribers included in the calculation of the free line rental service. GO explained that it had erroneously included subscribers that were migrated to a bundled product and therefore the number of subscribers in the revised cost model which was submitted in March 2021 was adjusted accordingly. The subscriber numbers benefiting from Telecare service and free line rental during 2017 amounted to 1,944 and 1,743 respectively. As mentioned above, the standard line rental was also adjusted leading to a lower claim. Following these adjustments, the claim for this component decreased from €327,812 to €182,629. The numbers of beneficiaries eligible for each type of social tariffs were confirmed by the responsible Ministry which provides GO continuous updates on the subscribers entitled for such tariffs.

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 €49,689 for specific measures to disabled end-users, and of €132,941 for reduced tariff options, totalling to a net cost of €182,629, was justified. More information on this USO component is available in Annex 1 of this document.

3.3 COMPREHENSIVE ELECTRONIC DIRCETORY

The universal service obligation for the provision of a comprehensive electronic directory was included in the MCA 2015 USO decision and the designated undertaking was also required to make available an interface that caters for smartphone users. GO decided to develop a smartphone mobile application and make it available free of charge to end-users to meet its obligations, and this was launched in December 2016. In their claim GO included the net cost incurred for the provision of the smartphone application during 2017.

In the Reasonability Phase EY considered that the inclusion of the costs connected to the mobile directory app in the USO claim were reasonable and appropriate in view of the MCA 2015 USO Decision provisions. It was concluded that the calculation details would be reviewed in the Calculation Accuracy Phase to further verify the cost.

During the Calculation Accuracy Phase EY reviewed the workings and methodology of this component of the universal service and GO were requested to provide updated calculations based on the review conclusions of the 2016 USO claim which included the first claim on the comprehensive electronic directory and conclusions by EY. The original claim for 2017 reached the MCA prior to the publication of the 2016 USO claim Decision Notice and to this effect GO sent updated workings as part of the revised cost model submitted in March 2021, leading to a revised claim amounting to €7,766 for the comprehensive electronic directory. The cost components updated in line with the previous year Decision Notice were related to directory updating and cost of capital. As per previous claim, the 'Updating of directory' consists of the internal human cost allocated for the updating of customer records.

There is an agreement in place between local operators to provide GO, as the designated undertaking of the comprehensive directory enquiry service, access to their subscribers' databases for that purpose. Since this is based on an automated 'dipping system', GO should not incur any costs associated with the updating of other operators' customers. As established in previous USO claim reviews, the sharing of subscriber information between operators falls outside the scope of USO and any costs or income pertaining to dips in directory data are not to be included in the claim. In 2015, the MCA published a decision on the 'Wholesale Access to Data and the Provision of Publicly Available Directory Information Services'[6]. In that decision the MCA provided for the conditions and obligations regarding the collection, storage and processing of personal customer records for directory information services which apply to all operators, and therefore any associated customer records and updating costs should not feature in the USO claim. EY also noted that the human resource costs incurred for the development of the mobile application are included under the 'Software development' cost element. In line with the previous year's USO claim Decision, GO has not included the cost of directory updating in its revised figures.

Another cost element updated by GO was the cost of capital which has been estimated by GO based on the MCA's Decision on the Weighted Average Cost of Capital ("WACC") at 9.65%. In accordance with the MCA Guidance on Accounting Methodologies for Regulatory Accounting Purposes, and in line with the previous year's claim Decision, the capital employed was recalculated on the mean net book values as at the beginning and end of 2017.

As a result of the above adjustments, the claim for this component decreased from €29,128 to €7,766. EY concluded that the net cost for the comprehensive electronic directory amounting to €7,766 is justifiable. More information on this USO component is available in Annex 1 of this document.

3.4 INTANGIBLE BENEFITS

In accordance with the MCA 2015 USO Decision, in its USO claim for funding GO included intangible benefits that arise from the provision of the universal services that are deducted from the net costs. In its claim, GO included the "brand enhancement" element as a component of intangible benefits, which is defined as the enhancement of the USP brand by offering universal services, and the influence on end-users' perception that might impact the overall profitability.

In the USO cost model submitted by GO, the brand enhancement benefit was quantified using a newer approach and methodology from that used in previous USO claims. This was based upon a benchmark comparison with benefit estimation rates (relative/percentage rate) that resulted for a number of other European USPs (including the UK). The benefit estimated by GO amounted to €85,440. During the

[6] https://www.mca.org.mt/consultations-decisions/decision-wholesale-access-data-and-provision-publicly-available-directory

Reasonability Phase, EY concluded that the estimation methodology, inputs and calculations employed by GO would be further assessed in the Calculation Accuracy Phase.

In the Calculation Accuracy Phase EY has reviewed the cost model calculations and applied some adjustments to GO's intangible benefit. In their calculation, GO included a discount factor based on the peer group's resulting proportion of brand enhancement benefit to total intangible benefits. Since the brand enhancement is the only estimated intangible benefit calculated by GO in the cost model, and is equivalent to 100%, a discount factor should not feature as a calculation input and was therefore excluded in the review calculations.

Like other international benchmarking exercises, it is difficult to evaluate the extent to which the USP and the market environment in which it operates are comparable to those of the benchmark group, and the final rate selection remains a subjective element. GO's submission does not provide a clear explanation of the method or approach used in the selection of the final estimation rate within the range of benchmark rates. In this regard, during the review work, EY applied a more standard, objective and arithmetically-based approach utilising the mean value across all benchmarks.

As in previous claims, the ubiquity, the life cycle and the marketing benefits elements of intangible benefits were not included in the claim.

Since the calculation of intangible benefits is not an exact science and there is no single defined methodology or answer, the estimation of intangible benefits is a challenging exercise by its very nature, and a number of different methodologies have been used for assessment purposes by the industry. Nevertheless, EY reported that the general approach used by GO is reasonable and in line with international practice.

As a result of the above adjustments, the value of the brand enhancement intangible benefit increased from €85,440 to €163,760, to be deducted from the total net cost of the USO components. More information on the intangible benefit component is available in Annex 1 to this document.

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

4.1 Feedback Received

The consultation document was published on the MCA's website and the consultation period ran between 2nd and 27th September 2021. The MCA received feedback solely from Melita and would like to thank this respondent for the interest shown in submitting its views.

4.1.1 Payphones

Melita is of the view that the USO funding should exclude expenses for the provision of public payphones due to the increased availability and access of pre-paid services and IP based communications.

The MCA considered this feedback, however, since the 2015 USO Decision applicable for the funding application under review clearly established a required minimum number of payphones as a universal service subject to the population size in each locality, the MCA's position is that the designated undertaking has every right to claim any net costs it incurred in providing this universal service during 2017.

Furthermore, in March 2021, the MCA published an updated version of the Decision on Universal Service Obligations which withdrew the obligation for the provision of public payphones by the USP given that the utilisation of this service had declined substantially over the years, access to emergency services is readily available from mobile phones, other alternative technological solutions are available which have similar functionalities to those of public payphones, and an increasing number of Local Councils were requesting the removal of a number of public payphones due to embellishment of areas, inappropriate use of the payphones (illegal matters), and lack of usage.

4.1.2 Funding Mechanism

In its feedback, Melita also stated that the MCA should adopt the same procedure and source the current claim from public funds. Melita does not agree with a cost-sharing mechanism, even more so since the funding mechanism operates retrospectively, given that financial planning and annual budgets cater for expenses in advance. Melita also stated that applying the cost sharing mechanism retrospectively would be contrary to the principles of transparency, least market distortion, non-discrimination and proportionality as established in Article 90 of Directive (EU) 2018/1972.

The Authority reiterates that, as in the case of previous USO claims, it will address the source of funding for GO's 2017 USO claim in a separate consultation specifically on the financing of the universal service obligations as also stated in the consultation document and in Section 5 of this Decision Notice.

4.1.3 Costing of the Universal Service Obligations

Melita mentioned that the profits made by the designated undertaking in providing the universal services are to be taken into account and deducted from the compensation.

In accordance with the MCA 2015 USO Decision, where the Authority determines that a universal service obligation may represent an unfair burden, the calculation of the net cost should be based in accordance with the provisions in Part A of the Sixth Schedule in S.L. 399.28[7] as referred to in the proposed decision. The calculation of the net cost should also take into account any market benefits resulting from the provision of the universal service obligation which accrues to the undertaking. As mentioned in Section 3 above, the net cost is calculated as the difference between the net cost for a designated undertaking of operating with the universal service obligations and operating without such obligations. Furthermore, the value of the brand enhancement intangible benefit was included in GO's 2017 USO claim and is being deducted from the net cost of the USO components.

3.6 FINAL ASSESSMENT

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

USO Components	Audited net cost €
Payphones	(50,023)
Social tariffs	(182,629)
Comprehensive electronic directory	(7,766)
Intangible benefits:	
- Brand Enhancement	163,760
Total	(76,659)

GO, as the undertaking designated to provide each of the USOs listed in the table above, is to be compensated for the net costs incurred for the provision of these USOs during the financial year 2017 which amounted to a total of €76,659.

[7] These provisions were substantively retained in Part A of the Seventh Schedule of S.L. 399.48 which became effective from 1st October 2021 after S.L. 399.28 was repealed by LN379 of 2021 and replaced by S.L. 399.48.

5. SOURCE OF FUNDING

In the assessment process undertaken by EY it was established that GO, as the USP, has incurred an element of unfair burden for the provision of the public payphones, social tariffs including Telecare and free line rental, and comprehensive electronic directory during financial year 2017.

In accordance with the provisions of regulation 31 (1) of S.L. 399.28 as referred to in the proposed decision (which were substantively retained in the provisions in regulation 77 (1) of S.L. 399.48 that became effective as from 1 October 2021 after S.L. 399.28 was repealed by LN379 of 2021 and replaced by S.L. 399.48), when the Authority establishes that a designated undertaking has suffered an unfair burden to provide a universal service, it is to be compensated by one of 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.

More detail on the allocation of the source of funding on GO's claim for the financial year 2017 would be dealt with by means of a separate consultation document earmarked for publishing following the publication of this decision.

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 2017

Calculation Accuracy Phase

Abridged version of full report

June 2021

Building a better working world

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

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Contents

Introduction and background information

Introduction (1)

This report relates to the review of GO plc's ("GO") application for funding of the net cost claimed to have been incurred to provide Universal Service Obligations ("USO") during 2017.

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

As the entity responsible for the regulation of the local electronic communications sector, the MCA is required to decide which electronic communications services are to be classified as universal services, and which undertaking/s are designated as the USP. The MCA Decision determining the USOs applicable for the year under review (2017) was published by the MCA in May 2015 (MCA-OPS/tf/15-2265) entitled "Universal Service Obligations on Electronic Communication Services" Decision and Response to Consultation which came into effect as from 1st July 2015. Any future reference to "MCA USO Decision" in this Report is made with respect to this 2015 Decision. The USO revisions introduced by the MCA USO Decision are explained in further detail on the next page.

Under the MCA USO Decision, GO is designated as the USP for a number of USOs, including:

- the provision of access at a fixed location and functional internet access in cases of market failure,
- comprehensive electronic directory,
- public payphones,
- specific measures for disabled users,
- reduced tariff options, and
- measures ensuring users can control expenditure.

Introduction (2)

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

- In 2012, GO submitted its first written request to the MCA for the funding of the net cost claimed to have been incurred to provide USO for the year 2010. GO has since then submitted a USO claim request annually, including the claim for the year 2017 being reviewed in this Report. The MCA has commissioned EY to review the claims before publishing its final decision with the final refund entitlement.

- GO’s claim for the year 2017 was submitted on 04 December 2018, with a funding request of €321,596. Following clarifications requested during this Calculation Accuracy Phase review, GO submitted a revised USO Model which would result in a net USO cost of €154,979. This revised claim submission is the subject of this review.

- The scope of this engagement is to assist the MCA in its assessment of this (revised) funding application, and to assess whether the evidence provided is sufficient and detailed enough to support this claim.

Scope of work

Scope of our work

In accordance with the contract terms, EY has been requested to assist in the review of GO's USO claim for the year 2017, submitted by GO in December 2018 (and subsequently revised over the course of the review).

The assignment is split into two phases:

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

This report relates to the Calculation Phase only. This Calculation Phase follows on the conclusions of the Reasonability Phase which was finalised in December 2020. An overview of the conclusions of the Reasonability Phase is provided on pgs. 11-12 of this Report.

Use of report

This report provides a summarized overview of the Reasonability 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 2017. 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 Reasonability and Calculation Phase.

Sources of information/ data (1)

Throughout the course of this engagement we have been provided with/ referred to a number of information sources/ documents:

Reasoning Phase

For the Reasoning Phase we have been provided with the following information and documents dated 04 December 2018 and received by EY in July 2020:

- Covering e-mail related to GO's 2017 USO funding application
- GO USO funding request 2017 - summary ("USO Methodology and Results")
- GO Cost Model to evaluate the 2017 USO ("USO Model")

Calculation Accuracy Phase

Besides the above described information sources available from the Reasonability Phase, further information and clarifications on the claim components have been requested from GO during the Calculation Phase review. Information requests were sent on 4th March 2021, to which GO provided replies on 26th March 2021 with an adjusted USO Model calculations, including updating of fixed line origination and termination rates, standard line rental, social tariff and comprehensive electronic directory components (any future reference to USO Model refers to this revised model). The revised claim which is subject to the review presented in this Report would result in a net USO cost of €154,979.

In the Calculation Accuracy phase review, reference has also been made to a confirmation from the Ministry for the Family, Children's Rights and Social Solidarity (Ministry responsible for social benefits and telecare services) on the number of subscribers that benefitted from social tariffs over 2017, obtained by the MCA on 15th March 2021.

Sources of information/ data (2)

During the compilation of this Report, reference has and will be made to information, discussions, principles and decisions related to previous USO claims. The MCA has requested the approval of GO to make use 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. The MCA decisions in connection with these previous USO claims are:

- MCA-OPS/tf/14-2006 related to the 2010 claim
- MCA-OPS/tf/15-2450 related to the 2012 claim
- MCA-OPS/tf/16-2719 related to the 2013 claim
- MCA/D/18-3076 related to the 2014 claim
- MCA/D/19-3540 related to the 2015 claim
- MCA-OPS/tf/20-3991 related to the 2016 claim (“2016 USO Claim Decision Notice”)

The key conclusions of the above decisions (including those impacting the calculation of USO net costs based on the USOs delineated in the applicable MCA USO Decision and EC Directive) are referred to in this Report’s respective claim component reviews.

Overview of GO's 2017 USO claim

- GO's 2017 claim includes the same components included in the preceding claim for the year 2016. The net USO cost for 2017 has been calculated on the basis of the following cost-benefit components: *Payphones*, *Social Tariffs*, *Comprehensive Electronic Directory,* less *Intangible Benefits*.
- The table below compares the funding request by USO claim component for the:
  - GO's claim for 2017 as per the latest updated USO Model following clarifications and adjustments during the Calculation Accuracy phase and claim confirmations provided by GO; and
  - The 2017 claim following the conclusions of this Calculation Accuracy phase review. The 'Analysis by component' section of this report documents our review and verifications of the calculations in GO's 2017 USO model.

(in €)	GO's claim as per latest USO Model*	Final review outcome
Payphones	(50,023)	(50,023)
Social tariffs	(182,629)	(182,629)
Comprehensive electronic directory	(7,766)	(7,766)
Intangible benefits	85,440	163,760
Total	**(154,979)**	**(76,659)**

*Revised following clarifications and adjustments by GO during the Calculation Phase.

Reasonability Phase: Conclusions summary (1)

The Reasoning Phase dealt with the following areas:

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

The following tables present the summarised conclusions for each component of the claim from the Reasoning Phase review, based upon GO's claim submission (USO Model dated on 04 December 2018) as at this phase's review. During the Calculation Accuracy Phase further information and clarification questions were requested from GO on USO components.

Component	Initial reasonability assessment
Public payphones	• On the basis of the EC Directive, the 2015 MCA USO Decision and international practice, payphones can form part of the USO claim. • The 2015 MCA USO Decision and previous USO claim decision notices concluded that the claim for public payphones should be based on the optimal number of payphones, and not the existing number of payphones. The parameters for the calculation of the optimal/ minimum number of payphones per locality depends on locality population figures, as established by the 2010 MCA USO Decision (2011 update) and confirmed by the 2015 MCA USO Decision. • GO's 2017 submission has been based on the optimal number of payphones and is considered as reasonable.
Social tariffs	• Based on the EC Directive and the 2015 MCA USO Decision, social tariffs can form part of the USO claim given that they represent a social obligation imposed on GO by the regulator. • In line with previous MCA Decisions, the social tariff computation should be based on standard tariffs to ensure that those funding the social benefits are not burdened by higher cost than "normal" consumers. • GO have based their claim on standard tariffs and the claim for this component is considered as reasonable. During the Calculation Accuracy Phase, the accuracy of the social tariff component calculation will be assessed, and the number of users claimed by GO to have benefited from social tariffs in 2017 cross-checked against figures held by the responsible Ministry.

Reasonability Phase: Conclusions summary (2)

Component	Initial reasonability assessment
Comprehensive Electronic Directory (CED)	• The 2015 MCA USO Decision established that the universal service shall include the provision of a free electronic telephone directory which is web-based and includes an interface that allows smartphone users to look up directory related data. This obligation replaced the obligations for the provision of a printed telephone directory and a telephone directory service (with the exception of telephone service for visually impaired persons). • In connection with the above obligation, GO launched a directory smartphone app in December 2016. The 2017 CED component claims funding for the operating costs of servicing this directory app. • The inclusion of the costs connected to the operation of the smartphone directory app in the USO claim is considered reasonable and appropriate in view of the MCA USO Decision provisions. In the Calculation Accuracy phase, the calculation details will be reviewed to verify the claimed cost components to USO.
Intangible benefits	• 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 have claimed 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 or utilized to advertise. GO also claim that the ubiquity benefit is no longer relevant given the withdrawal of the fixed line access obligation (except for cases of market failure) in the 2015 MCA USO Decision and given that all geographical areas are economically profitable. • The methodology employed by GO for the estimation of this benefit for the 2017 claim is based upon a benchmark comparison with the benefit estimation results of a number of other European USPs. The estimation methodology, inputs and calculations employed by GO will be further assessed in the Calculation Accuracy phase.

GO's USO claim approach and methodology

GO's approach and methodology (1)

GO has submitted a written request to receive funding for the net costs claimed to have been incurred in providing USO during the year 2017, based on a base methodology developed for GO by a third party.

Cost accounting basis

- The 2017 claim follows the same approach used in previous claims and 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: IT data warehouse

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 to work out revenue / traffic per subscriber
  - If a service was inactive as at June, GO identified the earliest service active between 30 March and 31 December.
  - Technical data (tel. number/ active lines/ local loop length)

GO's approach and methodology (2)

Data approximation (cont.)

- For the first 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 previously) as an approximation.

- Given the nature of the exercise and the various data sources used, it is inevitably difficult to reconcile revenues and costs included in the USO claim to the audited regulatory accounts and statutory financial statements. Where possible, however, reconciliations have been sought (against regulatory account workings extracts included in USO Model) to verify the accuracy of the claim's cost calculations.

Efficiency factor

- When asked whether an efficiency factor has been included in the USO calculations, GO confirmed that similar to previous claims, no efficiency factor has been included in the 2017 claim. In previous claims GO had explained that "GO is subject to intense competition in the markets that encompass USO and as such cannot afford not to be efficient. In fact, in the past years it shed a considerable number of employees and has revised many of its procedures and operational practices. All these have for a time been at levels commensurate to a company subject to competition in the market".
  - Had an efficiency factor been included, this could have possibly resulted in a lower cost and a lower claim, particularly in the payphones components.
  - Furthermore, certain revenues and costs are estimated on the basis of traffic volumes. In particular, interconnection costs included in the USO Model are based on traffic volume data, and origination/ termination rates for 2017 as set by the MCA decision notice MCA/D/12-1420 on the new Bottom-up Cost Model (BUCM2) for fixed networks and fixed interconnection prices, dated 21 December 2012. The origination and termination rates set by the decision are based on long-run incremental cost and are modelled on "the services of a hypothetical efficient operator with a view to set efficient regulated wholesale charges for fixed interconnection".

GO's approach and methodology (3)

Return on Capital Employed (ROCE)

- The calculation includes a Return on Capital Employed ("ROCE"), which is based on the MCA's Decision (MCA/D/12-1416, dated 20 November 2012) on the Weighted Average Cost of Capital ("WACC") of 9.65% for regulatory accounting periods ending on or after 31 December 2012. There have been no revisions to this rate.

Access deficit

- The USO Model and the formal claim put forward by GO do not take into account access deficit, in line with MCA Decisions on previous claims.

Analysis by component

Public payphones

Public payphones (1)
GO's methodology

- The ***public payphones*** claim relates to the net cost of serving the territory with public payphones.
- GO's payphone net USO cost calculation follows the same approach/methodology and data sources adopted in past years' claims. The public payphone cost estimation adopted by GO derives a net margin based on revenues less costs (as per below table), with a claim being made on an individual payphone basis.

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	• 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, was obtained from the regulatory accounts model.
Traffic costs	• Traffic volumes (on-net, outgoing international, fixed-to-mobile, and off-net) x unitary cost/minute. • Traffic volumes were extracted from billing data. • Unitary costs/ minute have been based on origination and termination rates, and the commercial cost/ minute. • The commercial cost has been derived from the regulatory accounts model.

Direct OPEX	• Equal allocation of operating costs (derived from actual invoices), including:
	    • Electricity
	    • Hire of premises
	    • R&M – Cardphones
	    • Sub-contracting costs
	    • Metering cost
	    • Payphone share of corporate costs

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 • Cost of capital of 9.65% (previously discussed)

Public payphones (2)
GO's methodology

- The 2015 MCA USO Decision confirmed that the public payphones claim should not be based on the total number of existing payphones but rather on the minimum number of payphones per locality based on the parameters established in the 2010 MCA USO Decision (based upon locality population).
- GO's USO Model presents the net payphone cost based on both the total existing number of payphones, and the optimal number of payphones as set by the minimum requirements as established in the MCA USO Decision. GO's funding request for 2017 is based on the optimal number of payphones, in line with the MCA USO Decision and previous MCA USO Decision Notices. The optimal number of payphones as calculated by GO's USO Model based on the minimum payphone requirement set by the MCA USO Decision, is of 184 payphones across the Maltese islands.
- Based on GO's USO Model, 181 payphones (out of the 184 minimum payphone requirement) across all localities generate a negative margin, leading to a net cost of €50,023.

Public payphones (3)
Review Work

Review Work

During Calculation Accuracy phase of this review, clarifications have been requested from GO regarding certain inputs underlying the 2017 claim calculation.

In reply to these queries, GO have applied revisions to the Model's origination/ termination rates leading to the payphone net cost of €50,023 being claimed in the final USO Model. The payphone calculation revisions applied in this process by GO are presented below, together with the Calculation Accuracy phase review work/adjustments performed upon the final USO Model submitted by GO.

Origination and Termination rates

- In reply to queries on the origination and termination rates utilised for the calculation of the payphone technical costs, GO have revised these rates to be aligned with those applicable for 2017 as set in the MCA Decision on the Bottom-up Cost Model for Fixed Networks and Fixed Interconnection Prices (MCA/D/12-1420). In our review, the origination and termination rates applied in GO's revised USO Model have been verified with the respective applicable rates.

Sub-contracting costs (OPEX)

- As in the 2016 claim, GO's payphone net USO cost calculation includes sub-contracting costs under the payphone operating expenditure. When during the prior year review GO were requested to clarify the nature of this cost component, they explained that as from 2016 GO started shifting its maintenance of lines onto sub-contractors. The sub-contracting costs being included as direct payphone costs in the USO claim are thus related to this subcontracting shift
  - As concluded in the 2016 MCA USO Decision the inclusion of such sub-contracting costs can be considered in effect direct payphone costs. In the absence of sub-contracting, the associated costs would have otherwise been reflected under the direct payroll cost component.

Public payphones (4)
Review Work and Conclusion

<u>Electricity costs (OPEX)</u>

- It is noted that GO's USO Model records a lower level of operating electricity costs than in the previous 2016 claim. This is consistent with the observed reduction in the number of operative payphones.

<u>LAN costs (line costs).</u>

- During the review, GO were requested to provide reasons/ explanations for observed increases in LAN costs being reported in the 2017 USO Model compared to the prior year claim. In this regard, GO have outlined the associated technical and operation factors driving these cost increases.

Conclusion

- In line with previous MCA Decision Notices, GO's calculation of the public payphones component is based on the optimal number of payphones as calculated through the 2010 Decision Notice's mechanism.
- On the basis of our review work described above, the public payphone claim results in a total net cost of €50,023.

Analysis by component
Social tariffs

Social tariffs (1)
GO's methodology

- Under its current USP status, GO provides social tariff options to a number of users identified by the responsible Ministry. In turn, GO can claim back the net cost of providing such services, similar to what is done in a number of other European countries.
- As the designated USP, GO provides two types of social services free of charge to the end user: free line rental and free Telecare service.
- Following calculation clarification requests sent during the Calculation Accuracy phase, GO have revised the subscriber numbers included in the USO Model calculations. As a result, the social tariff claim component decreased from €327,812 (as per original claim for 2017) to €182,629 (following clarifications and adjustments during the Calculation Accuracy phase).
- The users eligible for such social tariffs are identified by the Ministry for the Family, Children's Rights and Social Solidarity, which we understand provides GO with a monthly update of the subscribers entitled for such services. As part of the review, the MCA have obtained the Ministry's confirmation on the number of subscribers that benefitted from social tariffs during 2017 which were found to be aligned with those recorded in GO's (final) USO Model.
- The cost of social tariffs has been computed as the difference between the discounted rate, which in this case is free, and the standard line retail price. This calculation is aligned with MCA's previous USO claim decisions that the Social Tariffs claim should be based on standard line rental charges (i.e. excluding charge for access deficit).

Social tariffs (2)
GO's methodology and conclusion

- The table across summarises the updated (with adjusted free line subscriber numbers) social tariffs calculation for 2017, totalling €182,629 (i.e. €132,941 for reduced tariff options; and €49,689 for specific disability measures)

.

Conclusion

- Following Calculation Accuracy clarification requests, GO have adjusted downwards the free line rental subscriber numbers included in the USO Model calculations. As a result the claimed social tariff cost decreased from €327,812 to €182,629.
- The subscriber numbers recorded in GO's Model are aligned with figures for eligible subscribers obtained by the MCA from the Ministry.
- The social tariff component has been calculated by GO as the difference between the current retail tariffs and the amount actually charged to subscribers, which in this case is free. This net cost calculation, based on the current net cost scenario, is aligned with the MCA's decisions of previous claims that access deficit should not form part of the USO claim.
- The social tariff claim, on the basis of current costs and subscriber numbers, results in a net cost of €182,629.

GO's claim	Reduced Tariff Options for Users	Specific Measures for Disabled Users
Users		
DUO PACK		
Free Telecare	n/a	42
HOME PACK		
Charged Rent and Free Telecare	n/a	34
Free Telecare	n/a	217
NO PACK		
Charged Rent and Free Telecare	n/a	1,027
Free Rent and Charged Telecare	381	n/a
Free Rent and Free Telecare	624	624
Free Rent No Telecare	738	n/a
Total number of users	**1,743**	**1,944**
Annual cost per user Line rental at €6.356 per user per month Telecare at €2.13 per user per month	€76.27	€25.56
Total annual cost	**€132,941**	**€49,689**

Analysis by component

Comprehensive electronic directory (CED)

Comprehensive electronic directory (1)
GO’s methodology

- This USO claim component relates to the net cost of providing this service to all end-users at an affordable rate. Article 24 of the Regulations establishes that the designated USP shall ensure that a comprehensive directory of subscribers to publicly available telephony services is made available to all end-users in a form approved by the MCA, and is updated on a regular basis at least once a year.
- In relation to the above obligation, the 2015 MCA USO Decision concluded that the universal service shall include the provision of a comprehensive electronic directory (“CED”) which is web-based and includes an interface that caters specifically for smartphone-based users. This directory is to be free of charge and updated in real-time whenever technically possible.

  In relation to the above obligation, GO has launched a free telephone directory app in December 2016.
- In view of the above USO revisions, as from the 2016 claim GO’s USO Model includes the costs incurred by GO in the provision of directory services through the launched smartphone app.
- GO were requested to update the CED calculations submitted in their original cost model (with a calculated cost of €29,128) to be in line with the review conclusions of the 2016 USO Claim Decision Notice (MCA-OPS/tf/20-3991). In this regard, it is noted that GO’s original claim for 2017 reached the MCA prior to the publication of the 2016 decision. GO has accordingly provided an updated model with a revised CED cost calculation of €7,766. The related cost components claimed by GO in the updated model are summarised in the adjacent table.

Comprehensive electronic directory (directory app) – Operating Expenses
Depreciation
Maintenance agreement
Cost of capital @ 9.65% WACC

Comprehensive electronic directory (2)
Review work

The net cost calculations in GO's USO Model were assessed with the review adjustments and conclusions made in the 2016 USO Claim Decision Notice, and found to be consistent. The rest of this section presents an overview of the operating expenditures making up GO's 2017 CED claim, in relation to the information provided by GO and the review conclusions of the 2016 USO Claim Decision Notice.

Depreciation
Cost of Capital

- Depreciation cost and cost of capital have been calculated on the basis of the capital expenditure costs reported by GO in the USO Model. In view that these costs had been incurred in 2016 prior to the smartphone app launch (launched in December 2016), the costs reported in the 2017 USO Model are the same costs which had been reported in the 2016 Model. These relate to:
    - The charges invoiced by a third party software development company for the works on the design and development of the smartphone app. GO have provided a breakdown of the invoice records making up this cost component.
    - GO's internal human resources cost in connection with the development of the CED application.

- The depreciation on capital expenditure is being calculated on the basis of a straight line depreciation method with an estimated useful life for the app of 5 years, starting from the year 2016 (year of app launch). Given GO's applied accounting policy of taking a full-year depreciation in the first year of acquisition (2016), no capital depreciation would have to be charged on the final year of the capital's estimated useful life (Jan-Nov 2021).

Comprehensive electronic directory (3)
Review work and conclusion

Depreciation
Cost of Capital

- Cost of capital has been estimated by GO based on the application 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.
  - In line with the 2016 MCA USO Decision, the rate is applied upon the average capital employed over the year, which has been calculated based on the mean of the assets' net book values as at beginning and end of 2017.
  - The approach adopted in the 2017 USO Model is consistent with the MCA Guidance on the accounting methodologies and treatments to be applied in the preparation of separated accounts for telecommunications sectors in Malta ("Guidance on Accounting Methodologies for Regulatory Accounting Purposes", dated March 2003). The Guidance outlines that the average capital employed during any period should be referred to for cost of capital calculations.
  - The Guidance also specifies that there must be consistency between the measure of capital employed on which the cost of capital is based and the measure of capital employed reported in the regulatory accounts. It is noted that the claim's approach is consistent with GO's regulatory accounts' reporting, where 'mean capital employed' is used for financial reporting purposes. The mean is calculated as the mathematical average of the start and end values of the financial reporting period.

Maintenance agreement

- An invoice record breakdown provided by GO shows that this claimed cost component relates to the costs charged by the third party app developer for the maintenance of the app.

Conclusion

- Based upon the above described review procedures and adjustments, the CED cost should amount to €7,766.

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.

- In their USO claim, GO provided an estimate for the ***brand enhancement benefit*** which is 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.
  - As per submitted USO Methodology and Results, in estimating this benefit for 2017, GO have referred to and benchmarked against the benefit quantification results of other European USPs. The approach and methodology utilised by GO, leading to a claimed intangible benefit of €85,440 are reviewed over the following pages.

- Other intangible benefits which were not considered by GO include:
  - ***Life cycle***: evaluation in terms of the evolution of the average telephone bill, and the increase of the telephone bill through the evolution of the familial structure.
  - ***Marketing/ access to customers’ database***: benefit associated with the savings in acquisition costs and operational costs of a customer’s database.
  - ***Ubiquity benefit:*** benefits associated with the extended network of customers gained by the USP as a result of its USOs, for example comparatively lower costs (compared to competitors) in extending its customer network or profit gains as a result of customer moves from uneconomic to economic geographical areas. In the 2016 claim review process GO have argued that such benefit is no longer relevant from 2016 given the withdrawal of the fixed line access obligation (except in the case of market failure) in the 2015 MCA USO Decision and given that all geographical areas are economically profitable. On the basis of the obligations set out by the 2015 MCA USO Decision and observed international practice, the 2016 USO Claim Decision Notice had deemed the exclusion of the ubiquity benefit from the USO claim to be reasonable.

Intangible benefits (2)
GO's methodology and review work

Brand enhancement

- The brand enhancement intangible benefit relates to any improvement in the USP brand image that results from the provision of USOs. There is no standard methodology to estimate this benefit, with varying approaches being used across different jurisdictions.
- The 2017 brand enhancement benefit calculation in GO's claim submission is based upon a benchmark comparison with the benefit estimation rates (relative/ percentage rate being used to take into account USP size) that resulted for a number of other European USPs (including UK). Utilising this approach GO estimate a brand enhancement benefit of €85,440 for the year 2017.

Review work

- In our review procedures, the following adjustments to GO's benefit calculation were deemed appropriate:
  - In their calculation GO apply a discount factor based on the peer group's resulting proportion of brand enhancement benefit to total intangible benefits. It is noted that this solely represents an outcome figure - for GO it's 100% since it's the only estimated intangible benefit. This discount factor should, thus, not feature as a calculation input and was excluded in the review calculations.
  - As in other international benchmarking exercises of this form, the extent to which the subject entity and the market environment in which it operates are comparable to those of the benchmark group it is difficult to evaluate, and hence the final rate selection remains a subjective element. In this regard, GO's submission does not provide a clear explanation of the method/ approach used in the selection of the final estimation rate within the range of benchmark rates. It is deemed that a more standard, objective and arithmetically-based approach can be followed by utilising the mean value across all benchmarks**.** The calculation of mean values is based on all underlying data points, and thus with this approach the outcomes from all European USP estimations are taken into account in the review calculation.

Intangible benefits (3)
Conclusion

Conclusion

- We note that the calculation of intangible benefits is not an exact science and therefore there is no one defined estimation methodology or correct answer.
- Following the calculation review adjustments described over the previous page, the value of the brand enhancement benefit to be deducted from the cost of the other components is estimated at **€163,760.**

Summary of conclusions

Calculation Phase: summary of conclusions

Based on the review assessments contained in this report, the following table summaries the conclusions of the Calculation Accuracy Phase. Following review adjustments, the resulting net USO cost amounts to **€76,659.**

Component	€	Summary of review work/conclusion
Payphones	(50,023)	As per GO's latest updated USO Model. The origination and termination rates used in GO's USO Model are aligned with those applicable for 2017 as set in the MCA Decision on the Bottom-up Cost Model for Fixed Networks and Fixed Interconnection Prices (MCA/D/12-1420). In line with previous MCA Decision Notices, GO's calculation of the public payphones component is based on the optimal number of payphones as calculated through the 2010 Decision Notice's mechanism.
Social tariffs	(182,629)	As per GO's latest updated USO Model. Social tariff subscriber numbers reported in GO's latest updated USO Model have been verified with a confirmation of eligible users for 2017 obtained by the MCA from the relevant Ministry.
Comprehensive electronic directory (CED)	(7,766)	As per GO's latest updated USO Model. The net cost components and calculations included in the GO's latest updated 2017 USO Model are consistent with the review conclusions established in the 2016 USO Claim Decision Notice.
Brand enhancement benefit	163,760	The following calculation review observations and adjustments have been made upon GO's benefit calculation (claimed benefit of €85,440): • In their calculation GO inaccurately apply a discount factor based on the peer group's resulting proportion of brand enhancement benefit to total intangible benefits. This discount factor should not feature as a calculation input and has been excluded in the reviewed/ adjusted calculation. • GO's submission does not provide a clear explanation of the method/ approach used in the selection of the final estimation rate within the range of benchmark rates. A more standard, objective and arithmetically-based approach has been considered in the adjusted review calculations by utilising the mean value across all benchmark rates.
Total	**(76,659)**	

List of references

List of References (1)

- Commission for Communications Regulation (2011), *Decision on the Costing of universal service obligations: Principles and Methodologies – Report on Consultation and Decision*
- Commission for Communications Regulation (2012), *The provision of telephony services under Universal Service Obligations - Scope and Designation*
- European Commission (1996), *Assessment criteria for national schemes for the costing and financing of universal service in telecommunications and guidelines for the Member States on operation of such schemes*
- European Commission (2002), *Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive)*
- Malta Communications Authority (2003), *Universal Telecommunications Services – Report on Consultation and Decision*
- Malta Communications Authority (2011), *Universal Service obligations on electronic communication services - Report on Consultation and Decision*
- Malta Communications Authority (2013), *ECS WACC Review 2013 - Statement on revised WACC rates*
- Malta Communications Authority (2014), *Review of GO plc's application for funding of the net cost claimed to have been incurred to provide universal service obligations during 2010*, MCA-OPS/tf/14-2006
- Malta Communications Authority (2015), *Universal service obligations on electric communication services, Decision and Response to Consultation,* MCA-OPS/tf/15-2265

List of References (2)

- Malta Communications Authority (2016), *Review of GO plc's application for funding of the net cost claimed to have been incurred to provide universal service obligations during 2012*, MCA-OPS/tf/15-2450
- Malta Communications Authority (2016), *Review of GO plc's application for funding of the net cost claimed to have been incurred to provide universal service obligations during 2013*, MCA-OPS/tf/16-2719
- Malta Communications Authority (2018), *Review of GO plc's application for funding of the net cost claimed to have been incurred to provide universal service obligations during 2014*, MCA/D/18-3076
- Malta Communications Authority (2018), *Review of GO plc's application for funding of the net cost claimed to have been incurred to provide universal service obligations during 2015*, MCA/D/19-3540
- Malta Communications Authority (2020), *Review of GO plc's application for funding of the net cost claimed to have been incurred to provide universal service obligations during 2016*, MCA-OPS/tf/20-3991