

BEFORE THE PUBLIC UTILITIES COMMISSION

**In the matter of the Public Utilities
Commission Act 1999 (No. 10 of
1999)**

-and-

**In the matter of Tariff Notice 1-
2001 submitted by The Guyana
Telephone & Telegraph Company
Limited.**

JUSTICE PREM PERSAUD, C.C.H	-	CHAIRMAN
MR. JOHN L. WILLEMS, A.A.	-	MEMBER
MR. HUGH K. GEORGE	-	MEMBER
MR. BADRIE PERSAUD	-	MEMBER

REPRESENTATIONS-

THE GUYANA TELEPHONE AND TELEGRAPH COMPANY LIMITED	-	Mr. Rex H. Mc Kay, S.C. Mr. Miles S. Fitzpatrick, S.C. Mr. Keith S. Massiah, S.C. Attorneys-at-Law.
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**Mr. Godfrey Statia,
Consultant**

THE CONSUMERS' ADVISORY BUREAU	-	Ms. Eileen Cox, A.A. Chairperson
THE GUYANA CONSUMERS' ASSOCIATION	-	Mr. Patrick Dial – Secretary Mr. Stephen Fraser, Attorney-at-Law

Decision

The Guyana Telephone and Telegraph Company Ltd. (GT&T) has submitted on the 31st December 2001 Tariff Notice No. 1/2001, under the provision of Sections 41(1) and 41(2) of the Public Utilities Commission Act, No. 10 of 1999, pursuant to Section 33 of the said Act, seeking approval of a tariff establishing a change of rate in some instances and new rates in order to give effect to its entitlement of a minimum rate of return of 15% on its capital. It is for the incumbent operator, GT&T, to propose tariffs and the regulator PUC to react by accepting, rejecting or modifying these tariffs.

The Public Utilities Commission had on its own motion on the 20th December 2001 initiated proceedings to consider the effect of the proposed reduction of the international settlement rates and if necessary to make such amendments or adjustments to the current rates.

GT&T however subsequently, on the 31st December 2001 filed their application seeking approval for change of rates.

By consent of all parties we proceeded to hear GT&T's application and did not pursue ours.

Under Section 33(a) of the Act, the 15% return on its capital means the capital **invested or dedicated for providing a service**, or in other words the capital dedicated to public use.

The tariff document which forms part of the notice detailed the following:-

- (a) the existing and duly established rate or rates;
- (b) the changes proposed to be made in the rates;
- (c) the reasons for the change in the rates.

Briefly, the reason for the change in the rates is to enable GT&T to recoup whatever revenue it expects to lose as a result of the reduction of the international settlement rates. This reduction has come about because of an order by the United States Federal Communication Commission (FCC) in 1997, mandating that the rates be reduced from 85 cents US to 23 cents US per minute by the 1st January 2002. In effect it means that GT&T will receive 23 cents US per minute for calls terminating in Guyana from the USA instead of 85 cents per minute. Reciprocally, GT&T will pay to the US carrier 23 cents per minute for calls terminating in the USA from Guyana.

ATN/GT&T had petitioned the FCC seeking a waiver with respect to the Benchmarks order for 23 cents for the next 5 years with respect to Guyana. The Petition was dismissed on 15 November, 2001 and GT&T entered into an agreement with Concert Global Network Services Ltd for the international accounting rates to be in accord with the FCC's ruling.

However, prior to its filing in December 31, 2001, with which application we are dealing, GT&T on the 17th day of December 2001 further petitioned the FCC to review that November ruling.

If the application by GT&T is allowed and the FCC grants a waiver the Commission will have to revisit the order we are now making concerning the rates, under the provisions of the Public Utilities Commission Act No. 10 of 1999. The basis on which our present order is made would have been varied.

At the hearing of the application, on the 9th January 2002, the Consumer Associations objected to the application, which they said should be rejected on the grounds inter-alia:—

- (a) the application does not comply with the requirements of its Licence and the PUC Act;
- (b) the principles and methodology used for the determination of the revenue requirement are highly questionable.

With respect to (b) above the objection, with respect, does not constitute a valid reason for rejection, in that if the principles and methodology used for the determination are questionable the Commission will reject them and apply the correct principles and methodology in the determination of the issues before it.

Concerning (a) the Consumers contend that the licence issued to GT&T require that its operations must be separated for accounting purposes, into four different businesses; the reasons for such being to prevent cross-subsidization or transfer pricing between the various businesses.

The Commission accepts that it is desirable that the different businesses be separated for accounting purposes, but their failure to do so, is not fatal to the application. In the filing the landlines and cellular operations were separated. The “Consumers” in a letter to the Commission dated 11th February 2002 noted that by “excluding cellular services from its application GT&T stands to reap a windfall”

The Commission is however taking the cellular operations into account in determining GT&T’s rate base and revenue requirement.

We accordingly reject the contention of the Consumers that the application is flawed and should be struck out.

The application before the Commission is one for what is commonly referred to as “**Tariff Rebalancing**”

Tariff rebalancing is a change in the structure of telecommunications prices, moving the prices of the various services closer to the underlying costs of these services.

We must not lose sight of the basic fact that these costs must be dedicated to public use, or in other words, costs for providing a service from which consumers will benefit.

In our context because of the reduction of the settlement rate from 85 cents to 23 cents as a result of bilateral agreements between GT&T and the international carriers rebalancing would appear to involve reductions in the prices of international calls and , possibly increases in the line rental and the prices of local calls.

There is increasing pressure from a number of sources for the payments for terminating international calls world-wide to fall as it is generally accepted that they were well above cost. Since 1992 there has been a general tendency for accounting rates to fall over time, on average by 9% per annum worldwide. But costs have also been falling with rapid advances in telecoms technology (**Focus Group – ITU**).

The FCC considers that settlement rates above cost lead to artificially high international calling prices for US consumers. It has adopted the Benchmarks order in an attempt to bring settlement rates closer to cost. In the FCC's views this will result in much lower prices paid by consumers for international calls, which in term will stimulate significant increases in traffic volumes. Indeed, Mr. Godfrey Statia, consultant to GT&T testified at our hearing that the rates have gone down to as low as 5 cents per minute in some countries as a result of the tremendous increase in the volume of international calls.

An important and interesting contributing factor concerning the international market will be the pattern of migration. North America is the major destination country for emigrating Guyanese. Migration leads to telecommunication flows between the countries as family and friends stay in contact by telephone. It may not be unreasonable to assume that relatives and friends overseas are more wealthy than their Guyanese counterparts and would be a reason for more calls from overseas than what would be going out. This pattern may result **in a net settlement surplus** to the local utility.

The application by GT&T is under Section 41 of the PUC Act , and the Commission was of opinion that public interest required that a temporary rate be fixed to be charged by GT&T pending the final decision in these proceedings. We held this view since it is unlikely that the matter could be determined within the next three weeks as the application merited serious consideration, e.g. the testimony of witness and information supplied by GT&T; and other information supplied by the consumer groups:

We accordingly suspended the operation of the rates filed by GT&T for six months with effect from the 1st February 2002.

Our order which we make and contained in this decision is made **without prejudice**, as upon further information and investigation additional issues may arise and modification of our temporary order may be taken based upon further testimonies.

We believe that with the full co-operation of all parties who have interest in this matter permanent rates may be established by June 2002, which is within the six months time allowed between the filing and the rate setting. In the event that any requested information is not provided in a timely fashion the Act provides for extension of the interim period for another ninety days.

For the purposes of establishing temporary rates, we have computed the required return as the product of 15% times the appropriate components of the test year rate base.

The PUC's responsibilities with respect to the regulation of GT&T's rates are contained in section 32 of the PUC Act of 1999, which states specifically:

- (1) Every rate made, demanded or received by any public utility, from persons making use of the service provided by it, shall be fair and reasonable and in conformity with any written law and such rules as the Commission may from time to time prescribe.

- (2) In determining the rate a public utility may charge for any service provided by it, the Commission shall have regard to consumer interest and investor interest and to the rate of return obtained in other enterprises having commensurate risks, provision of safe and adequate service at reasonable costs, and to assuring the financial integrity of the enterprise.

Temporary rates are defined in Section 43 of the Public Utilities Commission Act of 1999. Specifically, section 43(1) states:

On a prima facie consideration of the criteria set forth in section 32(2) or, as the case may be, subject to the terms of any written law, license or agreement between the Government and a public utility or between the Government and an investor referred to in section 33, the Commission may, in any proceedings initiated under section 41(3) involving rate or rates charged or to be charged by a public utility, either upon its own motion or upon a complaint, if the Commission is of the opinion that the public interest

so requires, by order fix a **temporary** rate or rates to be charged by such public utility pending the final decision in such proceedings.

Section 43(3) of the Act states:-

Subject to sections 32(1) and 33, where the Commission, upon examination of any annual or other report or of any papers, records, books, or other documents or on the appraisal of property of any public utility, is of the opinion that having regard to the criteria set forth in section 32(2), any rate or rate charged by such public utility are producing a return in excess of a fair return upon the fair value of the property of such public utility, used or useful in the service provided by it, the Commission may by order fix for a trial period not exceeding six months such temporary rate or rates to be observed by such public utility as, in the opinion of the Commission, will produce a fair return upon the fair value, and the rate or rates so fixed shall be effective from the date specified in the order of the Commission and shall become permanent at the end of such trial period, unless modified or terminated at any time during such trial period by the Commission.

To the extent the permanent rates are different than those established as temporary in this proceeding GT&T (or the ratepayer) will be made whole. Specifically, sections 46(1) and (2) of the Act state:

- (1) Subject to section 33, where any rate as finally determined by the Commission is in excess of the rate existing prior to the filing with the Commission by a

public utility of a tariff stating a new rate under section 41(1), or of the rate fixed temporarily under section 43 then the public utility shall be permitted by the Commission to amortize and recover, by means of a temporary increase in the rate as finally determined, the sum which represents the difference between the gross revenue commencing on the date on which, under the notice given by it to the Commission, the new rate was to have come into effect and ending on the date on which the rate as finally determined by the Commission became effective, and the gross revenue which would have been received by the public utility during the same period if the rates as finally determined by the Commission had been in effect.

- (2) Subject to section 33, where, consequent on an order finally determining that a rate that a public utility is entitled to demand and receive for any service provided by it, any consumer becomes entitled to receive any sum from the public utility, it shall be adjusted towards any sum likely to become due to the public utility from the consumer for a reasonable future period, to be determined by the Commission taking the interests of the public utility and the consumer into consideration.....”.

In its filing GT&T estimated that with the reduction in the accounting rate, it would under-earn its authorized return of 15% in 2002. Although GT&T estimated that an increase in traffic from the US would result in an additional \$1.1 billion in additional revenues through “stimulation”, the lost revenues that would result from the decreased accounting rate require additional net revenues of G\$4.4 billion to be derived through

increased Guyana rates. To recover the alleged deficiency, GT&T proposed increases in the basic monthly phone charges, increases in intra-exchange measured rates and to initiate charging for access to GT&T's exchange for Internet end users. Currently there is no charge for such access.

We suspended GT&T's proposed rates at the hearing in January 2002. At the hearing, GT&T offered to exclude certain items from this temporary rate calculation; namely:- advisory fees, the working capital allowance requested by GT&T and the issue of the revaluation of assets over the past several years. When these issues are removed from the Tariff Notice 1-2001, GT&T's requirement for additional revenues is reduced from G\$4.4 billion to G\$2.9 billion. The rate filing and adjusted position are quantified below:

	<u>Filed Position</u> <u>(G\$000's)</u>	<u>GT&T's</u> <u>Adjusted</u> <u>Position</u> <u>(G\$000's)</u>
Rate Base	\$ 18,175,362	\$ 15,445,994
Return	<u>15%</u>	<u>15%</u>
Required Earnings	\$ 2,726,304	\$ 2,316,892
Operating Expense	8,454,367	7,649,690
Operating Taxes	<u>2,230,612</u>	<u>1,895,639</u>
Revenue Requirement	\$ 13,411,284	\$ 11,862,221
Revenue at Existing Rates	<u>7,855,132</u>	<u>7,855,132</u>
Additional Net Revenues	\$ 5,556,152	\$ 4,007,089
Net Revenues from Stimulation	<u>1,105,501</u>	<u>1,105,501</u>
Additional Local Revenues Required	\$ 4,451,101	\$ 2,902,038
% Increase	56.7%	36.9%

A preliminary study of the data submitted to date has led the Commission to conclude that a total of approximately G\$491 million (in net revenues) is additionally required from domestic service to ensure not less than 15% on capital dedicated to public use.

We reached our conclusion regarding the appropriate level of revenues for GT&T upon which to establish interim rates based upon our conclusions regarding the test year (calendar year ending December 2002). GT&T has proposed in its filing and adjusted position to use the year 2002 as its test year. For establishing temporary rates, the Commission accepts the use of the test year ending December 2002 as reasonable, but reserves its judgment on the forecasts until further investigation are carried out in the fixing of permanent rates. The actual results for 2002 will also be reviewed to verify to some measure the accuracy of the forecasts. For the purposes of the temporary rates, the Commission has largely accepted GT&T forecasts for revenues and expenses. **The recommended rate increase includes all the labour and capital costs in that budget. Therefore, any reductions in the budgeted labour and capital costs would require immediate corresponding downward adjustments to temporary rates.**

Only recently a copy of the 2002 budget was received and it is noted that many of the revenue and expense line items do not tie to the version of the budget that was filed with the Commission. This will be investigated further, but it is of note that if the budget provided to us is the appropriate budget to be used in this filing,

GT&T's alleged deficiency would be less than originally filed. Further testing of the budget projections will be a requirement before the setting of permanent rates.

The Commission also accepts GT&T's proposal concerning deferring of PUC consideration of the appropriate level of advisory fees. The computation of GT&T's working capital and asset revaluation to be used in the determination of revenue requirement has been changed.

SUMMARY OF RATE BASE AND INCOME ADJUSTMENTS

To summarize:-

The test year ending December 31, 2002 forms a reasonable basis upon which to set rates. The rates set are based upon the entire operations of GT&T, including investment, revenues and expense from its cellular operations.

For the rate base, the average for calendar year 2002 of G\$11.9 billion was used in the determination of required earnings adjusted for the following items. The average rate base was adjusted for:

1. The elimination of the Franchise Asset from the test year;
2. An allowance of G\$242 million for working capital;
3. Removal of the interest bearing account (other assets) which are designated as sinking funds from the ratebase; and

4. The increases in the Plant and Accumulated Depreciation accounts that result from the revaluation of GT&T's assets in 1994 and 1998.

See Schedules 1-3 attached hereto.

These adjustments are consistent with FCC procedures to determine appropriate items of rate base. **The Purchase Agreement calls for the use of FCC procedures.** For the determination of income required by GT&T to meet both its legitimate obligations, the interim rates were established using an after tax return of 15% on adjusted average rate base as discussed earlier.

An accounting rate of \$0.23 per minute for international calling services by AT&T and other carriers has been assumed in the test year results of international incoming revenues and settlement expenses. The Commission has accepted GT&T's calculation of the impact on GT&T of this reduction in the accounting rate in setting temporary rates. **Staff will review the work papers and actual results in 2002 to confirm that the accounting rates and agreements with the various carriers have been modified before making a recommendation to the PUC on final rates.**

In addition to the accounting rate adjustment, the estimate of the test year earnings at current rates in the forecast of test year results was modified for the following items at a **minimum** – See Schedules 4-7.

1. Removal of all Advisory Fees (net of tax) from the cost of service as proposed by GT&T in the adjustment;

2. Removal of the amortization expense related to the Franchise Asset from the cost of service (consistent with FCC procedures); and
3. Decrease in the amount of test year depreciation expense that represents the increased depreciation expense from the asset revaluation, which GT&T has affirmed that it had omitted.

The result earnings (included the recommended increase) will result in a 15% return on rate base.

GT&T should continue to accrue depreciation expense on a straight-line basis (at calendar 2000 depreciation rates) and not adjust the method of rates of depreciation without a formal filing to the PUC and subsequent approval by the Commission in this or future Tariff Notices.

GT&T's request for rates for time charges for connection to the Internet is denied at this time.

JUSTIFICATION FOR ADJUSTMENTS IN THE ESTABLISHMENT OF TEMPORARY RATES

Rate Base:

Franchise investment – The test year average of the unamortized balance of the excess purchase price over book value was removed from rate base. This is consistent with the FCC's rules for determining rate base as required by the Purchase Agreement.

This adjustment is consistent with Part 65 of the FCC's rules regarding rate base items and with prior Guyana PUC decisions. This Franchise Asset is sometimes referred to as Goodwill. This asset is not one of the items of rate base permitted in the practice and procedures of the FCC. **A listing of all permitted rate base items is contained in 47 CFR 65.820, from which goodwill is excluded.** Moreover, goodwill is required to be amortized to Account 7360, Other Non-operating Income, a below-the-line item and therefore not included in the cost of regulated services. This adjustment is consistent with the FCC principle and removes an asset from the rate base from which no benefit to ratepayers occurs. GT&T included in its rate base the unamortized excess cost (or goodwill) that it paid to originally acquire GT&T in its updated filing.

Working Capital – The Commission has modified GT&T's adjusted position on working capital. This Company has not used a practice consistent with the practices and procedures of the United States Federal Communications Commission (FCC) as the Company is required to do under Article 6.9B of the Purchase Agreement. FCC rules, contained in 47 CFR 65.820, provide three options for a Class B company such as GT&T. It may produce for the Commission's review a full lead-lag study, follow a formula specifying the computations to be made to arrive at a cash working capital allowance, or it may use an amount equal to 15 days of its cash operating expenses including interest. The latter methodology would derive GT&T's working capital allowance of only G\$0.24 billion using the pro forma test year results. Specifically, regarding the working cash method, the FCC Order states:

“A Class B Carrier will be permitted to include in the rate base a standard cash working capital allowance equal to 15 days of its cash operating expenses.....We revise the rule to specifically mention that interest should be included in cash expenses and that both depreciation and amortization should be deductions from total operating expenses to determine cash operating expenses”.

The method chosen by GT&T to measure the allowance for working capital is based upon its balance sheet and assumes that the net balance of cash and receivables less payables and liabilities correctly measure the working capital requirement on a normalized basis. This method is not permitted by the FCC and we reject it. The FCC requires that if the utility desires a return on working capital, a lag study needs to be performed to determine the appropriate level of that allowance. This study measures the timing of payments and receipts to and from the utility and measures the cash flows of the utility. The net result of the study determines the appropriate allowance.

Sinking Funds – The last rate base adjustment that was made is related to the removal of the test year balance of other assets, which have been designated sinking funds in the budget. These funds are derived from cash amounts provided by the ratepayer. Interest income is recorded “below the line” and is in general not considered operating income, by the FCC. These amounts are essentially in escrow waiting to be paid out. This does not qualify as rate base under FCC rules and is not capital dedicated to public use.

Operating Income

As indicated earlier, the Commission has accepted GT&T's Fiscal Year Budget projections and its estimation of the impact on international revenues of the decreased accounting rate. The only adjustments that were made (other than removal of advisory fees) are the amortization of the franchise and the impact of the revaluation on depreciation expense. The expense related to a forty-year amortization of the GT&T's **goodwill** or purchase price in excess of book value was eliminated for the same reasons that it was removed from rate base. The FCC's rules do not permit inclusion of this expense for rate making purposes.

The Commission has eliminated the total amount of test year **advisory fees** from the cost of service as proposed by GT&T in the establishment of temporary rates. The last adjustment that we make is an estimation of the annual impact of the re-valuation adjustments that GT&T has made. GT&T has eliminated the rate base impact of these adjustments, but failed to remove the increased **depreciation expense** that would result from the restatement of assets to a larger Guyana value.

For our purposes, at the present time, we do not have a trend in relation to the volume of calls as the impact has not been felt. In due course when figures are available we will of course factor this into the configuration when we consider permanent rates.

That GT&T has applied to rebalance the rates is based on their perception that the prices for domestic services are below cost which losses are recovered from or sustained by profits from international calls.

If the profitability earned by GT&T on the incoming international calls was to fall by a sufficiently large amount to reduce its return below the 15% minimum to which it is entitled the price for the other services would have to rise to allow it to earn the permitted rate of return. Such increases, however, could possibly be offset by decreases in unit costs deriving from improved operational efficiency and adoption of cheaper new technology.

The most appropriate way for the structure of prices to be examined would be in relation to the costs of the several services offered by GT&T. We need the cost information to identify the extent of unbalanced tariffs before we can properly rebalance the rates. We will have to understand and be satisfied about the basis of this derivation.

One of the tasks to progress the issue of tariff rebalancing will be the investigation of relevant and robust cost information. We cannot reach firm conclusions on rebalancing until the existence and extent of unbalanced tariffs is properly established.

The Public Utilities Commission has a pivotal role in the matter of rate fixing and we wish to assure both the utility and the consumers that our findings are intended to strike a reasonable balance in this regard.

ORDER

The Commission has considered the submissions made on behalf of GT&T and the Consumer Groups and in the light of all the above and bearing in mind that GT&T is entitled to a minimum of fifteen percent (15%) rate of return on capital dedicated to public use, the Commission has proceeded to determine temporary rates as stated below:-

- (a) There shall be two periods for all calls, international and local, to be called the **'Peak'** and **'Off Peak'**.

Peak Periods are from 6a.m. to 6 p.m. from Mondays to Fridays.

Off Peak Periods are from 6 p.m. to 6 a.m. Mondays to Fridays, and all day Saturdays, Sundays and all public holidays.

There shall be no Second Off- Peak Period.

- (b) For all countries except the USA and UK the current Peak rates remain, and the Off Peak rates shall be the rates currently charged for the First Off Peak period.
- (c) The charge for the USA and UK shall be as follows:

	USA	UK
Peak Rates	G\$100	G\$136
Off-Peak Rates	G\$90	G\$123

- (d) The local rates shall be as follows:

- (i) Intra-exchange rates:

Peak - G\$0.60 per minute

Off- Peak- G\$0.30 per minute

- (ii) Inter-exchange rates are as set out in schedule 8 hereto attached.

- (iii) Line rentals are as follows:

Residential Main Line (first and second line)- G\$500.00 per month

Residential Main Line (Third and subsequent line) - G\$750.00 per month

Business Main Line (first four lines) -G\$1,500.00 per month

- (iv) All other charges/rates for services not mentioned above or in Schedule 8 remain in force.

The temporary rates fixed by this Order shall come into operation with effect from 12.00 midnight between the 31st January and 1st February, 2002, and shall continue to be in force until the final decision or unless modified or terminated by the Commission. The notice of suspension by the Commission of the rates filed and proposed by GT&T in Tariff Notice 1/2001 is terminated with effect from the date and time of the coming into operation of the temporary rates.

GT&T is directed to make public for the benefit of consumers and members of the public the new tariff in accordance with the law.

Dated this 18th day of February, 2002.

.....(Sgd.).....
Prem Persaud, C.C.H. - Chairman

.....(Sgd.).....
L.J.P. Willems, A.A. - Member

.....(Sgd.).....
Hugh George - Member


.....(Sgd.).....
Badrie Persaud - Member

Dated this 18th day of February, 2002.


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Prem Persaud, C.C.H. - Chairman


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L.J.P. Willems, A.A. - Member


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Hugh George - Member


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Badrie Persaud - Member