



May 4, 2011

Mrs. Kathleen Riviere-Smith
Director of Policy and Regulation
Utilities Regulation and Competition Authority (URCA)
UBS Annex Building
East Bay Street
Nassau, The Bahamas

Dear Mrs. Riviere-Smith,

Re: Consultation document on Proposed Charging for Interconnection Joining Services – ECS 07/2011

BTC welcomes this opportunity to respond to URCA's consultation document on proposed charging for interconnection Joining Circuits (ECS 07/2011). As URCA has pointed out, interconnection circuits form an important part of the interconnection service portfolio, and BTC is of the view that when URCA is proposing substantial changes in policies that have already been subject to public consultation, further consultation is desirable to ensure transparency and accuracy.

Introduction

BTC has attempted to set its tariffs for Joining Services in order to ensure:

- Cost recovery – to recover legitimately incurred costs associated with the service; including mark-ups for indirect and common costs.
- Stimulation of efficiency – costs should be efficiently incurred and tariffs should be in line with best practice observed elsewhere.
- Transparency – the relevant tariffs should be clear to the operators taking up the service from the outset.
- Compliance with relevant instructions received from URCA.

BTC is pleased to see that URCA has largely subscribed to BTC's tariff proposals, while recognising the difficulty of deriving cost-based tariffs for a relatively new and immature service.

.../2

BTC believes that tariffs for joining circuits should be set in such a way that it stimulates incentives to invest in this key interconnection service. BTC notes that Other Licensed Operators (OLOs) in the Bahamas are not regulated on this bottleneck service and BTC is therefore pleased to see that URCA requires 'Joining Paths to be mutually planned and constructed, with each party paying for the whole or part it constructs'. Through this process of mutual planning BTC and the OLOs should come to a reasonable position as to which part of the service is constructed by which of the parties and we believe such a process should result in a reasonable outcome, without a major risk of exploitation by either side. Of course, during these negotiations we will require that any deviations from our own tariffs are properly justified to ensure that BTC does not end up paying for inefficiencies incurred by OLOs. We trust this approach meets with URCA's approval.

BTC has also set out its proposal on the recovery of duct costs through its Joining Circuit tariffs, which is accepted by URCA. We believe it is crucial that this approach is accepted also by the industry. Obviously, if any party to negotiations on Joining Services would be put in a position where, through regulatory intervention, they could not recover the costs associated with their investment, then the logical and rational response would be to ask the other party to make this investment on behalf of both parties. This is likely to result in inefficient investment outcomes because the other party may not always be in a position to roll out new infrastructure at the same low cost.

BTC is also pleased to see that URCA recognises the need for mark-ups for indirect and common costs, as they reflect legitimately incurred business costs for all services, including Joining Services. The alternative of not charging for such costs would result in inefficient allocation outcomes and, in the long run, would undermine the financial viability of a regulated firm like BTC. BTC, however, does not currently have detailed cost estimates for indirect costs incurred by the business as these are not required for its separated accounts which are based on a fully-allocated-costs (FAC) methodology. For practical reasons we have therefore relied on conservative external benchmarks, although we appreciate the limitations of this approach.

The conservative nature of these benchmarks is borne out by URCA's review, with BTC's OPEX estimates in particular being much lower than that which URCA would have deemed reasonable. In fact, URCA's comments suggest that the real risk associated with BTC's tariff proposals is that they are below the reasonable cost levels observed in other markets. URCA should not have a bias towards under-recovery and we therefore hope that URCA agrees that further work is required on these tariffs in order to ensure that this situation is properly reviewed, BTC therefore proposes to:

- Make an adjustment to BTC's proposed tariffs to include URCA's estimate of reasonable levels of operational expenditures.
- Review the Joining Service tariffs after a reasonable number of OLOs have made suggestions for tariffs for their Joining Services. If these proposals are consistently above the tariffs proposed in BTC's RAIO (and these differences are objectively justified), then this might provide an indication for the need of an upward adjustment of BTC's tariffs.

Charging inter-island Joining Segments

BTC is pleased to see that URCA largely supports the proposed methodology to derive charges for inter-island Joining segments and indeed URCA has adopted most of the key inputs like cost information (including discounts) obtained from supplier contracts, custom duties and mark-ups.

BTC is not in a position to comment on the appropriateness of the assumption that 'a typical assumption made in a bottom-up model is that annual operating (and common) costs are equivalent to 10% of the gross replacement costs (GRC) of the asset base of the business'. URCA has not provided a source for this statement and it is also not clear from the consultation document whether this statement refers to bottom-up models in general or bottom-up models that have been developed specifically for Joining Services. However, our own research into public sources for operational expenditures relating to Joining Services is also suggesting that our original estimates are conservative.

We have reviewed one of the few public sources of information for service costs relating to joining services, as provided in BT's separated accounts for 2009. We have taken historic cost information from these accounts (as opposed to current cost information) to ensure consistency with BTC's (separated) accounts. The BT accounts provide the following information for interconnection circuits:

Table 1: BT Service Cost information: Interconnection Circuits

BT 2009 statements - page 22 (attribution of wholesale current cost and mean capital employed)	
HCA operating costs - Technical areas (Interconnection circuits)	in £m
Provision/Maintenance	14
Network Support	5
General Support	10
General Management	22
Finance and Billing	1
Accommodation	11
Total operating costs	63

The total capital employed in the accounts relating to joining circuits amounts to 101 £m, so at an assumed WACC of 10%, ROCE (return on capital employed) for these services amounts to around 10 £m in 2009. From the accounts we can also obtain a total depreciation amount for relevant assets of 27 £m, giving total capital costs of around 37 £m.

We have then grouped the various operational expenditure categories in order to derive some rudimentary mark-ups:

Table 2: BT Indirect Costs Mark-up proxies

Mark-up calculations	
Maintenance, network operations, support and accomodation	30
Common costs	33
Total	63
Total network capital costs	10.1
Total depreciation	27
Total network capital costs	37.1
Common costs as mark-up capital costs	88.95%
Indirect network costs as a mark-up capital	80.86%
Total	169.81%

These mark-ups are around a factor 5 higher than the ones proposed by BTC in its Joining circuit calculations.

We have then reproduced the table provided by URCA, this time with the relative differences between BTC's cost estimates and URCA's '10% test'. The results are presented in the following table.

Table 3: Comparison of operating cost assumptions

	Monthly Operating costs - BTC assumptions (BS\$)	Monthly Operating costs calculated as annual cost equal to 10% of GRC (BS\$)	Deviation (%)
Distant dependent charge per mile for duct	446	980	119.73%
OC3 per unit	131	228	74.05%
DS3 per unit	62	107	72.58%
Footway Box per unit	10	24	140.00%
Submarine tariff/T1 link	355	729	105.35%

The table shows that BTC has provided OPEX estimates that are significantly below the benchmark that URCA deems to be reasonable for services of this type. This suggests that the principal area of concern for URCA should be to ensure that BTC does not under-recover against incurred costs for the service. This table and the BT benchmark suggest that the mark-ups proposed (based on confidential data) are too conservative, so BTC's suggestion would be to use URCA's suggested benchmark to set the final rates for the time being.

Finally, BTC can confirm that the proposed inter-island charge is calculated as the cost for two T1 ports. The cost calculations for BTCs inter-island capacities are done on a per-T1 port basis and a circuit would require a T1 port at either end.

Proposed Charging for OC3 and DS3 units

BTC considers it inappropriate to use operational examples from the UK on how interconnection services are provided (i.e. with Joining Paths expressed as STM1s and with Joining Circuits provided as E1 multiples), because the UK interconnection situation is much more stable after more than 25 years of competition in the market. Over this period of time, a complex and diverse interconnection circuit network

has been built up, enabling the operators to minimise underutilisation. This implies that underutilisation of Joining Services assets is less of an issue in the UK than it is likely to be in The Bahamas, where the number of new entrants and the success of these new entrants are more difficult to predict at these early stages of market liberalisation. We would however be interested in further elaboration by URCA on the treatment of unutilised capacity in BT's Joining Service tariffs as it is our understanding that these costs are included in BT's service tariffs.

It is also not accurate to suggest that an 'OLO faces similar costs at its end of the joining path and BTC is therefore not disadvantaged'. All operators are likely to require interconnection capacity from BTC, while not all operators will require interconnection with each other, perhaps preferring to use BTC as a transit operator. BTC is therefore likely to require a higher degree of spare capacity in order to prevent shortages. It is also clear that these costs are incurred by BTC because of the provision of interconnection Joining Services and they should therefore be recovered from tariffs for Joining Services. These costs clearly meet the required standard for cost causality, one of the key principles used by URCA to set cost-based tariffs, and it would be inconsistent and inappropriate to exclude them.

BTC appreciates that there is a risk that OLOs may pay for unnecessarily high spare capacity if there is no restriction in the tariff calculations. We therefore propose to include a 25% spare capacity in the calculations for equipment, which we believe is a reasonable margin for planning purposes. This will ensure proper dimensioning of the Joining Circuits and it will ensure that BTC recovers its legitimately incurred equipment costs.

Finally, BTC can confirm that the equipment costs provided relate to fully loaded equipment, although separate terminating cards for T1s are no longer used. BTC can also confirm that no costs have been included for T1 ports in the exchange as part of the presented tariff calculations.

Conclusion

BTC believes that the above provides a strong case for changes to URCA's tariff calculations for Joining Services. We have re-calculated the tariffs based on the above suggestions to show the tariffs now proposed by BTC. This results in the following proposed tariffs for the various services.

Table 4: Proposed tariffs for Joining Services

BTC Tariff Schedule - Joining Circuits		
	One-Off [\$US]	Monthly Recurring [\$US]
Intra-island joining circuit segments		
Distance dependent charge per mile for duct		\$2,154
OC3 per unit - Charge per T1 circuit		\$10.23
DS3 per unit - Charge per T1 circuit		\$15.04
Footway box (per box)	\$3,951	\$53
Inter-island joining circuit segments		
Submarine tariff/T1 link		\$1,744
Testing charges		Per man-hour
Service testing charges		\$23.47

We are of course available to elaborate further about the above at your convenience.

We thank you for this opportunity to reply to this consultation, BTC is looking forward to URCA's final decision on this last main outstanding matter before the RAIO can be approved.

Yours sincerely,

The Bahamas Telecommunications Company Limited (BTC)



Felicity L. Johnson
Vice President of Legal, Regulatory Affairs &
Interconnection and Company Secretary