The Bahamas Telecommunications Company Limited

Response To

Proposed Review and Revisions to the Regulation of Retail Prices for SMP Operators – Rules (Previously published as ECS 15/2010)

(ECS 16/2013)

Legal and Regulatory

January 3, 2014

Executive Summary

The Bahamas Telecommunications Company Limited (BTC) welcomes the opportunity to respond to this Public Consultation on the proposed review and regulation of retail prices for Significant Market Power (SMP) Operators – Rules (previously published as ECS 15/2010). BTC has long awaited the commencement of this consultation process as the Retail Pricing Rules which have been in place for more than four years, in the opinion of BTC, are no longer fit for purpose.

While some improvements have been suggested by URCA in the Consultation Document, BTC is generally disappointed in the results of URCA's review. In BTC's view:

- The review is timid, lacks significant progressive thought and initiatives and does not take the opportunity to make the regulation of retail prices more appropriate to the market structure of the telecommunications industry in The Bahamas. In particular, the review should consider seriously a move to a price cap, as both BTC and Cable Bahamas Limited (CBL) have urged
- The result of the review consists mainly of placing additional burdens on SMP operators, which this is contrary to the requirement for light-touch regulation necessary to stimulate and sustain a telecommunications industry on the cusp of development
- URCA maintains identical obligations on fixed and mobile services. Given the significant differences between these markets (in 2009 and today) it is difficult to see how such an approach can be seen as relevant or proportionate. BTC proposes to align remedies with problems identified in both markets. The resulting remedies are unlikely to be the same for each market
- URCA should take the opportunity to streamline and make its own decision making processes more efficient, and reduce the timescales for decisions in the Retail Pricing Rules

- The margin squeeze and predation tests proposed should be based on the Reasonably Efficient Operator (REO) tests, not the Equally Efficient Operator (EEO) tests proposed by URCA because REO tests are more appropriate to the market structure of The Bahamas and in light of the availability of data
- Margin squeeze tests should not be applied to mobile services, and predation tests are not appropriate for mobile promotions
- Margin squeeze tests should cover a longer time period than the proposed two years, with the regulated operator having the flexibility of suggesting an appropriate timeframe
- Replication tests should recognize that competition is based on the total offering to customers, not on individual services, and that they should be used to measure whether the alternative operator - CBL or BTC, as appropriate, and not some abstract theoretical entrant - can provide the proposed service.
- URCA does not address the main practical problem with the anti-competitive tests, that there is currently no adequate costing data to populate them and using Fully Allocated Costs would result in highly distorted outcomes. BTC proposes to put more reliance on observed prices in the market i.e. if any Other Licensed Operator (OLO) offers a service at a price point lower than that requested by BTC, then replicability of that price point would have already been proven by the market. In addition benchmarks should be used
- Currently OLOs charge a significant premium for fixed local call termination on their networks compared with BTC (1.98 cents per minute versus 0.93 cents per minute, which represents a premium of 113% for OLOs). This rate premium will allow an OLO to obtain higher wholesale revenues from a fixed line customer than BTC would, which in turn allows the OLO to lower retail prices below costs, without incurring an economic loss. This anomaly, while it is allowed to persist, should be reflected in any margin squeeze tests applied to BTC.

BTC has submitted significant comments on URCA's reactions and responses to the submissions from BTC and CBL, and proposals for improvements to the proposed Retail Pricing Rules and the tests set out in Annex A of the Consultation Document. It is BTC's intention that its comments will help improve the functioning of competition and the standard of regulation in The Bahamas, and that URCA will give them serious consideration.

General comments

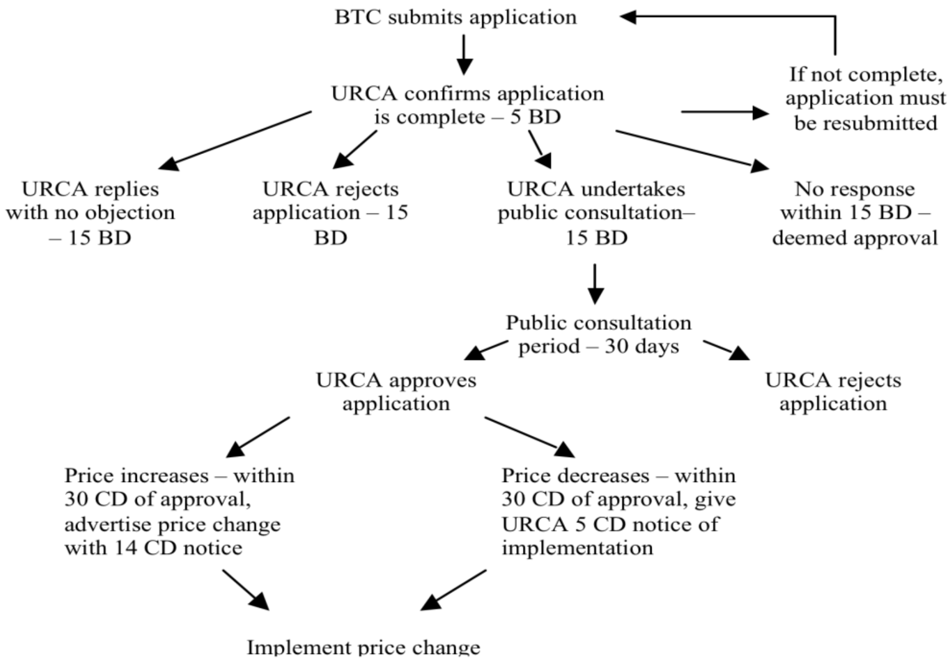
Impact of proposed changes

BTC maintains that regulatory intervention should take place in situations in which the regulator believes that market forces alone are unlikely to achieve the objectives of the Communications Act within the required timeframe. Further, in imposing regulatory requirements, due consideration should be taken of cost and the need to ensure that the cost to the regulator and affected parties is proportionate to the problem identified for remedying. BTC wishes to remind URCA that it is required under the Government's sector policy:

"… to apply a light touch regulatory approach … and not unduly … restrict the commercial freedom of communications providers" (paragraph 24).

BTC considers that the changes proposed by URCA to the Retail Pricing Rules do not satisfy these requirements – they make regulatory burdens on operators *worse*, and they *reduce* their commercial flexibility. The diagram below shows a flow chart for the existing Rules, and it illustrates that the present system consumes significant amounts of time and resources for both the SMP operator and URCA. None of URCA's proposed changes reduce these burdens. On the contrary, they increase the amount of information that operators must provide and URCA must review, and do nothing to make the timeframe shorter.

Figure 1: URCA approval process for price changes under Retail Pricing Rules



BTC acknowledges that there are some areas of improved clarity under the proposed new Rules, i.e. definition of new services, expanded definition of One Week Special Promotion (to include seven (7) non-consecutive days within a fourteen-day period) and outline of the various competition tests (predatory pricing, margin squeeze and undue discrimination). But generally the proposed changes to the Retail Pricing Rules (ECS 16/2010) are even more onerous than the existing Rules (ECS 15/2010). It is envisaged that the proposed changes will further hamper BTC's ability to respond to changes in the marketplace and slow the benefits that can be accrued to consumers as a result of price reductions.

In reviewing the proposed Regulation of Retail Prices for SMP Operators – Rules at Annex A (ECS 16/2013), it is evident that the proposed rules are not proportionate or fit for purpose. While the competition tests, i.e. predatory/margin squeeze, assessment of undue discrimination and assessment of bundled offers including regulated services, provide some sought-after clarity with respect to the application of the rules, the rules as proposed in Annex A are even more onerous than the existing rules (ECS 15/2010). For example, paragraph 19.9.5 requires the SMP operator to specify the relevant wholesale services and associated prices required by an alternative operator to offer a similar retail service. This is a new burden being placed on operators. Similarly for price change applications, under the proposed Rules, the requirement is for two (2) years of actual and projected subscriber and revenue data broken down by month, compared to the provision of one (1) year of actual and projected subscriber and revenue data under the existing Rules.

Regulation of price decreases

BTC has always maintained that there should be greater flexibility on the part of URCA in granting approvals for price reductions, which are seen as beneficial to consumers. Instead of simplifying the approval process the proposed Retail Pricing Rules have added more layers of data requirements for price changes, in particular, price reductions. The requirement for the performance of a predation test in the absence of competition in mobile and where there is no evidence to date, where such tests are performed for the provision of mobile services in other jurisdictions is another example of the imposition of unnecessary and irrelevant considerations. Further, the same challenge that URCA had pointed out at the time of imposing the transitional rules-based approach to Retail Price Regulation compared to the use of Price Caps, is presented by way of the predatory and margin squeeze tests. These tests require stable and reliable costing data. If URCA is satisfied with the costing data presently, then there is justification to move towards price cap regulation and abandon the onerous rules based approach to regulation.

Mobile market predation tests

BTC has found no evidence from other jurisdictions, where there is the application of a predation test in the regulation of cellular mobile services. It is not in the economic interest of BTC to engage in predatory pricing, given the ramifications for its own profits. Further, with prospective competition in mobile and fierce competition in the provision of other services, i.e., fixed voice and broadband, there is no economic incentive for the Company to engage in predatory pricing. We would invite URCA to specify in much more detail the kind of predatory behaviour it is concerned about in the mobile market, based on a 2009 review which did not anticipate competitive entry in the projection period. Such examples would be very useful to ensure remedies are proportionate to problems identified.

Nature of competition in The Bahamas

Four years have elapsed since competition in fixed telecommunications was permitted under the Communications Act 2009. While the market will continue to develop, the basic structure has settled down to two facilities-based operators, one on the fixed telecommunications network, one on a cable television network. This pattern is found in many other Caribbean countries, and despite freedom of entry, service-based competition has not developed, mainly due to the small market size in The Bahamas and the other Caribbean countries. The Government has announced that one mobile licence will be issued in 2014, resulting in a duopoly in fixed and mobile markets.

BTC considers that price controls should recognize this structure of competition, which consists of two operators with different cost structures competing against each other. Hence:

- Tests designed to ensure competition – margin squeeze and predatory pricing, for example – should be based on the proxy costs of a Reasonably Efficient Operator test, not the Equally Efficient Operator test. This implies that adjustments need to be made to BTC’s costing data to reflect and/or that more emphasis should be placed on observed market price levels and/or benchmarks
- Price regulation should focus more on protecting consumer interests rather than on competitive effects.

Learning curve

Over the last four year URCA has gained experience and additional resources in the operation of retail price controls. BTC believes that these benefits should be passed on to operators – and hence to customers - in the form of faster decision making in URCA, and shorter timescales in the Retail Pricing Rules.

Transparency

BTC notes that URCA has not highlighted or justified any of the changes made to the Retail Pricing Rules, and as a result the Consultation Document is deficient. BTC suggests that at least URCA should call a meeting of operators to explain the detail and justification for its changes. In the absence of such a meeting this process would be devoid of the transparency upon which such regulatory procedures are usually predicated.

URCA’s comments on BTC’s submission

In paragraph 3.2 of the Consultation Document URCA comments on BTC’s submissions of March and May 2013. BTC would like to respond to URCA’s views, as follows.

Exercise of regulatory forbearance

As outlined above, BTC believes that the structure of competition in fixed services is stable, at least for the foreseeable future, as a duopoly. In the mobile market the Government will permit only two operators for the next few years. In a duopolistic market operators compete on a total service offering to customers, not on individual services, and react to price changes made by each other. BTC considers that URCA’s very limited approach to change in this Consultation Document is mistaken and a missed opportunity to demonstrate forward movement in regulation in the Bahamas.

BTC is not arguing for a change in the remedy of price controls, which will be reviewed as and when URCA undertakes a market review, but in the form of the price control remedy. BTC reiterates its call for greater regulatory forbearance, and in particular proposes that URCA should distinguish between price decreases and price increases in its review of price changes. In general price decreases are in consumers’ interests, except when predatory pricing is being practised, and should therefore be subject to fewer checks and a faster decision making process than price increases. BTC considers that price decreases should be subject to ex post regulation, leaving price increases, new services and bundles subject to the Retail Pricing Rules.

Greater reliance on ex-post competition powers

In its earlier comments BTC called for greater use of ex-post regulation and less ex ante regulation, which is the path most regulators follow as competition develops. As competition in fixed services appears to be stable in The Bahamas, BTC considers that the time is right for such a move.

URCA in its response refers to the danger of margin squeeze etc. where BTC provides wholesale inputs to other operators. However in reality the only wholesale input provided to other operators will be call termination because competition is facility based, not service based. In these circumstances, BTC considers that regulatory oversight of price changes should be reduced – whereas URCA proposals result in an *increase* of ex ante regulatory burdens. BTC reminds URCA that under section 5(b) (ii) of the Communications Act 2009 it should have regard to the cost and implications of regulatory measures on affected parties, and it has failed to do this in its review of the Retail Pricing Rules.

Greater transparency of the approval process

BTC notes URCA's comments, and wishes to remind URCA that requests for additional information should not be made without regard for the cost and time implications for operators, which it must consider under section 5(b) (ii) of the Communications Act 2009.

Predictability of the Rules

BTC is obliged to URCA for the detail provided in relation to the margin squeeze and bundles tests.

Need for greater pricing flexibility

BTC appreciates the reassurance by URCAthat subsidized prices are permissible in certain circumstances. As mentioned above, competition in both fixed and mobile markets is based on a total service offering to a customer, not on individual services, and price regulation must be based on an analysis of packages, not individual services.

BTC takes issue with URCA's satisfaction with the timescales set out in the revised Retail Pricing Rules, and considers URCA refusal to contemplate faster decision making processes to be self-serving. URCA has had almost four years of experience in price regulation and has gained additional resources, and should be required to meet more stretching targets. This would be in the interests of consumers, who would see faster implementation of price changes. BTC therefore proposes that the timescales for URCA's decisions should be reduced significantly, and believes that if URCA rises to this challenge, it will find ways of improving its performance. Regulatory authorities, as do operators, must act and have a duty to act in an efficient and responsive manner.

Restructured Pricing Rules

BTC had expected as part of the review of the Retail Pricing Rules that a baseline for URCA as part of the review process would have been streamlined pricing rules. URCA as part of the review process proposed a reduction in the number of days between *similar* promotions from one hundred and twenty (120) days to ninety (90) days. This is not material, given the frequency that BTC expects to run Special Promotions, in an effort to provide benefits to consumers.

Despite the absence of competition in the provision of cellular mobile service, URCA as per the proposed revised Rules requires ten (10) business days, which equates to an estimated fourteen (14) calendar days for a Full Length Special Promotion. BTC is hard pressed to see the justification for fourteen (14) calendar days for an approval that involves a temporary price reduction, in the absence of competition in mobile. Such a prescriptive approach delays providing customers with benefits.

CBL's submission

In section 3.2.6, CBL states "in reference to Section 5 of the Communications Act, CBL viewed the existing Retail Pricing Rules as neither efficient nor proportionate and believe the Rules are better suited for the monopoly environment of the past rather than the current market in which there is competition". BTC fully agrees. BTC notes URCA's observation that "acknowledges the importance of timely review and updating of regulatory measures to keep pace with experience in how the Rules function". BTC believes that, after more than four years have lapsed since the last market review, there is a significant risk that the Rules are no longer proportionate to any market issues identified in the *current* market circumstances, particularly in fixed markets where competition has developed well. Without such reviews on a much more regular basis than has been the case, URCA is not in a position to state that any remedies are proportionate.

In section 3.2.10, URCA agrees with CBL on the need for review and updating of the Retail Pricing Rules to clarify the treatment of price-regulated USO-related services. URCA has now proposed to include new responsibilities on universal service providers seeking to change prices of universal services. For example the new rules require USO operators to demonstrate affordability, and that price increases are beneficial to consumers and the telecommunications sector. BTC considers that these general concepts are impossible to demonstrate effectively, and that the idea that price increases can be beneficial to consumers and other operators is mistaken. It is quite extraordinary that URCA refers to its 2013 Working Program, where URCA proposed to undertake various activities to ensure USPs comply with their USOs. This would presumably include a working definition of the term 'affordability'. However, URCA never defined either the term "affordability" or how an operator should demonstrate that price increases can be beneficial to consumers. Even where such benefits exist, for example to facilitate competitive entry, it would be highly debatable that such an argument would receive a fair hearing through a public consultation process, if it is not explicitly supported by URCA guidelines. It would therefore be inappropriate to include terminology in the Retail Pricing Rules that have neither been defined or agreed, and which have the effect of increasing regulatory burden and uncertainty on USO operators. BTC considers that there is no need for additional requirements when price changes are made to universal services, and proposes that paragraphs 49 – 52 should be removed.

BTC notes CBL's comment in section 3.2.11, that "off/on-net price discrimination is a popular tactic employed in other jurisdictions and CBL would like to see ex-ante safeguards in place prior to mobile competition to prevent possible abuse of this practice in the event of price changes that can potentially raise concerns related to policy or competition." It is ironic that CBL expresses concerns on this matter, since it was CBL that pioneered on-net/off-net price differentials in The Bahamas in its Revoice plans. The assumption has to be that CBL therefore sees the commercial merits of on-net/off-net price differentials, as does BTC. BTC also notes that this review of the Rules relates to a mobile market review of 2009, which did not anticipate competitive entry into the mobile market in its projection period. The legal basis therefore does not currently exist to address competition concerns related to competitive entry in the mobile sector.

Implementation of a Price Cap for Fixed Line Services

BTC in its response to the Public Consultation on Retail Pricing in the Communications Sector, August 3, 2009, supported the implementation of price caps. URCA in the August 3 2009 Retail Pricing Consultation had indicated that the existing Retail Pricing Rules (ECS 15/201) were intended to be a transitional arrangement for a period of six (6) to twelve (12) months. These rules have now been in place for more than four years and BTC would welcome further clarification from URCA on the envisaged steps towards a price cap for fixed services.

BTC supports the implementation of a Price Cap with notification based on the following:

- The implementation of a price cap to a basket of services would afford BTC greater flexibility in rebalancing its tariffs.
- Price caps reduce the time and resources required for price regulation for both the SMP operator and for URCA
- Price Caps would provide SMP operators with the flexibility to adjust prices quickly in response to market changes compared to the existing rigid rules based approach to price regulation which deter and slow pricing innovation.
- With the progress to date with the Separated Accounts, the outputs of the Separated Accounts should be used as the starting price (Po) under a price cap regime for fixed line services. Adjustment to price over time will be based on the x-factor.

BTC has quite a different view on the merits of price caps to that of CBL, which largely sees price caps as a vehicle to force price changes (including price increases) on BTC's customers. BTC takes quite a different view on the merits of price caps, which is a view in line with international best practice. BTC also only sees merits in price caps for fixed SMP services, and not for mobile services. In the mobile market, after competitive entry takes place in 2014, BTC's pricing behavior will be adequately constraint by a new entrant, which will likely be able to provide alternative service in all of The Bahamas shortly after launch. In similar circumstances, regulators around the world have relied on market forces, Competition Law interventions and regulation of wholesale markets to ensure consumers are adequately protected. There is no reason the Bahamas should deviate from international practice which has a proven track record of successful competition.

Annex A – Regulation of retail prices for SMP operators - Rules

BTC has the following comments on URCA's proposals.

Para 14.1 – with three and a half years of experience, URCA should now be able to reduce the timescale for a response from five (5) days to three (3).

Para 14.3 – the public consultation is a major uncertainty in rolling out a price change, especially as competition in mobile is introduced. URCA needs to reconsider the value of public consultation on price changes because it causes significant damage to the commercial market by giving the SMP operator's competitors plenty of prior notice of price changes. In reality the public will be opposed to price increases and in favour of price decreases, and public consultation is of little value for most price changes. BTC considers that public consultation should take place only when substantial changes to the underlying structure of prices is proposed – for example the introduction of calling party pays, or the withdrawal of a service. It urges URCA to provide more clarity on when it thinks that public consultation is necessary on price changes in order to give more certainty to operators. BTC suggests that the last sentence of paragraph 14.2 should be reworded as:

"URCA will consider undertaking public consultation when a significant change to pricing structures or a withdrawal of a service is proposed".

Para 15.1 and 15.2 – BTC does not understand why notice of a price change has to take place within 30 days of URCA's decision, and why the decision should lapse if this does not take place. The marketing of a price change is a commercial matter, not a regulatory matter, and this requirement should be removed. In the electronic age, the requirement to publish the notice in a newspaper is archaic, ineffective and costly, and an announcement on a website should be sufficient.

BTC therefore proposes that paragraph 15.1 should be reworded as:
"15.1 In the event of a price increase (for either a Single Price Regulated Service, or a Price Regulated Bundle), the SMP operator must, give subscribers at least fourteen␣(14) calendar␣days'' notice of the price change and advertise the change prominently on its website.

15.2 For all other price or service changes (including the introduction of new services deemed by URCA to be Price Regulated Services), if the implementation date differs from that set out in the corresponding application, the SMP operator shall notify URCA at least five␣(5)␣calendar␣days␣before the price or service change takes effect."

Para 19 – URCA has included many additional information requirements which are not in the current Rules, BTC considers that URCA should be reducing, not increasing the burden on operators and itself. The additional items include:

- 19.2 – targeted customers segment
- 19.4 and 19.5 – price broken down by recurrent and non recurrent element
- 19.9 – data required on a monthly basis; data required for a two year rather than a one year period
- 19.9.5 – a replicabilty test
- 19.10.2 – an undue discrimination test

BTC notes that in its consultation document URCA does not mention these changes, let alone provide any justification for them. BTC proposes that these requirements for additional information should be deleted.

Para 22 – BTC considers that a period of 30 business days (six weeks) is now too long for a regulatory decision, and that URCA should speed up its process so that a period of 10 business days applies to price decreases (if price decreases continue to be subject to ex-ante regulation) and 15 business days for price increases. This will enable SMP operators to respond more rapidly to market changes, especially with the advent of competition in the mobile sector.

Para 24 – BTC is pleased to see that the cap on the number of Single Day Promotions in a year has been removed. However it is concerned that URCA's approval or disapproval will be communicated only the day before the promotion is due to be launched. This does not permit an operator sufficient time to change its plans efficiently. BTC proposes that URCA should inform the operator of its decision three (3) business days before the planned launch date, and if this not received within this timescale, the operator may deem approval

Para 27 – while BTC welcomes a reduction of the repeat period for special promotions to 90 days, it considers that the reduction should go further in anticipation of mobile competition, where the use of special offers will become much more common. BTC proposes that the repeat period should be reduced to 60 days.

Para 28 – again, URCA has increased in the information it requires for promotional price changes without any justifications. It now requires additional information on:

28.3 – launch date and duration

28.4 – commercial rationale

28.5 – demand data

28.6 – revenue data

28.7 – cost data

28,8 – replicability analysis

BTC cannot see how this is consistent with the requirement on URCA to exercise "light touch regulation". BTC proposes that these requirements for additional information should be deleted.

Para 29 –the period for URCA's decisions on promotions should be cut to 3 days for a one week promotion and 5 days for a full length promotion

Para 35 – URCA is again increasing the regulatory burden on operators by demanding additional information:

> 35.9.1 - data required on a monthly basis; data required for a two year rather than a one year period
>
> 35.9.2 - data required on a monthly basis; data required for a two year rather than a one year period
>
> 35.9.3 – revenue data required for a two year rather than a one year period
>
> 35.9.4 – cost data required for a two year rather than a one year period

Para 36.2 – Here URCA is specifying an Efficient Operator Test by requiring information on the costs of the operator proposing the change. BTC believes that this is not appropriate for the market structure in The Bahamas, where two facility based operators compete against each other in fixed (and in 2014 mobile) markets. The key issue is whether the alternative operator can replicate the bundle on its own network, not whether it will use wholesale products from the SMP operator. Instead URCA should test the bundle using the Reasonably Efficient Operator test, that is a proxy of the costs of the alternative operator. This could be done through a combination of adjusted cost data from the separated accounts, observed OLO prices in the market and benchmarks.

Para 40.4 – Again URCA is increasing the burden on operators by requiring monthly data.

Para 50 – this paragraph places new responsibilities on universal service providers seeking to change prices of universal services. It requires operators to demonstrate affordability, and that price increases are beneficial to consumers and the telecommunications sector. As noted above, BTC considers that these general concepts are impossible to demonstrate effectively, and that the idea that price increases can be beneficial to consumers and other operators is mistaken. BTC considers that there is no need for additional requirements when price changes are made to universal services, and proposes that paragraphs 49 – 52 should be removed.

Annexes 1-3 to Annex A – Details of the various tests

Annex 1: Details of the test for the assessment of predatory/margin squeeze prices

While BTC welcomes the much sought after clarity with respect to the appropriate tests that should be applied in assessing predation and margin squeeze, there are a number of fundamental issues that are not being addressed in this annex. In the interest of transparency and predictability, BTC would welcome additional amendments to address the below points.

Differentiation of the Rules in fixed and mobile markets

BTC is of the view that the significant observed differences between fixed and mobile market dynamics should result in different margin squeeze tests and predation tests for these markets and how they are applied.

For example this should include:

- ✓ No margin squeeze testing for mobile services – BTC does not (currently) provide mobile wholesale services that are needed to provide domestic retail services in The Bahamas and it should be pointed out in the rules that margin squeeze testing is therefore not needed for retail mobile services.
- ✓ No predation testing is needed for temporary mobile price changes including any promotions (single day, one-week or full length Promotions). In the absence of a second mobile entrant in the market, it is difficult to see how BTC can behave in an anti-competitive way in relation to temporary price changes, where prices are restored to their original level after the promotion has ended. BTC appreciates that there could be a concern that multiple promotions are launched which, in combination, mimic the effect of a permanent price change. However, this can be addressed by imposing a notification obligation for promotions to ensure

they are not repeated within agreed timeframes. Predation testing of *any* short-term promotions, however, serves no purpose in a monopolistic market and should be removed.

- ✓ Predation testing should be applied differently in fixed and mobile markets. In the mobile market, BTC is likely to have a monopoly until the second mobile operator receives its licence (currently projected for April 2014), after which there will be a period of competition between two operators (i.e. a duopoly), with further entry restricted until (potentially) a third licence is issued. The two mobile operators will compete across all mobile services and market segments, which means that even if prices fall below (a definition of) costs in a certain segment or for a certain service in the market, cross-subsidies will be available to the second operator to match such prices from segments where prices remain above costs. In general it is very hard to make a realistic case for predatory behaviour in a mobile market with a duopolistic structure. This would require BTC:
  - To lower *average* mobile price below costs in order for the second operator to either leave the market or restrict its growth
  - Followed by BTC benefitting from this behaviour through increased prices, or the prevention of price declines.
- ✓ In BTC's case this would involve lowering average mobile prices very substantially. Based on the S/A and using the result of URCA's efficiency study, BTC would need to lower average mobile prices by 41% to get to S/A costs and by 79% to get to efficiently incurred costs (taking account of URCA's assessment of efficiencies in the mobile business). Prices would need to drop further for single-market predation in the mobile market to occur. This pricing approach would result in 1) substantial accounting losses (BTC still has the costs URCA deems inefficient in its accounting systems) and 2) investigations under competition law.
- ✓ BTC asks URCA to demonstrate what predatory pricing would look like in this market structure and how this is reflected in the remedies, particularly since remedies are based on a market review that did not anticipate

competitive entry in the mobile market. It would also be useful to discuss examples from other markets where predation in a two-operator mobile market has been found. In BTC's view these instances are very rare (we found <u>none</u>).

- ✓ This implies that pricing below (a definition of) costs for an individual plan or price point is not anti-competitive as long as profit levels in the overall market are sufficient to match such price points. This is a very different dynamic to the fixed market where smaller entrants could potentially focus on niche segments. This difference is not captured or appreciated at all in the Rules.
- ✓ BTC is also concerned that URCA takes a view of anti-competition tests that is too narrow by only focusing on the margins of the price points or bundles for which approvals are sought, while ignoring the profitability of the customers who may be affected by such price changes. The following example illustrates.
- ✓ Let's take an example of a mobile post-paid customer taking:
  - Access (a monthly subscription)
  - Ability to make and receive calls
  - Ability to send and receive SMS/MMS
  - Ability to download/upload data
- ✓ Illustrative margins for such customers are presented in the table below – the overall margin per customer across all services taken is $30.

Figure 2: Pre-paid customer margins

Margins - average post-paid customer (illustration)				
	REV	Costs	Margin	
Handset	10	20	-10	
Access	20	10	10	
Calls	30	10	20	
SMS/MMS	10	2	8	
Data	5	3	2	
Total	75	45	30	

- ✓ Now let's assume BTC would like to introduce a bundle to make international calls for 10$ with costs for this bundle of $12.
- ✓ If URCA applies the margin squeeze test just on this bundle for which approval is sought, the negative margin would presumably be seen as anti-competitive.
- ✓ However, the overall margin for the customer is hardly affected (and still positive, see the next table) and the customer can therefore still be competed for by the second mobile operator.

Figure 3: Pre-paid customer margins (after introduction of the new bundle)

Margins - average post-paid customer (illustration)				
	REV	Costs	Margin	
Handset	10	20	-10	
Access	20	10	10	
Calls	30	10	20	
SMS/MMS	10	2	8	
Data	5	3	2	
INT'L Calls	10	12	-2	
Total	85	57	28	

- ✓ BTC therefore proposes to:
  - Apply a predation test on mobile services that takes account of profit levels across the entire mobile service portfolio, not just for the service to which the price change relates.
  - Apply predation tests on mobile services (and fixed call services, where the same issue applies) that take account of the wider profitability of customers. It is important that the Rules reflect that competition in The Bahamas takes place for <u>customers</u>, not for individual bundles or for types of calls.
  - URCA should allow BTC to match the price points of the mobile second entrant and not conduct predation tests if price points remain above those introduced by the second entrant – i.e. if the new entrant prices at a certain level, this should be treated as proof of replicability in a two-operator market.

In short, BTC is firmly of the view that URCA in the proposed predatory and margin squeeze tests have ignored the structure of fixed line versus mobile markets. The former potentially lends itself to the application of anti- competitive tests (i.e. predatory and margin squeeze) of more narrowly defined combinations of services, while the latter suggests the application of these tests across a broader suite of services.

<u>Limitations of using Fully Allocated Costs (FAC)</u>

As URCA has pointed out in Annex I, '… In line with international precedence, URCA's considers the use of Long Run Incremental Costs to be the most appropriate cost measure for this test. **However, URCA recognizes that LRIC costing information is not currently available in The Bahamas.'** Given that LRIC costing models are not available in The Bahamas, URCA requires the use of a Fully Allocated Cost (FAC) data in assessing predatory and margin squeeze tests.

BTC agrees with URCA that LRIC cost estimates are more appropriate and BTC also believes that fully allocated costs are generally an unsatisfactory basis for margin squeeze and predation testing. FAC suffers from a number of draw-backs including:

1. Costs are based on historic price levels, not current price levels
2. Costs may include inefficiencies
3. Costs are not forward-looking and do not take account of the impact of new services on service volumes and unit costs
4. FAC assumes an allocation of common costs to services which may be quite different to how operators design prices in practice (this is more likely to be based on perceived pricing elasticities). As a consequence, a regulated firm will find it impossible to compete in price elastic segments of the market, if price floors are based on FAC.

These limitations have the potential to severely damage the ability of a price-regulated firm, while not providing the consumer protection intended. A test based on the costs of the alternative operator (Reasonably Efficient Operator) is appropriate to the structure of competition in The Bahamas, whereas a test based on the SMP operator's costs (Equally Efficient Operator) will result in consumers enjoying fewer price decreases and hence higher bills. The telecommunications sector is characterized by high fixed common costs i.e. unit costs fall with an increase of volumes.

It is in the interest of consumers for prices to be reflective of this cost structure with high-volume customers getting higher discounts or lower effective prices than low-volume customers. This will stimulate usage overall, lower unit costs and lower tariffs for services going forward. However, using FAC will restrict the regulated firm to an average cost standard and prevent it from competing with operators pricing towards LRIC costs in the market. This is obviously unnecessarily restrictive and the limitations of FAC costs should be recognized and addressed in the Rules. BTC therefore proposes, in the absence of LRIC cost estimates, to put greater emphasis on observed market pricing levels as offered by OLOs. For example, if BTC requests a price change for an SMP service, with the effective prices being above the price level offered by an OLO in the market, then this should provide sufficient evidence that offers are economically replicable and further costing analysis should not be needed. If BTC proposes price levels below those observed in the market, other data should also be used, including benchmarks, as proposed by URCA.

Using costs for an equally efficient operator

BTC completely disagrees with URCA proposal to apply tests that allow for an *Equally* Efficient Operator (EEO) to obtain a reasonable margin. EEO may be an appropriate approach where forward-looking LRIC cost estimates are available, it is *not* an appropriate standard to use where only historic FAC costs are available.

For example, in its analysis of BTC's relative efficiency, URCA came to the conclusion that BTC's cost information as presented in the 2010 Separated Accounts (based on FAC) were reflective of significant inefficiencies (64% for mobile services and 36% for fixed services, see ECS 20/2012). Where such inefficiencies are reflective of historic price levels for infrastructure or outdated business practices, clearly resulting costs would be inappropriate to use as price floors for a regulated firm as it would embed inefficiently incurred costs in the minimum price levels BTC would be allowed to charge. Based on URCA's own assessment, OLOs should be able to price significantly below BTC's FAC without incurring economic losses and to restrict BTC to FAC would clearly be detrimental to the development of competition in the market in these circumstances. Finally, BTC incurs higher costs than its competitors as a consequence of its universal service obligations and again it would be inappropriate to use the unadjusted costs incurred by a universal service provider as the basis for retail price floors.

In BTC's view, the appropriate price floor should therefore be based on:

- ✓ For mobile services: cost for a reasonably efficient operator or REO, which in BTC's case implies that accounting costs *at least* needs to be adjusted to reflect efficiently incurred costs. Alternatively, benchmarks or LRIC estimates from other markets should be used.
- ✓ For fixed services: network costs for *call services* should be reflective of URCA's decision on call termination rates, for other fixed services again an estimate of REO costs will be needed. Alternatively benchmarks or LRIC estimates from other markets should be used.

BTC would welcome an adjustment in the rules to reflect these concerns.

<u>Margin squeeze tests and the length of the projection period</u>

BTC notes that URCA intends to apply margin squeeze/predation tests over a two year period. However, margin squeeze/predation testing over such a short projection period is not appropriate. The relevant timetable for tests will vary between markets and market segments and should be related to the period of time a customer is expected to stay with an operator, as this is the appropriate time-period over which to spread customer acquisition costs.

In a duopolistic market structure customers can be expected to remain with a provider for much longer than two years, with customer life cycles in the fixed market generally being longer than in mobile markets. URCA should capture this in the rules by allowing for variation in the period of time over which a test is applied, with the justification of this time-period being left to the regulated operator. URCA could think to maintain the two-year projection period as a *minimum* period for which to provide forecasts. Moreover, URCA's requirement for monthly data is onerous, especially given the likely errors at such a level of disaggregation.

If the draft rules are left as they are, BTC would be prevented from competing for customer segments characterized by high customer acquisition costs, which clearly does not benefit consumers in any shape or form.

Taking account of call termination rate asymmetries

In the fixed telephony market, currently call termination rates are asymmetric with OLOs charging 1.98 cents/minute and BTC charging 0.93 cents/minute for local call termination on their networks. When an OLO competes for a fixed line customer, it will therefore do so in the knowledge that any wholesale revenues related to that subscriber will be significantly higher than BTC's wholesale revenues relating to the same customer. This puts BTC at a competitive disadvantage and it allows the OLO to charge lower retail tariffs than BTC without incurring economic losses as a consequence of the available cross-subsidy from the call termination service. It is bad enough that this situation is allowed to persist in the market, but it is even worse that it is not recognized in margin squeeze/predation tests described by URCA. BTC therefore proposes to adjust the margin squeeze/predation formulas to reflect incremental wholesale revenues related to fixed call termination services available to OLOs and to lower relevant retail price floors for BTC accordingly.

Annex 2: Assessment of undue discrimination

It is our understanding from Annex 2 that URCA believes that margin squeeze and anti-competitive on-net and off-net pricing are the main concerns in relation to undue discrimination. The comments made by BTC on URCA's margin squeeze approach apply equally to this Annex 2 and we will therefore focus our comments on the on-net/off-net pricing example.

First of all, BTC believes that on-net/off-net pricing is highly beneficial to consumers in the market and we are pleased to see that URCA approves of on-net/off net price differentials if certain safeguards are met. In a market characterised by high fixed costs and common costs across services, operators should be allowed to compete for business traffic of groups of customers that share social ties (families, groups of friends, co-workers etc.) in a way that recognizes the network effect for such groups and stimulates traffic on the network. This increase in traffic in turn lowers unit costs of services provided, resulting in lower tariffs overall and increased customer benefits. In a Calling Party Pays (CPP) market, the network effect is particularly strong for such groups because callers are not just sensitive to charges for calls they make, but also to charges for calls they receive, because often (for example with parents and their children) they end up paying for those charges, too. On-net/off-net price differentials are therefore a legitimate and common feature in competitive markets to attract and retain such groups, with CBL first introducing the concept into The Bahamas.

BTC notes that the hypothetical example presented on on/off-net price differentials is only relevant in markets where competition exists for separate voice services. This could, for example, relate to markets where competition for domestic calls takes place separately from competition for international calls, for example through carrier selection platforms. The example presented is, however, not relevant at all in The Bahamas, where fixed competition takes place across bundles of services which include access, local calls, domestic long distance calls and international calls. In a market of this structure, replicability testing should take place across all call services combined to ensure offers can be replicated.

This approach is of even greater importance in the mobile market. There, competition will take place across bundles of services covering voice and data and any on-net/off-net differentials should be assessed based on the overall profitability of the services acquired by customers, not just for domestic mobile-mobile calls. We trust URCA agrees with this and that the example is simply intended to demonstrate the mechanics of the test, not its actual applicability in The Bahamas.

Annex 3: Assessment of bundled offers including Price Regulated Services

In relation to the flow chart presented on bundled offers, BTC has two main observations.

The first one relates to economic replicability of a bundle. BTC's particular concern relates to how traffic outside bundles is treated, both overage and out-of-bundle traffic. In other countries, margin squeeze tests have been developed for bundles within the context of competition taking place on a call-by-call (carrier selection) or call categories (carrier pre-selection) basis. Margin squeeze tests in such countries tend to be more restrictive because OLOs should be able to compete for individual calls inside the bundle and margin squeeze tests on the effective prices within bundles are therefore necessary. In The Bahamas by contrast, competition takes place for *customers* not for *traffic*, i.e. when an operator is successful in attracting a customer to its network, all traffic of that customer will migrate to the network of that operator, whether such traffic is inside or outside the bundle. Margin squeeze tests for voice bundles should reflect that this is how competition takes place, the easiest way to achieve this is to include out-of-bundle traffic in the margin squeeze or predation test. BTC proposes that the Rules are changed to reflect this.

The second observation relates to bundles including mobile services. BTC appreciates that for such bundles (unlike for single price changes or promotions for mobile services) anti-competitive tests are necessary to ensure SMP in the mobile market does not distort competition in other retail markets. This includes testing for margin squeeze and predatory pricing.

Reservation of Rights

BTC has addressed the issues but reserves the right to comment further on all issues and states categorically that the decision not to respond to any issue raised on this Consultation in whole or in part does not necessarily indicate agreement in whole or in part with URCA's position; nor does any position taken by BTC in this consultation mean a waiver of any of BTC's rights in any way. BTC expressly reserves all its rights.

Legal and Regulatory Division

The Bahamas Telecommunications Company Limited (BTC)

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