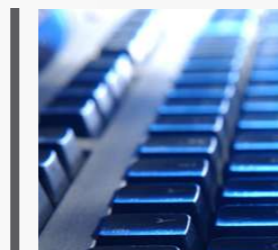


Economic Regulation



The Authority shall have the power to set and collect application, initial, annual and renewal fees for licenses, collect fines and fees under any license and, where appropriate, collect fees for services provided by Authority.

SECTION (3) (c, 6)

Retail price controls

On 9th August 2003, the TRA issued a consultation on retail price controls and subsequently held a public hearing on 4th October 2003. The consultation proposed the introduction of retail price controls on Batelco for some of the services which it provides, using a retail basket approach. The consultation also proposed the introduction of elapsed time charging and measures to protect vulnerable users in Bahrain.

Generally speaking, retail price controls are put in place to ensure that the ex-monopolist, in this case Batelco, is not passing unnecessary costs onto consumers, and that certain services will continue to be delivered at affordable rates to all sectors of the community. Price controls act as a proxy for competition in the early stages of liberalization.

Price controls ensure that, through increased efficiency, costs to the consumer are reduced, while still allowing Batelco to make a reasonable profit on all parts of the services it offers. The result is a fairer and more transparent telecommunications market.

In order for economic efficiency and reduced costs for consumers to be delivered, the prices that Batelco charges for services need to move more in line with the costs of delivery. The consultation sought to introduce this notion, known as 'tariff rebalancing', in a measured manner.

The definition of telecommunications markets

The TRA published a consultation on the definition of telecommunications markets on 19th February 2003. This set out the TRA's proposed method for defining telecommunications markets for the purposes of regulation. The TRA decided to employ the internationally accepted 'hypothetical monopolist' test developed by competition law authorities. This defines a market on the basis of the goods or services traded, the areas in which they are traded and the degree of demand or supply substitution that may be possible. Following comments received, the TRA published a determination on 19th April 2003.

The determination of market power

Concurrently with the definition of telecommunications markets, the TRA issued a consultation on the methodology for the determination of market power. This set out the criteria, such as market share, control of infrastructure not easily duplicated, absence of counterbalancing buyer power, and economies of scale or scope, that the TRA would use to determine whether an operator is dominant or possesses significant market power in a relevant telecommunications market. Following comments, a determination was issued on 19th April 2003.

Under the Telecommunications Law, the degree of regulation applied to a particular operator is usually based on a specification of their market power in a relevant market. Together with the Definition of Telecommunications Markets, this Methodology for the Determination of Market Power sets the framework within which an operator may be found to have market power and so become subject to more extensive regulation, or be investigated for potential abuse of a dominant market position.

Ownership regulation

The TRA published a consultation on a proposed ownership regulation on 2nd May 2003. This consultation set out the TRA's proposals on the ownership of telecommunications companies serving the Kingdom of Bahrain. The regulation is intended to place limits on controlling ownership in different companies serving the same concentrated telecommunications markets, in order to avoid the creation of dominance in a market through cross-ownership. This would reduce the development of real competition. Following detailed comments from interested parties, the Regulation was published on 29th October 2003.

Cost of capital

On 10th May 2003, the TRA issued a consultation on Batelco's cost of capital. It considered both the methodology to be used in calculating cost of capital, as well as the relevant factors to be used in calculations on Batelco's cost of capital. A determination was issued on 9th August 2003.

Cost of capital is one of the many costs incurred by any business. It is less immediately visible and tangible than costs such as wages and operating expenses, but nevertheless an important factor. In normal circumstances, a business must seek to make a return on the capital employed that is equal to the recurring cost of that capital.

This information is essential when calculating the relevant costs to be included when

considering Interconnect charges, certain tariffs and other matters that may be applicable to Batelco, as a dominant operator. It was a clear priority for the TRA at the early stages of market liberalization to ensure that Batelco was recovering only an efficient return on capital for those services which are regulated.

The TRA determined four separate cost of capital figures reflecting the relative risk of the separate business streams. These figures have subsequently been used in calculating the relevant costs for Batelco's products and services.

Accounting separation

On 9th June 2003, the TRA issued a consultation on accounting separation for licensees in Bahrain. The consultation sought views on the requirement for licensed operators to account separately and on the reporting standards that should apply.

When competition is introduced to a market such as Bahrain, where the incumbent operator has enjoyed a virtual monopoly for many years across all telecommunications services, it is necessary for the relationships between the various business streams contained within the overall integrated business of the incumbent to be visible, i.e. separately accounted. The aim is to ensure that the dealings between the business streams of the incumbent's business are on the same basis as dealings between the incumbent and its competitors. This guarantees that prices charged for services and intermediate products to other operators reflect the 'true and fair' costs that Batelco incurs, with no cross-subsidy from other parts of the business, and ensures a level playing field for competition.

The consultation considered the principles to be adopted for accounting separation, as well as the extent to which all individual licensees should be required to account separately for defined activities. This applied particularly to Batelco, as a recipient of all types of licenses and a potential licensee with significant power in certain markets.