



## **Review of GO plc's application for funding of the net cost claimed to have been incurred to provide universal service obligations during 2016**

### **Decision Notice**

---

Published: 5<sup>th</sup> October 2020

Internal Reference: MCA-OPS/tf/20-3991

**Malta Communications Authority**  
Valletta Waterfront,  
Pinto Wharf, Floriana,  
FRN 1913, Malta

**T** + 356 2133 6840  
**F** + 356 2133 6846

**E** [info@mca.org.mt](mailto:info@mca.org.mt)  
**W** [www.mca.org.mt](http://www.mca.org.mt)

## EXECUTIVE SUMMARY

---

In August 2020, the Malta Communications Authority (hereafter "MCA" or the "Authority") published a consultation and proposed decision on the review of GO plc's (hereafter "GO") application for funding of the net cost claimed to be incurred for providing universal service obligations (hereafter the "USO") during financial year 2016<sup>1</sup>.

In accordance with national law<sup>2</sup>, and the MCA Decision of 2015 entitled "*Decision on Universal Service Obligations on Electronic Communications Services*" (hereafter "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 December 2017, GO submitted its funding request for the unfair burden it claims it suffered during 2016.

The MCA commissioned 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. Furthermore an intangible benefit was also included in the claim 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 2016 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 €66,438. 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 from the 25<sup>th</sup> August 2020 until 2<sup>nd</sup> October 2020. The MCA did not receive any feedback on its consultation and proposed decision.

---

<sup>1</sup> GO's financial year was from 1<sup>st</sup> January to 31<sup>st</sup> December 2016.

<sup>2</sup> Electronic Communications Networks and Services (General) Regulations, (S.L 399.28 of the Laws of Malta) regulation 30.

## CONTENTS

---

EXECUTIVE SUMMARY .....	2
CONTENTS .....	3
1. INTRODUCTION & BACKGROUND .....	4
2. LEGAL BASIS .....	7
3. ASSESSMENT AND AUDIT OF NET COST .....	8
4. SOURCE OF FUNDING .....	15

## 1. INTRODUCTION & BACKGROUND

---

The Electronic Communications (Regulation) Act (Chapter 399 of the Laws of Malta) (hereafter 'Cap. 399') specifies that one of the objectives of the Authority is to promote the interests and rights of users by ensuring that all users have access to universal services.<sup>3</sup> Universal services are defined as a minimum set of services of specified quality which are made available to all end-users irrespective of their geographical location in the light of specific national conditions and at an affordable price.<sup>4</sup>

In April 2010, the Authority published a USO Decision, which was updated in May 2015 establishing 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 two or more undertakings to provide different elements of universal services and to cover different parts of the Maltese islands, and that in default of an expression of interest from third parties, or if the established criteria 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 service/s in question.

During 2016, 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;

**Directory enquiry services and directories:**

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;

---

<sup>3</sup> Cap. 399, article 4(1)(c)(i)

<sup>4</sup> SL 399.28, regulation 21(1)

**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 Electronic Communications Networks and Services (General) Regulations, SL 399.28 of the Laws of Malta (hereafter the "Regulations") and in the USO Decision, an undertaking designated to provide universal services has the right to apply to receive funds within a time period of eleven months following the end of the previous financial year for any net costs accrued in meeting these obligations. Such a request must be accompanied by supporting documentation to enable the MCA determine whether the provision of the universal service/s resulted in an unfair burden on the designated undertaking.<sup>5</sup>

On the 1st December 2017, GO submitted an application for the USO funding of the net costs it claimed to have incurred in providing universal services during 2016, 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 2016 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.

---

<sup>5</sup> SL 399.28, regulation 30.

During the Reasoning Phase, following a few questions on some elements of the claimed USO components, in October 2019, GO submitted a revised cost model including a few updates following some clarification requests. EY finalised the Reasoning Phase in December 2019 and the findings were included in a Report which was sent to GO. The findings emanating from this review phase can be found under the section “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. Additional information and clarification requests were made to GO, and as a result a revised cost model was submitted to the MCA in February of 2020. EY finalised the Calculation Accuracy Phase in June 2020.

The MCA requested EY to submit an abridged version of the review report which is sufficient for the purpose of making the results of the cost calculation and conclusions of the audit publicly available, without revealing any financial information of a commercially sensitive nature. This report is being made available in Annex 1 of this document. A summary of the findings emanating from this Report can also be found under section 3 “Assessment and Audit of the Net Cost” found below in this document.

## 2. LEGAL BASIS

---

The fundamental aspects of costing and financing of universal services are outlined in the Regulations and in the Directive 2002/22/EC (as amended) of the European Parliament and of the Council (hereafter the "USO Directive").

Regulation 30 of the Regulations stipulates that a universal service provider designated to provide all or parts of the universal service obligations outlined under regulations 21 to 28 of the Regulations, may submit a written request to the Authority to fund the net costs it claims to have incurred in providing the universal service/s concerned. Such a request must be accompanied with detailed and supporting information to enable the Authority to determine whether the claim represents an unfair burden to the USP<sup>6</sup>.

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<sup>7</sup>. 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 stipulates that the Authority shall compensate the designated undertaking from public funds with the approval of the Minister responsible for finance and, or from sharing the net cost between the providers of the electronic communications networks and, 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.

---

<sup>6</sup> SL399.28, regulation 30 (1) and (2).

<sup>7</sup> SL399.28, regulation 30 (4) and (7).

### 3. ASSESSMENT AND AUDIT OF NET COST

---

As mentioned earlier, the Authority commissioned EY to evaluate the reasoning behind GO's claim and to audit and verify the various calculations of the net cost GO claimed it had incurred during 2016 in fulfilling its obligations and providing universal services on electronic communications services outside normal commercial conditions. The net cost is calculated as the difference between the cost a designated undertaking would incur when operating with universal service obligations and that when operating without such obligations.<sup>8</sup> 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 2016*" is available in Annex 1 of this document.

For the financial year 2016, 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" which is based on actual line rental charged to their subscribers. GO also included a second scenario – the "Current cost after rebalancing" - which was included in some previous USO claims based on a higher line rental tariff to cover the claimed line rental cost and return on capital. Nevertheless, GO made its claim request in line with MCA's previous decisions on USO funding claim on the "current net cost" scenario totalling €186,240. Following a number of clarifications that took place during the Reasonability Phase and the Calculation Accuracy Phase, in February 2020, GO submitted a revised cost model totalling €91,470.

GO based the 2016 USO claim on the same cost model developed for its previous USO claims. For the first time following the revised MCA USO Decision in 2015, GO claimed for the provision of a Comprehensive Electronic Directory services which includes the development of a web-based interface for smart phone users which is provided free of charge to the end-users.

As in previous USO claims, GO's 2016 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

---

<sup>8</sup> SL 399.28, the Sixth Schedule thereto.



clarifications on a number of items identified in the cost model, GO also submitted an updated version of the cost model which was analysed by EY during the Calculation Accuracy Phase. Supplementary questions were sent to GO during the review work for clarifications and justification purposes and as a result GO sent an updated cost model. Changes were made in figures in relation to payphones and brand enhancement intangible benefit. Further detail on each component is provided in Section 3.1 below and Annex 1.

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

### 3.1 PAYPHONES

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

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

The number of payphones around Malta and Gozo during 2016 amounted to a total of 485, out of which 456 were according to GO unprofitable. Taking into account the minimum number of payphones requirement set by the MCA USO Decision, GO was obliged to provide 184 payphones, out of which 182 were reported by GO to be unprofitable.

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

During the Reasonability phase, GO were requested to review the repairs and maintenance costs in line with the calculation basis adopted in the claim of the previous year. GO accordingly reviewed the cost model leading to a reduction in the claimed costs. In the Reasonability Phase report, EY confirmed that on the basis of the USO Directive and of international practice, payphones could form part of the USO claim.

During the Calculation Accuracy Phase, further clarifications were sought from GO on the revised cost recorded under the repairs and maintenance cost element. GO clarified that besides the direct payroll costs, the claim also included indirect attributable costs. In line with previous claim reviews, it is only the direct cost that should form part of the funding request. In view of the adjustment made to the payphone repairs and maintenance costs, a proportionate adjustment is made to the 'Share of corporate costs' included in the payphone USO Model calculations.

Other cost elements were also reviewed during the Calculation Accuracy Phase, namely those relating to sub-contracting costs and to electricity costs. The sub-contracting cost was included in the cost model as part of the payphone operating expenditures. GO were requested to clarify this cost component since it was not included in previous claims (except for the first claim).

GO explained that in 2016 it started to shift the maintenance of lines to sub-contractors and EY concluded that such costs should in effect be treated as direct payphone costs. Due to an increase in electricity costs, GO were also requested to provide further justification on the reasoning used why these operating electricity costs are included in the USO Model. GO submitted further detailed information on the electricity cost component. EY reviewed the calculation accuracy of the work. EY concluded that for an accurate estimation of electricity costs, the same approach needs to be consistently applied in future claims.

During the process of the review, some other data inaccuracies were identified, and the calculation was also adjusted to source the correct net margin for each unprofitable payphone.

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 2015 USO Decision, and the net cost of public payphones has been adjusted to €61,559. 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 eligible end-users. As specified in the 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 Government department.

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

As in previous years GO claimed for two types of social tariffs which were provided free of charge during 2016, namely the *Telecare* service and the free line rental, benefiting 2,006 and 1,831 subscribers respectively. During the Calculation Accuracy Phase, the number of beneficiaries eligible for the social services were confirmed by the responsible Ministry which provides GO continuous updates of the subscribers entitled for such services.

Following the Calculation Accuracy Phase, it was concluded that the claim on social tariffs based on the current net cost scenario amounting to a net cost of €51,273 for specific measures to disabled end-users, and of €130,342 for reduced tariff options, totalling to a net-cost of €181,616 was justified. More information on this USO component is available in Annex 1 of this document.

### 3.3 COMPREHENSIVE ELECTRONIC DIRECTORY

The universal service obligation for the provision of a comprehensive electronic directory was included in the revised MCA USO decision published in 2015 and the designated undertaking was also required to make available an interface that caters for smart phone users. GO decided to develop a smart-phone mobile application free of charge to the end-users to meet its obligations, and this was launched in December 2016. To this effect, for the first time GO included in their claim the net cost which it submitted it had incurred for the provision of the smart phone application.

Following the Reasonability phase, EY concluded that the inclusion of the costs connected to the mobile directory app in the USO claim was reasonable and appropriate in view of the MCA USO Decision. It was concluded that further calculation details were required from GO especially since this type of service was being included for the first time in GO's claim.

During the Calculation Accuracy Phase, GO were requested to provide detailed information on each cost element in order to analyse the methodology used, namely: updating of directory, and software development and maintenance agreement. It was observed that 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 directory enquiry service, access to their subscribers' databases in order to be in a position to provide an updated comprehensive telephone directory enquiry service to all end-users. Since this is an automated 'dipping system' there should be no costs for GO associated with the updating of other operators' customers. As in previous claim reviews, the sharing of subscribers information between operators falls outside the scope of USO and any costs or incomes 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.' 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 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 view of the above, it transpires that the 'Updating of directory' costs included in GO's 2016 claim are costs which are not specifically attributable to the comprehensive electronic directory USO, and hence should not form part of the claim.

The cost component of the maintenance agreement involves the maintenance of the mobile application by a third party developer and its cost included in the claim was apportioned correctly.

During the review work, it was observed that whilst the cost of capital has been estimated by GO based on the MCA's Decision (MCA/D/12-1416 dated 20 November 2012) on the Weighted Average Cost of Capital ("WACC") at 9.65%, EY had to re-calculate the capital employed based on the mean net book values as at the beginning and end of 2016 so as to be in accordance with the MCA Guidance on Accounting Methodologies for Regulatory Accounting Purposes.

As a result of the above adjustments, EY concluded that the net cost for the comprehensive electronic directory amounted to €6,991 a substantial decrease from GO's claim of €26,208. More information on this USO component is available in Annex 1 of this document.

### 3.4 INTANGIBLE BENEFITS

In accordance with Regulation 30 and with the Sixth Schedule of the Regulations, in its USO claim for funding GO included intangible benefits that arise from the provision of the universal services and

deducted from the net costs<sup>9</sup>. In its claim, GO included the “brand enhancement” element as a component of intangible benefits, which is being defined as the enhancement of the brand of the universal service provider by offering universal services, and the influence on end-users' perception that might impact the overall profitability.

As in the case of previous USO claims, during the Reasonability Phase, EY concluded that justifiable intangible benefits should form part of the USO claim, and that although they are difficult to quantify, international research shows that in other countries intangible benefits are also included. In the final USO cost model submitted by GO the brand enhancement benefit was quantified using the same approach and methodology used in previous USO claims. It is based on the calculation of 20% of the advertising expenditure applied on different media such as TV, fixed telephony and corporate branding. GO provided further breakdown on the advertising campaign related to fixed line whose cost was used for this calculation. Following the review of this claim, EY concluded that based on this methodology the brand enhancement amount stated by GO in its final cost model should remain unchanged at the amount of €183,728.

In previous USO claims, GO included the ubiquity benefits which take into consideration the comparatively lower cost that the USO operator undertakes compared to its competitors when extending its network to new customers. GO as part of the detailed information initially submitted stated that a focus group carried out by it indicated that consumers have no knowledge of the status of GO as the universal service provider. During the Reasonability phase, GO were requested to provide information on how this knowledge was obtained to support its claim. Furthermore, since the ubiquity component relies on the number of estimated consumer moves from unprofitable geographic areas to profitable Main Distribution Frames (hereinafter MDFs) zones, GO were requested to confirm whether the twenty two MDFs zones available on the Maltese islands were profitable. GO confirmed that in 2016 all MDF zones were considered profitable, and to this effect its exclusion from the 2016 USO claim has been assessed to be reasonable.

Other intangible benefits which were not included in the USO claim, as per previous claims, are the life cycle and the marketing benefits.

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

The value of the intangible benefits amounting to €183,728 for the brand enhancement would be deducted from the total of the USO components. More information on the intangible benefit components is available in Annex 1 in this document.

---

<sup>9</sup> SL 399.28, regulation 30(4).

### 3.5 FEEDBACK ON PROPOSED DECISION

The consultation document was published on MCA's website and on the Government's online public consultations portal hosted by the Ministry for Justice, Equality and Governance. The consultation period ran from the 25<sup>th</sup> August until the 2<sup>nd</sup> October 2020 and no feedback was received from stakeholders. To this effect, the MCA is publishing its decision based on the proposals issued in its consultation document.

### 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	( 61,559)
Social tariffs	(181,616)
Comprehensive electronic directory	( 6,991)
Intangible benefits:	
- Brand Enhancement	183,728
Total	( 66,438)

## 4. SOURCE OF FUNDING

---

In the assessment process undertaken by EY it was established that GO, as the universal service provider, has suffered an unfair burden for the provision of the public payphones, social tariffs including Telecare, free line rental, and comprehensive electronic directory during 2016.

In accordance with regulation 31(1) of the Regulations, 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 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<sup>10</sup>.

More detail on the allocation of the source of funding on GO's claim for the financial year 2016 would be dealt with by means of a separate consultation document earmarked for publishing following the publication of this decision.

---

<sup>10</sup> SL399.28, Regulation 31 (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 2016  
Calculation Accuracy Phase

Abridged version of full report  
4<sup>th</sup> June 2020



# Disclaimer notice

---

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

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

EY does not accept or assume any responsibility in respect of the Report to any readers of the Report, other than the MCA (“Third Parties”). To the fullest extent permitted by law, EY will accept no liability in respect of the Report to any Third Parties. Should any Third Parties choose to rely on the Report, then they do so at their own risk.

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

EY reserves all rights in the Report.

# Contents

---

- ▶ Introduction and background information
  - ▶ Introduction
  - ▶ Scope of work
  - ▶ Sources of information/ data
  - ▶ Overview of GO's 2016 USO claim
  - ▶ Summary of Reasonability Phase conclusions
- ▶ GO's USO claim approach and methodology
- ▶ Analysis by component
  - ▶ Payphones
  - ▶ Social tariffs
  - ▶ Comprehensive electronic directory
  - ▶ Intangible benefits
- ▶ Summary of conclusions
- ▶ List of references

# 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 2016.

The Malta Communications Authority ("MCA"), as the National Regulatory Authority of the electronic communications sector in Malta, is responsible for the regulation of a minimum set of electronic communication services of specified quality which are to be made available to all end-users in the Maltese islands ("universal services"). As per the provisions of EC Directive 2002/22/EC ("EC Directive"), these universal services are to be made available at affordable prices with the objective of promoting social inclusion of electronic communication services. Universal Services Provider/s ("USP") designated by the MCA have 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 (2016) 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 1<sup>st</sup> July 2015. This 2015 Decision updated the USO provisions laid out in the preceding USO Decision published in April 2010 and updated in March 2011. This is the first review for which these provisions in the Decision (any future reference to "MCA USO Decision" in this Report is made with respect to this latest 2015 Decision) apply for the full year. The USO revisions enforced 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 explained on the previous page, the 2015 MCA USO Decision introduced a number of USO revisions which updated the obligations previously in place. Of most relevance to the USO claim under review, the updated decision specifically allows for:

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

In relation to the above obligations it is noted that:

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

# Introduction (3)

---

- ▶ As per the provisions of the EC Directive and the Electronic Communications Networks and Services (General) Regulations (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 operator, 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 2016 being reviewed in this Report. The MCA has commissioned EY to review these claims before publishing its final decision with the final refund entitlement.
- ▶ GO’s claim for the year 2016 was submitted on 01 December 2017, with a funding request of €186,240. Following clarifications and confirmations requested from GO on the applied methodologies and claimed net costs, GO have provided a revised USO Model with a revised total funding request of €91,470. This revised USO Model 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 2016, submitted by GO in December 2017 (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 November 2019. An overview of the conclusions of the Reasonability Phase is provided on pgs. 12-13 of this Report.

## Use of report

This report provides a summarised 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 2016. 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 Phases.

# Sources of information/ data (1)

---

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

## **Reasonability Phase**

For the Reasonability Phase we have been provided with the following information and documents received on 22 August 2019:

- ▶ Covering e-mail related to GO's 2016 USO funding application
- ▶ Evaluation of Universal Service Obligations costs in Malta in 2016: Methodology and Results ("USO Methodology and Results")
- ▶ Cost Evaluation of 2016 Universal Service Obligation for GO: Cost Model ("USO Model")

Following the receipt of the claim submission, clarifications have been requested from GO in relation to the methodology, data sourcing and net cost calculations applied in the determination of the claim components. In reply to these requests, GO provided a revised USO Model on 14 October 2019 updating the payphone operating costs and the fixed line origination and termination rates reported for the year 2016.

## **Calculation Accuracy Phase**

In the preparation of this Report we have referred to additional information obtained/ provided during the Calculation Accuracy Phase, besides the above described information sources available from the Reasonability Phase.

Following the conclusion of the Reasonability Phase, further information and clarifications on the claim component calculations have been requested from GO in preparation for/ during the Calculation Phase review. Information requests were sent on 17 January 2020 and 12 March 2020, to which GO provided replies on 14 February and 27 March, respectively. The review of the claim presented in this Report is based upon the latest USO Model provided by GO (provided with the 14 February query replies) and any further reference to "USO Model" relates to this latest model.

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 2016, obtained by the MCA on 10 December 2019.



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

- ▶ GO's 2016 claim includes the same components included in the preceding claim for the year 2015. The net USO cost for 2016 has been calculated on the basis of the following cost-benefit components: *Payphones*, *Social Tariffs*, *Directory Enquiry Services* and *Intangible Benefits*.
- ▶ The table below compares the funding request by USO claim component for:
  - ▶ GO's claim for 2016 as per the latest USO Model and claim confirmations provided by GO; and
  - ▶ The 2016 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 2016 USO model.

(in €)	GO's claim as per USO Model*	Final review outcome
Payphones	(67,373)	(61,559)
Social tariffs	(181,616)	(181,616)
Comprehensive electronic directory	(26,208)**	(6,991)**
Intangible benefits	183,728	183,728
<b>Total</b>	<b>(91,470)</b>	<b>(66,438)</b>

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

\*\*The 2015 MCA USO Decision established that the USP shall make available to all users a comprehensive electronic telephone directory which caters for smartphone based users allowing them to look up directory information. The 2016 DES component included in GO's submission claims the costs of a smartphone app, which was launched by GO in December 2016. The cost elements making up the 2016 CED claim are outlined in a later section reviewing this component.

# 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 provided on 14 October 2019) 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	<ul style="list-style-type: none"><li>• On the basis of the EC Directive, the 2015 MCA USO Decision and international practice, payphones can form part of the USO claim.</li><li>• 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.</li><li>• GO's 2016 submission has been based on the optimal number of payphones and is considered as reasonable.</li></ul>
Social tariffs	<ul style="list-style-type: none"><li>• 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.</li><li>• In view of the previous MCA Decisions, wherein it was decided that access deficit should not form part of the USO claim, then it follows that the social tariff computation should be based on standard tariffs to ensure that those funding the social benefits are not burdened by higher cost than "normal" consumers.</li><li>• GO have based their claim on standard tariffs and the claim for this component is considered as reasonable.</li></ul>

# Reasonability Phase: Conclusions summary (2)

Component	Initial reasonability assessment
Comprehensive Electronic Directory (CED)	<ul style="list-style-type: none"> <li>• The 2015 MCA USO Decision (effective from 1 July 2015) updated the services which are to form part of the telephone directory USO. The decision concluded that the obligation for the provision of a telephone Directory Enquiry Service (DES) shall be withdrawn from USO. Additionally, the obligation for the provision of a printed telephone directory was effectively replaced with the obligation to service a comprehensive electronic directory (CED) that caters specifically for smartphone-based users. In this regard, GO has launched a directory app in December 2016.</li> <li>• Given the above obligation revisions, the 2016 CED component claims funding for the operating costs of servicing the directory app. In previous USO claims, the net USO cost of providing the telephone DES service had been calculated and claimed.</li> <li>• The inclusion of the costs connected of the mobile directory app in the USO claim is considered reasonable and appropriate in view of the MCA USO Decision provisions. In the Calculation Accuracy phase, further calculation details will be requested from GO and reviewed to verify the attributability of the claimed cost components to USO.</li> </ul>
Intangible benefits	<ul style="list-style-type: none"> <li>• 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. However, one needs to point that the calculation of intangible benefits is not an exact science and therefore there is no one correct answer.</li> <li>• 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.</li> <li>• For the 2016 claim, GO have considered another methodology for estimating the brand enhancement benefits received from the provision of USO. The method makes reference to a range of reference benchmarks from other European jurisdictions for the percentage of total intangible benefits, and percentage of total revenue from fixed services.</li> <li>• The methodology employed in previous claims to estimate the ubiquity benefit concludes that GO has not derived ubiquity benefits from USO in 2016, since all geographical zones resulted to be profitable. The employed estimation approach based on retention assumptions of migrating customers due to USP 'loyalty' is aligned to the approaches employed by USPs/ regulators in other European jurisdictions which have generally also assessed this benefit to be relatively small or insignificant.</li> </ul>

# 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 2016, based on a base methodology developed for GO by a third party.

## Cost accounting basis

- ▶ The 2016 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 2016 to work out revenue / traffic per subscriber
  - ▶ If a service was inactive as at June 2016, GO identified the earliest service active between 30 March and 31 December.
  - ▶ Technical data (tel. number/ active lines/ local loop length)

# Methodology and approach (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 above) 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 2016 claim. In the 2013 claim GO had explained that “GO is subject to intense competition in the markets that encompass USO and as such cannot afford not to be efficient. In fact, in the past years it shed a considerable number of employees and has revised many of its procedures and operational practices. All these have for a time been at levels commensurate to a company subject to competition in the market”.
  - ▶ Had an efficiency factor been included, this could have possibly resulted in a lower cost and a lower claim, particularly in the 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 2016 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”.

# Methodology and approach (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	<ul style="list-style-type: none"> <li>• Billing data for on-net calls, outgoing international, mobile calls, and off-net calls sourced from GO's Data warehouse.</li> </ul>
Technical Line costs	<ul style="list-style-type: none"> <li>• 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.</li> <li>• 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).</li> <li>• 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).</li> <li>• The operating cost per copper line length relates to the cost of the copper only, and is divided by the total copper line length.</li> <li>• 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.</li> </ul>
Traffic costs	<ul style="list-style-type: none"> <li>• Traffic volumes (on-net, outgoing international, fixed-to-mobile, and off-net) x unitary cost/minute.</li> <li>• Traffic volumes were extracted from billing data.</li> <li>• Unitary costs/ minute have been based on origination and termination rates, and the commercial cost/ minute.</li> <li>• The commercial cost has been derived from the regulatory accounts model.</li> </ul>
Direct OPEX	<ul style="list-style-type: none"> <li>• Equal allocation of operating costs (derived from actual invoices), including:               <ul style="list-style-type: none"> <li>• Electricity</li> <li>• Hire of premises</li> <li>• R&amp;M – Cardphones</li> <li>• Sub-contracting costs</li> <li>• Metering cost</li> <li>• Payphone share of corporate costs</li> </ul> </li> </ul>
Depreciation and Amortisation	<ul style="list-style-type: none"> <li>• Equal allocation of depreciation obtained from the regulatory accounts model.</li> </ul>
Cost of Capital	<ul style="list-style-type: none"> <li>• Regulatory cost of capital based on the net book value referring to payphones.</li> <li>• Cost of capital of 9.65% (previously discussed)</li> </ul>

# 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 2016 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.
- ▶ According to GO's USO Model, 169 payphones (out of the 184 minimum payphone requirement) in 66 localities (out of 68) generate a negative margin, leading a net cost of €67,373.

# Public payphones (3)

## Review Work

---

### Review work

During the Reasonability and Calculation Accuracy phases of this review, clarifications have been requested from GO regarding certain inputs underlying the 2016 claim calculation.

In reply to these queries, GO have applied revisions to their USO Model calculations leading to the payphone net cost of €67,373 being claimed in the final USO Model provided on 14 February 2020. 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 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 2016 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.

#### Repairs & maintenance (R&M) costs

- ▶ During the Reasonability Phase review, GO have been requested to adjust the claimed R&M (payroll) costs to be in line with the calculation basis adopted in the previous claim. The USO Model's calculation basis has been adjusted accordingly by GO, leading to a reduction in the claimed costs.
  - ▶ Following further clarifications requested in the Calculation Accuracy Phase, GO have clarified that the (revised) R&M costs recorded in the USO Model include indirectly attributed costs, besides direct payroll costs. In line with previous claim reviews, it is deemed that only direct R&M costs should be included in the USO funding request. On this basis, indirect R&M costs allocated by GO have been excluded from the reviewed USO claim.

# Public payphones (4)

## Review Work

---

### Sub-contracting costs

- ▶ In their USO Model, GO have included sub-contracting costs under the payphone operating expenditures. In view that such component was not included in preceding claims (except for first claim for the year 2010), GO have been requested to clarify the nature of this cost component. GO have explained that in 2016 it started shifting its maintenance of lines onto sub-contractors. The sub-contracting costs being included as direct payphone costs in the 2016 claim are thus related to this subcontracting shift.
  - ▶ On the basis of the above, it is considered that the inclusion of sub-contracting costs are 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 (accounting for potential efficiency differences and sub-contracting profit margins). The value of overall payphone maintenance costs included in the 2016 claim (sum of R&M costs and sub-contracting costs, following the previously discussed R&M cost adjustment) is close to that of R&M costs included 2015 USO claim accepted by the MCA in its Decision Notice.

### Electricity costs

- ▶ When asked to clarify further about the way in which operating electricity costs included in the USO Model are recorded, GO have explained that due to the volume of payphone kiosks they account for electricity costs in their books on actual invoice receipt. For the claim's purposes of determining the costs pertaining to the relevant year, accruals adjustments are applied on the electricity payment transactions made over the year, based on the retrospective volume of outstanding accruals as at the start and the end of the year.
  - ▶ For an accurate estimation of electricity costs in future claims, this approach needs to be consistently applied/ maintained, to ensure no double counting.

# Public payphones (5)

## *Review Work and conclusion*

---

### Share of corporate costs

- ▶ GO allocate corporate costs onto products, including public payphones, on the basis of the relative volume of direct/ previously allocated/ costs of the product. In view of the previously referred to adjustment to payphone R&M costs, a proportionate adjustment has been made to the 'share of corporate costs' included in the payphone USO Model calculations.

### Net margin sourcing

- ▶ Following the above review adjustments, the sourcing of individual payphone net margins in GO's USO Model for the calculation of USO cost as per the MCA USO Decision has also been adjusted accordingly so that the calculation sources the least unprofitable payphones in each locality in line with the payphone distribution rule. Margin sourcing has been adjusted to take into account the fact that some of the required payphones (as per distribution rule) which in the submitted USO Model had resulted to be unprofitable, have become marginally profitable following the above-described adjustments in R&M and share of corporate costs.

## **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 €61,559.

# 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. According to the calculation of the social tariff component within GO's USO Model, the cost of providing these social services during 2016 amounted to €181,616.
- ▶ 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 2016 which were found to be in line with those recorded in GO's USO Model.
- ▶ The cost of social tariffs has been computed as the difference between the discounted rate, which in this case is free, and the standard line retail price. This calculation is aligned with MCA's previous USO claim decisions that 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 2016 social tariffs claim submitted by GO totalling €181,616 (i.e. €130,342 for reduced tariff options; and €51,273 for specific disability measures) as submitted by GO.

### Conclusion

- ▶ The social tariff component has been calculated by GO as the difference between the current retail tariffs and the amount actually charged to subscribers, which in this case is free. This net cost calculation, based on the current net cost scenario, is aligned with the MCA's decisions of previous claims that access deficit should not form part of the USO claim.
- ▶ The social tariff claim, on the basis of current costs and subscriber numbers, results in a net cost of €181,616.

GO's claim	Reduced Tariff Options for Users	Specific Measures for Disabled Users
<b><u>Users</u></b>		
<b>DUO PACK</b>		
Charged Rent and Free Telecare	n/a	74
<b>HOME PACK</b>		
Free Rent and Charged Telecare	7	n/a
Charged Rent and Free Telecare	n/a	166
Free Rent and Free Telecare	2	2
<b>NO PACK</b>		
Charged Rent and Free Telecare	n/a	1,054
Free Rent and Charged Telecare	211	n/a
Free Rent and Free Telecare	710	710
Free Rent No Telecare	901	n/a
<b><u>Total number of users</u></b>	<b>1,831</b>	<b>2,006</b>
<b>Annual cost per user</b>		
Line rental at €5.932 per user per month	€71.19	€25.56
Telecare at €2.13 per user per month		
<b>Total annual cost</b>	<b>€130,342</b>	<b>€51,273</b>

# **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 obligation for the provision of a telephone directory enquiry service shall be withdrawn as a USO.
  - ▶ 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. This obligation has effectively replaced the obligation for the provision of a printed telephone directory which was withdrawn in the 2015 MCA USO Decision.

In relation to the above new obligation, GO has launched a free telephone directory app in December 2016.

- ▶ In previous USO claims, GO had calculated and included within this claim component the net USO cost incurred in the provision of the telephone DES (1182 number). In view of the above USO revisions, the 2016 USO Model now claims the costs incurred by GO during 2016 in the provision of directory services through the launched smartphone app. The related costs claimed by GO in this component totalling €26,208, are summarised in the below table:

<b>Comprehensive electronic directory (directory app)</b>
<b>Operating expenses</b>
Updating of directory
Depreciation
Maintenance agreement
Cost of capital @ 9.65% WACC
<b>Total operating costs</b>

# Comprehensive electronic directory (2)

## *Review work*

---

Given that this is the first year in which the smartphone app cost is being included in the USO claim, more detailed information (in addition to the information submitted with the original claim) has been requested from GO on the calculation methodologies and elements behind the claimed cost. The information provided by GO has been reviewed to assess whether the claimed costs are attributable and arising from the USO. In this regard, a review of the operating expenditures making up GO's 2016 CED claim is presented next.

### Updating of directory

- ▶ GO have explained that the 'Updating of Directory' operating cost component represents the internal human cost allocated for the updating of customer records.
  - ▶ Locally there is an arrangement between the operators (made with the direct involvement of the MCA) to share their respective directory data in order to provide telephone numbers of other operators. Given this automated 'dipping system' there should be no costs for GO associated with the updating of other operators' customers. As concluded in previous claim reviews, the sharing of subscribers information between operators (excluding ex-directory subscribers) to provide CED falls outside the scope of USO. Therefore, any costs or incomes pertaining to dips in directory data are not to be included in the claim.
  - ▶ The regulatory conditions for the collection, storage and processing of personal customer records for directory information services are set out in the 2015 MCA 'Decision on the Wholesale Access to Data and the Provision of Publicly Available Directory Information Services' (MCA/D/15-2245). These conditions apply to all local providers of Publicly Available Telephone Services (PATS). In view that these conditions/ obligations apply to all operators and are not specific to USPs, it is deemed that any associated customer records collection/ updating costs should not feature in a USO cost claim.
    - ▶ We understand that GO's CED service is operated under an automated system, and hence there should be no relevant additional human resource costs in the operation of the system. It is also noted that the human resource costs reported by GO to have been specifically incurred for the development of the app are included under the 'software development' costs (described on next page).
    - ▶ In view of the above, it is considered that the 'updating of directory' costs included in GO's 2016 claim are costs which are not specifically attributable to the CED USO, and hence should not form part of the USO claimed costs.

# Comprehensive electronic directory (3)

## *Review work*

---

<b>Depreciation</b>
<b>Cost of Capital</b>

- ▶ Depreciation cost and cost of capital have been calculated on the basis of the capital expenditure costs reported by GO in the USO 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 has been calculated on the basis of a straight line depreciation method, with an estimated useful life for the application of 5 years. GO have clarified that the cost for a full-year depreciation on capital expenditures has been claimed in line with the Company's accounting policy of taking a full-year depreciation in the first year of acquisition (app was launched in December 2016). Consistently with this approach, in future claims 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 (4)

## Review work

---

<b>Depreciation</b>
<b>Cost of Capital</b>

- ▶ Cost of capital has been estimated by GO 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. This rate is applied upon the total capital expenditure costs described over the previous page.
  - ▶ 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) outlines that the average capital employed during any period should be referred to for cost of capital calculations, rather than capital employed at a single point in time. This is in view that capital employed at a single point in time may not be representative of average working capital requirements over an extended period of time. The Guidance 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.
  - ▶ GO's regulatory accounts follow this MCA Guidance, with 'mean capital employed' being used for financial reporting purposes. The mean is calculated as the mathematical average of the start and end values of the financial reporting period.
  - ▶ Consistently with MCA Guidance on accounting methodologies and cost of capital accounting treatment within GO's regulatory accounts, in our review work we have re-calculated the cost for capital employed in CED software development based on the mean of the assets' net book values as at beginning and end of 2016. It is deemed that, in remaining consistent with the MCA Guidance and GO's regulatory accounts, the resulting value should be considered in the USO claim.

# Comprehensive electronic directory (5)

## *Review work and conclusion*

---

### Maintenance agreement

- ▶ An invoice record 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 (apportioned according to the relevant 2016 period – i.e. 2016 Q4).

### Conclusion

- ▶ Based upon the above described review procedures and adjustments, the CED cost should amount to €6,991.

# **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 the 2016 claim, GO provided an estimate for the **brand enhancement** intangible benefit. This benefit 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.
  - ▶ In the final USO Model submitted by GO this intangible benefit is quantified using the same approach and methodology used in previous claims, leading to an estimated brand enhancement benefit of €183,728. The methodology adopted in the calculation of this benefit is reviewed on the next page.
- ▶ Other intangible benefits which were not considered by GO include:
  - ▶ **Ubiquity**: the benefit associated with the comparatively lower cost of the USO operator (compared to its competitors) in extending its network to new customers. In previous years, GO have included in their claim submission an estimate of this benefit following a methodology in which the benefit is valued as the estimated additional profits derived by the USP from customer moves from unprofitable geographical areas to profitable areas which are attributable to customer loyalty resulting from the operator's USP status. An assessment of ubiquity benefit has been conducted in the Reasonability Phase – its exclusion from the 2016 claim has been assessed to be reasonable.
  - ▶ **Life cycle**: evaluation in terms of the evolution of the average telephone bill, and the increase of the telephone bill through the evolution of the familial structure.
  - ▶ **Marketing/ access to customers' database**: benefit associated with the savings in acquisition costs and operational costs of a customer's database.

# Intangible benefits (2)

## *GO's methodology and conclusion*

---

### **Brand enhancement**

- ▶ Brand enhancement relates to any improvement in the UPS' brand image when offering its services.
- ▶ There is no standard methodology to estimate this benefit. In the USO Model this benefit is estimated following the same methodology adopted in previous claims, where the calculation is based on the below assumptions and inputs:
  - ▶ Following the UK regulator's approach, the brand image benefit is assumed to be approximately equal to 20% of the combined cost of related marketing expenditure, including advertising campaigns related to fixed telephone, TV packages, and general corporate branding.
    - ▶ The 20% factor used in this calculation is the same as the one used in previous claims where, in relation the choice of this factor, GO had explained that in view of the costs involved in a market study to assess this intangible benefit, a benchmark with international experience is considered adequate.
    - ▶ GO has provided a list of the campaigns related to fixed line whose costs have been used in the calculation of this intangible benefit.
- ▶ Based on the above methodology, the brand enhancement benefit was valued at €183,728.

### ***Conclusion***

- ▶ The value of the brand enhancement benefit to be deducted from the cost of the other components should be equal to €183,728.
- ▶ 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. However we notice that the method applied by GO is based on an adequate international benchmark.

# Summary of conclusions

# Calculation Phase: summary of conclusions

Based on the review assessments contained in this report, the following table summarises the conclusions of the Calculation Accuracy phase.

Component	€	Summary of review work/ conclusion
Payphones	(61,559)	<p>The Repairs and Maintenance (R&amp;M) operating expenditures included in GO's claim were adjusted to include only direct costs (pg. 21)</p> <p>In view of the above R&amp;M cost revision, a proportionate adjustment was made on the share of corporate costs allocated to the public payphones component (allocated by GO on the basis of relative direct cost volumes) (pg. 23).</p> <p>Following the above review adjustments, the sourcing of individual payphone net margins in GO's USO Model was accordingly adjusted so that the USO cost calculation sources the least unprofitable payphones in each locality in line with the payphone distribution rule established in the MCA USO Decision (pg. 23).</p>
Social tariffs	(181,616)	As per GO USO Model/ claim
Comprehensive Electronic Directory (CED)	(6,991)	<p>The 'updating of directory' operating costs included in GO's CED component have been excluded in view that these costs are not specifically attributable to USO – the regulatory conditions for the collection, storage and processing of personal customer records for directory information services apply to all PATS providers (pg. 29).</p> <p>The cost of capital employed for the development of the CED smartphone app, has been adjusted to be based upon the average capital employed over the year, in line with accounting methodologies for regulatory accounting (pg. 31).</p>
Brand enhancement	183,728	As per GO USO Model/ claim
<b>Total</b>	<b>(66,438)</b>	

- ▶ The resulting net USO cost amounts to **€66,438**.

# 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 (2003), *Guidance on Accounting Methodologies for Regulatory Accounting Purposes*
- ▶ 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 (2015), *Decision on the Wholesale Access to Data and the Provision of Publicly Available Directory Information Services*, MCA/D/15-2245
- ▶ 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