HASHEMITE KINGDOM OF JORDAN

Telecommunications Regulatory Commission (TRC)

Information Memorandum

Regarding the

Determination on the Implementation of a Regulatory Regime for the prices of the Reserved Services of Jordan Post Company (JPC)

Date
14 September 2009

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PART 1 - INTRODUCTION

On the 14th of August 2008 TRC produced a consultation paper titled "***Notice Requesting Comments on the implementation of the tariff regulatory regime for the restricted services of JPC***" in line with its legal obligations and in particular Articles no. 9/a/e and 12 of the Postal Services Law No. 34 of 2007 *" the TRC should set the basis that the Public Postal Operator is committed to abide by, when determining the services tariff by virtue of the exclusive right granted to it under the provisions of Article 12 of this law"* and *"to regulate the postal services in the Kingdom in accordance with the public policy approved by the Council of Ministers and to issue related instructions."*

The aims of the consultation document were to:

- Establish a set of internationally accepted pricing principles;
- Present and discuss the main internationally accepted postal pricing principles for the reserved postal services of JPC;
- Request comments on a series of consultation questions both from JPC and from other stakeholders of the postal sector in order to establish TRC's position regarding the choice of a particular pricing and tariff methodology.

Following publication of the Consultation paper TRC received two responses, one from the Jordan Post Company (JPC) and one from the Lazard Consortium, MoICT Consultants, comprising Lazard, Ernst & Young, and Dewey & LeBoEUF. These responses were subsequently publicized on TRC's website.

In line with its standard Consultation process and decision making rules, TRC publishes this Information Memorandum, as a complement to its Determination on the subject. This Information Memorandum summarizes the responses received and provides comments, explanations and discussion as required to the issues raised by the respondents.

PART 2 - JPC's RESPONSE

2.1 JPC's General Response

<u>JPC response</u>

1- The public postal operator agrees with the following Regulatory Objectives:

- *To promote economic efficiency for JPC; in this regard JPC would request more explanation on this objective and how it could be achieved through pricing*

- *To ensure the financial viability of JPC through a satisfactory revenue requirement which should cover the costs of operations, depreciation and a reasonable return on the assets employed.*

- *To maintain and enhance quality of postal services at certain pre-specified standards.*

JPC would like that the quality standards to be agreed, should consider the current quality level, postal tariffs and postal revenues, those shouldn't also neglect the US obligations and JPC right to choose the method to offer services for beneficiaries.

- *To promote and facilitate future competition in the postal sector*

Regarding this objective, it is necessary to enhance the monitoring level of the market, to enable the TRC to limit the violation on JPCs' reserve rights, in which is the theme of the pricing principles.

- *To ensure non-discriminatory provision of postal services to all customers*

- *To promote economic efficiency of the customers' usage of postal services*

2- The public postal operator agrees with what is mentioned in the consultation document concerning which characteristics the Regulatory Pricing regime should have:

- *Economic Efficiency for beneficiaries*
- *Cost recovery*
- *Equality (Non-discrimination)*
- *Uniformity and stability*
- *Competition facilitation*
- *Transparency*
- *Simplicity*
- *Predictability of outputs*
- *Stability*
- *Consistency*
- *Affordability*

JPC would like to draw TRC's attention to the importance of defining the concept of economic efficiency as one of the pricing regimes' characteristics and how it's related to the expected performance of JPC.

TRC Comment

TRC's stated regulatory objectives are based upon economic principles in line with standard international best practice. These objectives provide the basis for a fair regulatory regime aimed at striking a proper balance between the objectives of JPC and the protection of JPC's customers.

Also, TRC's stated regulatory pricing principles are:

a) compatible with the stated regulatory objectives
b) based upon scientific economic principles
c) in line with standard international best practices

TRC welcomes JPC's agreement with both the stated regulatory objectives and pricing principles. Both will form the basis for the choice of the regulatory regime and the future development of appropriate models for the costing and tariff setting of JPC's reserved services.

Economic efficiency and its relationship to pricing

Regarding JPC's request to expand upon the concept of economic efficiency and how this relates with the pricing methodology the following points should be noted:

The fundamental quest of the science of Economics is to achieve economic efficiency, which is to allocate the right resources to their proper use.

There are several different aspects of efficiency. These are distinguished in:

Economic efficiency requires a company to produce a certain level of output at the lowest level of feasible true costs. Costs may rise above the lowest possible level due to lack of either technical or allocative efficiency.

Technical efficiency requires a company to produce a certain level of output by using the minimum level of physical inputs. An example of technical inefficiency is when more people than necessary are used to carry out a certain task.

Allocative efficiency requires a company to use inputs in the right proportion (for given input prices) to produce a certain level of output.

It should be clear from the above that economic efficiency is a more stringent requirement than technical or allocative efficiency. Both technical and allocative efficiency are required to achieve economic efficiency.

Finally when time is taken into account the relevant concept is the one of dynamic efficiency requiring companies to produce economically efficient (i.e. certain level of output at minimum costs) over time.

To achieve economic efficiency the resources used should be paid their true economic cost (not the accounting cost). The true cost of any resource (capital, labour, other) is the opportunity cost of its next best alternative use.

As accepted internationally, TRC also considers that Price Capping is advantageous in promoting economic efficiency since it is designed to include explicitly an efficiency factor (the X factor) reflecting anticipated efficiency gains.

Quality Standards

Regarding JPC's point on quality standards, TRC recognises that quality standards and legal obligations are an important parameter directly impacting JPC's costs. Certain standards and obligations on speed of delivery, reliability, customer care and others in order to be met require both a proper level of investment and additional operating costs. As a result TRC agrees that at least the minimum level of quality standards will have to be agreed with JPC so that its costs can be properly accounted for and be allowed into the pricing mechanism. To provide appropriate financial incentives to JPC to improve service quality and other obligations TRC will allow for JPC's compensation on investment required to meet obligations set by the TRC such as service quality enhancement.

Limiting the violation of JPC's reserved rights

Regarding the point of JPC about market monitoring to limit the violation of JPC's reserved services, TRC is of the view that any violations of the law are not acceptable. TRC will do everything in its powers to ensure that competition facilitation is always in accordance with the legal requirements of the Postal Services Law, and that the market functions lawfully with all players respecting their legal obligations.

2.2 JPC's Responses to the Consultation Questions

Question-1: Interested parties are requested to comment on postal pricing principles discussed above

JPC response

JPC states the previous two points answered this question.

TRC Comment

TRC records JPC's agreement with the stated regulatory objectives and postal pricing principles.

Question-2: Interested parties are requested to comment on the possibility of introducing a Rate of Return regime to regulate JPC's postal tariffs?

JPC response

Jordan Post Company agreed with the characteristics of the Rate of Return regime regulations in the consultation but JPC believes that there are some points that need to be clarified:

This regime may be the best for pricing reserved postal services due to its simplicity and direct implementation which would make it more suitable for the Postal sector, if we consider the recent experience in regulating this sector for both the TRC and JPC, also the calculation of costs and putting in place a mechanism whose tasks are not just the calculation of cost but also to balance between number of interests which might not all be going in similar tracks.

The uniqueness of the postal services, in allocating number of costs on different services in which in turn contains some categories that produces many cost driving stages. In addition the regulator needs to analyse the cost elements in more analytical descending way, as well as JPCs' experience with the Regulator in these issues, accordingly JPC states that this regime would be suitable for them in case the postal services and cost elements of each service were categorized in *agreement with JPC and in a way that the new regime does not add burdens to JPC in changing the implemented cost accounting system.*

TRC Comment

TRC notes that JPC appears not to have any major objections and would rather agree to the possibility of introducing a Rate of Return regime to regulate JPC's revenue.

However, as explained in the Consultation paper, despite its simplicity merit, the rate of return regime does not provide strong efficiency incentives to the regulated company. In fact the rate of return regime provides incentives to over invest as the regulated company always earns a guaranteed return on its declared assets. On the other hand the Price Cap regime is internationally considered to be a high powered incentive mechanism which provides efficiency incentives to the regulated company. It is mainly for this reason that the Price Cap mechanism has become the international best practice in postal regulation. TRC also notes here that in setting Price Caps regulators always consider the revenues required by the regulated company in order to cover the costs of operation, depreciation and a fair return on the assets employed.

As also explained in the consultation paper, an additional major advantage of the Price Cap regime is that it is forward looking. This enables the regulator to examine closely the anticipated supply and demand conditions, the required operating and capital expenditures (Opex and Capex) to meet them, the special investments required to meet service quality standards and obligations, the re-organisation and company restructuring efficiency plans to achieve enhanced performance, etc. so as to plan ahead the anticipated revenue requirements, their impact on prices and if required to even out the price profiles in order to avoid sudden and large price changes. Such "profiling" is not easily achieved through the rate of return regime which allows for next year's revenues based upon last year's revenue requirements. For example, according to the rate of return regime a large increase in the asset values of the last year due to a purchase of an expensive and needed asset will directly impact next year's prices introducing significant price fluctuations.

Another significant advantage of the Pure Price Cap regime is that it directly controls prices and not revenue. This can be considered as direct protection of the customers of the postal utility whose price increases are capped. Under a rate of return regime (cost plus) there is mainly a control of the revenue something which may enable the postal utility, depending upon the price elasticity of demand, to achieve a certain level of allowed revenue with increased prices without suffering particularly low volumes.

TRC clarifies that the chosen regulatory regime regulates JPC's reserved postal services as required by the Article 9 (par. a, and par. e) of the Postal Services Law.

Regarding JPC's point about the cost structure of the postal services TRC notes the following:

As in the case of telecommunications the postal service providers have a complex cost structure. This is not unusual for most regulated companies.

The job of the regulator is to understand, analyse and re-produce the company's cost structure so as to ensure that pricing is in line with the true and efficient level of costs. So the regulator has to understand cost causality, cost centres and elements, cost allocation mechanisms and cost drivers. The regulator should also be able to distinguish between exogenous and endogenous costs.

To achieve this task the regulator produces instructions and guidelines for the building of appropriate cost models.

Depending upon the legal requirements costing models are built on the basis of such instructions either by the regulated company or the regulator. For example, the so called Fully Allocated Costing (FAC) models are successfully employed in the costing of interconnection services in Jordan. TRC was responsible for the production of cost allocation guidelines while the operators undertook the task to build such model on the basis of TRC's guidelines.

TRC believes that similar arrangements may be applied and the model to be built by JPC in accordance with TRC's guidelines would utilise as inputs data produced by JPC's cost accounting system. As a result, the cost accounting system would not be required to be modified as long as it produces certain data to be used for the calculation JPC's costs for pricing purposes.

Question-3: Interested parties are invited to comment on the possibility of introducing a pure price cap to regulate JPC's charges

<u>JPC response</u>

JPC does not oppose the pure price cap regime, as it's considered to be one of the most widely used regimes in setting the prices for the dominant operators, who have complete freedom in making their policies and economic decisions in a particular market without competition.

Accordingly the TRC is required to clarify how this regime is to be implemented in the Jordanian case, where, JPC does not have any control, effective competition by private postal operators exist, and in the absence of freedom for JPC to make economic decisions without having to acquire several approvals or enduring great pressures.

<u>TRC Comment</u>

TRC records that JPC does not appear to have any major objections to the possibility of introducing a pure Price Cap regime. As explained in the consultation paper TRC considers that the main merit of the Price Cap methodology is its ability to generate strong efficiency incentives.

TRC, in consultation with JPC and other concerned parties, intend to produce more detailed instructions regarding the application of the chosen regulatory methodology, building guidelines concerning the costing and pricing model, which among others will include clarifications and definitions of key model variables, model structure, cost allocation principles, etc.

Question-4: Interested parties are invited to comment on the appropriate form and structure of the control.

<u>JPC response</u>

The accredited basket must (if the price cap regime was chosen to regulate prices), provide flexibility for JPC to be able to cope with many variables in the market of any of the services it provides or any category of those services. Demand on the service, customers' base, level of competition, cost and administrative decisions, all fall under the range of variables.

<u>TRC Comment</u>

TRC records that JPC appears to have no major objections with regards to the appropriate form of a Pure Price Cap regime with its application ranging from a separate cap for each individual service, to an average cap across all services or even to a weighted averaged cap over a basket of services.

TRC considers the application of Cap on a basket of service prices is standard and internationally accepted best practice.

Question-5: Interested parties are invited to comment on the appropriate basket structure and basket contents.

<u>JPC response</u>

The pricing-basket content requires having a clear methodology, and clear targets for combining a certain number of services in a certain basket and not another. Also it should be taken into consideration that the pricing regime, which TRC is currently accrediting in line with article (9) of the Postal Law, this regime cannot be implemented on the US; due to the absence of the legal basis, so, this particularity should be considered with care when issuing the US instructions which will set the range of these services.

<u>TRC Comment</u>

TRC clarifies that as per its legal requirement this Consultation is about JPC's reserved services. The title of the Consultation was: "***Notice Requesting Comments on the implementation of the tariff regulatory regime for <u>the restricted services of JPC</u>*"**. TRC also notes that the Consultation questions also specify that this Consultation is about the regulation of <u>JPC's reserved services.</u>

Question-6: Interested parties are invited to comment on the appropriate time horizon for the control period and possibility of introducing re-openers.

<u>JPC response</u>

Since JPC is going through an unstable period regarding its future, due to unfinished privatization studies and the instability in economic conditions worldwide in general and in the Middle East in particular, also the sudden and severe fluctuations in some cost elements, and for instance the turmoil in fuel costs.

JPC believes that the pricing period should not be less than two years and not more than four years. This proposed period will reduce the disadvantages of the short periods, which include inability to verify the results and effectiveness of the employed regime, increase of administration cost and others. In addition, the proposed period will reduce the disadvantages of long term periods (more than 5 years), which include delay of reflecting the positive pricing period (if it existed) reflecting on beneficiaries and competition in the postal sector, it can also negativity of the short and long term-periods, and would enable the regulator to rectify any dysfunctions during its implementation without waiting for a longer time periods to carry it out.

<u>TRC Comment</u>

JPC's proposal for the pricing period (control period) to be not less than two years and not more than four years appears to be in line with international best practices on timescales for control periods and is considered plausible by TRC. TRC considers that a three year control period is best suited for the case of JPC.

Question-7: Interested parties are invited to comment on the possibility of introducing a pure revenue cap to regulate JPC's charges.

<u>JPC response</u>

JPC confirms what has been mentioned in Question number (6).

<u>TRC Comment</u>
JPC has not submitted any comments regarding the potential adoption of a pure revenue cap regime neither in their reply to Question-7 nor under their reply to Question-6.

Question-8: Interested parties are invited to comment on the suitability of introducing a hybrid cap to regulate JPC's charges.

<u>JPC response</u>
JPC cannot comment on this question, since the consultation document did not elaborate this issue sufficiently so as to enable JPC to evaluate it whether positively or negatively, but what JPC could state is that this regime could imply some complexity and indirectness which would make both TRC and JPC's task prone to distortion (due to the lack of experience).

<u>TRC Comment</u>
TRC has outlined in a brief and clear way the main features of the Hybrid Revenue Cap regime in the consultation document.

As discussed in the Consultation paper, under a pure revenue cap, a firm's allowed revenues are determined directly by a price control formula that is independent of output. Under a pure price cap, the price control formula determines a firm's allowed average price, and a firm's allowed revenues are the product of this allowed price and output.

A hybrid revenue cap is a mix of a pure revenue cap and a pure price cap. A hybrid revenue cap is in fact a weighted average of a pure revenue cap and a pure price cap. The advantage of a hybrid revenue cap over these two limiting cases is that it gives the regulator a greater degree of flexibility to design a formula that best reflects a firm's (exogenous) cost drivers. The better a formula reflects a firm's cost drivers the lower the risk that the regulated company will suffer windfall losses or enjoy windfall gains as a result of "shocks" that are beyond the firm's control (e.g., demand "shocks"). However, TRC clarifies that for the Jordanian reality, while the *hybrid cap* is an option it would make more sense to apply simpler regulatory regimes such as the pure price cap especially during the initial years of JPC's regulation.

Question-9: Interested parties are invited to comment on the comparative analysis of pricing regimes for the regulation of JPC's charges.

<u>JPC response</u>
JPC agrees with the Comparative analysis of different pricing mechanisms addressed by the consultation.

<u>TRC Comment</u>

TRC welcomes JPC's agreement with the comparative analysis of the different pricing regimes presented in the Consultation document.

THE LAZARD CONSORTIUM RESPONSE

2.3 Lazard's General Response

Lazard Response

(i) General remark

Our Consortium believes that this consultation is a rather theoretical exercise, which cannot be dealt with by all JPC's stakeholders; for instance the customers are certainly not in a position to answer such a consultation which includes questions meant for specialists of regulation matters. To be addressed by the customers, this consultation should not be based upon such complex and sophisticated concepts, and the questions should not be as precise and orientated with, to a certain extent, largely suggested answers.

TRC Comment

TRC's Consultation regarding the choice of the pricing regime is a standard consultation discussing the rationale, the theory and the advantages and disadvantages of internationally accepted alternative pricing regimes. As usual the consultation was open to all interested parties. TRC always encourages consumer participation and particularly through customer unions and groups.

However, as with any consultation of TRC and of any regulator internationally, it requires certain level of regulatory background and knowledge about regulatory pricing regimes which usually typically lies with regulatory economists, lawyers, postal regulation experts, etc.

Lazard Response

(ii) Field of the regulation

This consultation only pertains to the monopoly regulation, but not to the Universal Service (US) one; since the monopoly is going to be progressively waived, it looks unusual to regulate only the restricted services area. In most other countries, all the US field is regulated as such.

TRC Comment

It is true that the consultation regarding the pricing regime as stated in its title, *"Notice Requesting Comments on the implementation of the tariff regulatory regime for* <u>*the restricted services*</u> *of JPC"*, and as stated in the consultation questions, focuses on the regulation of the reserved services. The rationale and the legal requirement to regulate JPC's reserved services were explained in the consultation document.

As a result, and acting transparently, TRC published the consultation document in order to fulfil its legal requirements to regulate the reserved services.

However, TRC recognises that according to Article 146 of the MoICT Policy requires TRC to produce principles and guidelines for the regulation of the Universal Services:

(146) Government requires that the cost of providing universal services, including any losses incurred by the universal service provider, will be calculated precisely by JPC under principles and guidelines developed by the TRC. Recognizing the value of private operator mail services, exceptions to this reserved area are allowed as detailed in the postal law and any upcoming amendments and supplementary regulations.

If required, by the Law, TRC could easily expand the regime to cover not only the reserved but also the Universal services.

Lazard Response

(iii) Cost accounting system

As far as we know, JPC has not yet implemented an efficient cost-accounting system and thus is not yet able to calculate accurately its costs for each category of services which it currently provides. This is a basic issue for JPC and TRC, as well as for all JPC's stakeholders, including its clients. Thus it may be premature to provide for a pricing methodology before such a cost accounting system is efficiently set up and operational within JPC. As a matter of fact, whatever methodology is used for deciding on tariff increases for reserved services, it must be based on a starting point which cannot be different from "historical costs" still remained to be determined in the case of JPC.

TRC Comment

TRC recognizes that the development of JPC's cost accounting system would provide much more accurate and reliable information regarding the required costing data, key economic variables and other data figures required for regulating JPC's prices of the reserved services. However, it is equally true that TRC, in accordance with Article 9 paragraphs (a) and (e) of the Postal Services Law is required to proceed and initiate the development of JPC's pricing and tariff regulatory regime starting from the choice among alternative regimes in line with international best practices. Two things need to be noted here:

It is usually the case that regulatory pricing and tariff regimes are being developed in parallel with tools and systems instrumental to those regimes. Furthermore, it is typical that the regulator starts by setting the tariff principles and methodologies in the first place while the regulated company develops their informational requirements, data definitions and cost accounting systems in line with the regulatory principles, methodologies and requirements.

TRC, in consultation with JPC and other concerned parties, intend to provide more detailed guidelines about the applications of the chosen regime, its key economic variables, their definitions, cost accounting rules and definitions, etc. TRC intends to work together with JPC in the further development and elaboration of the regulatory regime something which will also benefit the development of JPC's cost accounting system so as to achieve compatibility with the chosen regulatory regime.

As a result, TRC sees no reason to delay any further the development of pricing regime. The issue of whether to use historical cost (HC) values, versus any other types of costs such as current costs (CCA) or modern equivalent asset values (MEAV) is an important matter to be dealt with during the next stage which will provide details of the regulatory regime including costing guidelines, cost allocation, asset valuation methods, etc. TRC notes that such issues were discussed at the appendices of the consultation document, providing an indication of the numerous and specific issues to be decided by the regulator during the next consultation.

2.4 Lazard's Responses to the Consultation Questions

Question-1: "Interested parties are requested to comment on postal pricing principles discussed above."

Lazard Response

These ten regulatory pricing principles [Economic Efficiency, Cost recovery, Equity (Non-discrimination), Competition facilitation, Consistency, Transparency, Simplicity, Predictability, *Stability and Affordability] are totally acceptable and understandable. They happen to match those which are outlined in the EU recommendations linked to the Postal Directives and which must be applied in the EU countries. They are also consistent with the basic principles outlined in our Legal and Regulatory Report, which happen to be the same*

TRC Comment

TRC's welcomes the agreement of Lazard Consortium on the pricing principles discussed in the consultation document.

Question-2: "Interested parties are requested to comment on the possibility of introducing a Rate of Return regime to regulate JPC's reserved services tariffs"

Lazard Response

To our knowledge, the Rate of return (ROR) methodology is not applied in the Postal sector in EU countries, because of possible distortion effects. It is however applied in some Asian countries and in places like in Hong Kong. The negative aspect of this methodology is that, in order to achieve the ROR target, managers can be tempted to decrease artificially the value of the assets, and even the turn over. Thus, we do not think that such a regime is desirable for JPC.

TRC Comment

TRC notes the objection expressed by the Lazard Consortium to the possibility of introducing a rate of return regime to regulate the prices of JPC's reserved services. TRC agrees with the fact that a Rate of Return Regime does not provide appropriate incentives to JPC to operate efficiently. However, TRC clarifies that under a rate of return regime the regulated company has no incentive to artificially reduce the value of their assets since they are guaranteed to earn an allowed return to their declared assets. In fact under the RoR regime the regulated company has an incentive to increase the value of their assets even at the cost of economic efficiency in order to receive the ex-ante allowed WACC (Weighted Average Cost of Capital). As discussed in the consultation paper, *however, the ROR regulation has also come under criticism for a number of drawbacks.*

Question-3: "Interested parties are invited to comment on the possibility of introducing a pure price cap to regulate JPC's reserved services charges."

Lazard Response

This methodology is applied in almost all EU countries for the US prices (see remark above about the field of regulation). It is in line with the price revision mechanism suggested and approved for the elaboration of JPC's Business Plan. The downside aspect of this methodology is that it is difficult to determine ex-ante productivity gains on which basis or what is the reference year, as a starting point?)

TRC Comment

TRC notes the preference of the Lazard Consortium to introduce a standard pure price cap mechanism which is in line with the price revision mechanism suggested and approved for the elaboration of JPC's Business Plan prepared by the Lazard Consortium. As illustrated in Table-1 of Part 2 in JPC's response, Price Capping has numerous significant advantages over the rate of return.

Regarding ***Lazard***'s point on the *difficulty to determine ex-ante productivity gains,* TRC Clarifies that, under a pure price cap regime the ex-ante determination of productivity gains is estimated using a number of alternative methods which are in line of internationally accepted methodologies.

For example, assumptions about the forecasted efficiency gains can be made on the basis of the estimated Total Factor Productivity (TFP) for the Jordanian economy. Other methodologies include the use of international productivity gain benchmarks as well as forecasted JPC cost reductions resulting from technological change and restructuring business plans, etc. In any case, the forecasted efficiency gains (X-factor) is a central estimate for the application of price cap regime and the TRC will calculate such estimates transparently on the basis of internationally accepted methodologies and will put them forward for discussion with JPC and other concerned parties.

Question-4: "Interested parties are invited to comment on the appropriate form and structure of the control."

Lazard Response
It is a very heavy task to implement an average cap or a tariff basket, rather than a total cap, and we wonder whether TRC currently has the human resources to do so; besides, assuming the availability of resources, they would probably need to be trained to develop adequate skills in this respect.

TRC Comment
TRC does not agree with the view that the implementation of an average cap or a tariff basket is a very heavy task. Tariff baskets is a standard solution consistent with international best practice that applies to the regulation of companies with multiple services/products as it applies a restriction to the price of a basket of regulated services as opposed to each and every individual service. As such, it provides some flexibility to the regulated company to price the individual services as they wish subject to the price cap constraint of the basket. One however, may raise the argument that the capping of the basket of services instead of the capping of individual services may lead to some degree of cross subsidization among the services of the basket.

TRC has the required experience in the implementation of an *average* price caps on service baskets. However, if required, the TRC will source consultant with international relevant experiences and proven qualifications to train and assist the TRC staff in the implementation of the price cap regime

Question-5: "Interested parties are invited to comment on the appropriate basket structure and basket contents."

Lazard Response
The basket methodology is very complicated to apply and we wonder whether it is suitable to the case of JPC. We would rather favour a simple methodology, which is not the case with the basket approach. Moreover, this approach is generally based upon products and services coming from the US and reserved area, but not only from the reserved area.

TRC Comment
TRC does not believe that the service basket approach is complicated and difficult to apply. It is a standard solution consistent with international best practice for regulated firms with multiple services.

Question-6: "Interested parties are invited to comment on the appropriate time horizon for the control period and possibility of introducing re-openers."

Lazard Response

Our Consortium has recommended a schedule for the waiving of the monopoly (ten years maximum) in our Legal & Regulatory Report, which has been endorsed in JPC's Business Plan. Therefore, we see no reason to depart from that recommendation.

TRC Comment

TRC notes the Lazard Consortium proposal for a ten year forward looking control period. However, it should be noted that:

- The international standard for control periods for price caps is between three to five years.
- Even in the limited number of cases where control periods are set for ten years, in practice there is a periodic review every five years with re-opener clauses subject to special unpredictable circumstances.
- The longer the control period, the higher the efficiency incentives as the regulated company is anticipated to retain any achieved efficiency for a longer period.
- The longer the control period, the more difficult is to estimate and forecast the key variables such OPEX, CAPEX, return on capital, the RAB (Regulated Asset Base) and the X factor of efficiency gains.

TRC believes *that a three year* control period would be a plausible one which provides a proper balance and is also consistent with international best practice. This belief was further confirmed by JPC's response to the same consultation question.

Question-7: "Interested parties are invited to comment on the possibility of introducing a pure revenue cap to regulate JPC's reserved services charges."

Lazard Response

The Consortium is not in favor of such approach since JPC's incentive is to reduce not only its operating costs, but also its total revenue, in order to stay within the required revenue cap.

TRC Comment

TRC notes the Lazard Consortium objection to the possibility of introducing a revenue cap.

As illustrated TRC will apply a pure price cap regime which consider to be more appropriate on grounds of simplicity (especially during the initial years of regulation) and consistency with international best practice.

Question-8: "Interested parties are invited to comment on the suitability of introducing a hybrid cap to regulate JPC's reserved services charges."

Lazard Response

May be acceptable, once all the prerequisites are fulfilled (see our Preliminary comments), but difficult to implement.

TRC Comment

TRC notes the Lazard Consortium conditional agreement (subject to the stated conditions) to the possibility of introducing a hybrid cap to regulate JPC's reserved services tariffs. The advantages of such an approach have been discussed in the consultation paper. However, TRC notes that the implementation of a hybrid cap requires additional calculations and assumptions regarding key variables compared with the simple pure price cap case.

and, while the *hybrid cap* is an option, it would make more sense to apply simpler regulatory regimes such as the pure price cap especially during the initial years of JPC's regulation.

Question-9: "Interested parties are invited to comment on the comparative analysis of pricing regimes for the regulation of JPC's reserved services charges."

Lazard Response

Subject to the availability of adequate accounting tools within JPC, and of required skills within TRC, the Consortium shares the view of TRC that the yardstick and Sliding scale methods are not relevant in the case of JPC and believes that the most adequate method to implement is probably a pure price cap one, to make it as easy as possible both to implement and to justify.

TRC Comment

TRC records the agreement of the Lazard Consortium that the Yardstick and Sliding Scale regimes are not that relevant to the Jordanian case and their proposal for the introduction of a simple pure price cap mechanism to regulate JPC's reserved services tariffs. As illustrated above TRC will apply a pure price cap regime