WHOLESALE FIXED CALL TERMINATION PRICE CONTROL FOR SMP LICENSEES

PRELIMINARY DETERMINATION

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1 Introduction

1.1 Regulatory Framework of this Consultation

The Utilities Regulation and Competition Authority (URCA) is appointed under the Communications Act, 2009 ("Comms Act" or the "Act") as the independent regulator of the electronic communications sector in The Bahamas. URCA is responsible under the Comms Act for licensing undertakings that provide, operate or maintain an electronic communications network or provide an electronic communications service, including by the use of any radio spectrum. The Comms Act also provides, in sections 4 and 5 of the Act, guidelines that URCA must follow for issuing regulatory and other measures (including Determinations). The Comms Act gives URCA wide-ranging powers which are to be exercised in full compliance with principles of good regulation.

URCA is required to introduce regulatory measures which are efficient and proportionate to their purpose and must introduce them in a manner that is transparent, fair and non-discriminatory. This means that where URCA believes that market forces alone are unlikely to achieve a policy objective within the required timeframe, URCA may introduce regulatory requirements, having due regard to the costs and implications for affected parties.[1] However, as a general principle, market forces should be relied upon as much as possible and regulatory measures should be introduced by URCA only when necessary. In general, this means that regulation is only imposed on an operator who has a position in a market such that it can act independently of its competitors, consumers and subscribers (i.e., a position of significant market power (SMP)). To determine whether an operator holds such a position, URCA must undertake a review of the market.[2]

Following URCA's finding in its 2013 '*Assessment of Significant Market Power in Call Termination Services in The Bahamas under Section 39(1) of the Communications Act, 2009 - Statement of Results to Public Consultation and Final Determination'* (ECS 13/2013)[3] that Cable Bahamas Limited (CBL) and IP Solutions International Ltd. (iPSi) have SMP in the market for call termination on their individual fixed networks, this consultation document sets out URCA's preliminary assessment on the appropriate level of fixed termination rates to be charged by CBL/SRG and iPSi. In particular, URCA reviews the need to allow for these (regulated) termination rates to be set above those currently determined for BTC. Based on its preliminary review, URCA has preliminarily concluded that there is no justifiable reason for allowing such asymmetry in fixed termination rates in The Bahamas. URCA then also sets out its proposed approach for implementing the revised termination rates for CBL/SRG and iPSi.

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[1] See section 5(b)(i), 5(b)(ii) and 5(c) of the Comms Act.
[2] See sections 39(1) and 40(2) of the Comms Act.
[3] Available at: http://www.urcabahamas.bs/download/084131300.pdf

Given the importance of termination services and associated (regulated) charges to all Licensees, URCA now seeks the views of all interested parties on its preliminary views set out in this document. Any comments received in response to its consultation questions will then facilitate URCA's Final Determination on this matter.

1.2 Background to this consultation

Call termination is an essential wholesale service which all holders of Individual Operating Licences (IOLs) providing voice or messaging services must purchase from each other in order to allow their customers to call customers on other public voice networks. Termination describes the service whereby one operator (the terminating party) accepts traffic that has originated on another network but which is destined for customers on its own network, and delivers that traffic to those customers. As such, all Licensees who operate their own network infrastructure to provide fixed or mobile voice and messaging services in The Bahamas also offer termination services to other Licensees.

Until recently, only Bahamas Telecommunication Company Ltd. (BTC) was presumed to hold SMP in call termination services in The Bahamas. As part of URCA's 2010 Final SMP Decision[4], URCA imposed the requirement on BTC to, amongst others, prepare and publish a Reference Access and Interconnection Offer (RAIO) with cost-oriented charges for call termination and other wholesale charges for which it holds SMP.[5]

BTC published its first (approved) RAIO in June 2011. In that document, it set interconnection charges for a number of services, many of which were based on its 2009 accounting separation unit cost results. In 2012, URCA then published a Final Decision requiring BTC to update its charges for fixed and mobile (international traffic) call termination services, to ensure that these charges remain cost oriented and reflective of efficiently incurred costs only.[6] [7] At the time, URCA concluded that due to on-going concerns with BTC's accounting separation results, BTC's fixed and mobile call termination rates should be set with reference to international benchmarks, and follow the glide paths set out in **Table 1** below. Whilst these rates were considered an interim measure until more robust costing information from BTC became available, these glide paths remain in place to date (i.e., BTC currently charges BSD 1.98 cents /min for on-island calls and BSD 2.65 cents /min for off-island calls and is due to move to the next step on the glide path).

[4] ECS 11/2010, available at URCA's website: www.urcabahamas.bs.

[5] Further to the wholesale price control for termination services and the need to publish a RAIO, BTC was required to prepare regulatory accounts and publish cost accounting information (upon request from URCA).

[6] ECS 25/2012, available at URCA's website: www.urcabahamas.bs.

[7] The Access and Interconnection Guidelines (ECS 14/2010) require BTC, as an SMP operator to, amongst others, publish cost oriented interconnection charges which should only reflect the efficiently incurred cost of providing these services.

Table 1: BTC's Call Termination Charges for the period up to 2014/15 (BSD cents/min)

	Initial RAIO	2012/13	2013/14	2014/15
Fixed call termination				
On-island service	1.98	0.93	0.83	0.75
Off-island service	2.65	1.40	1.26	1.13
Mobile call termination				
International traffic	7.24	6.03	5.13	4.61

As mentioned in Section 1.1 above, URCA recently conducted a review of call termination markets in The Bahamas.[8] As part of this review, URCA found that BTC, CBL and iPSi all hold SMP in the respective markets for fixed and mobile call termination on their individual networks (i.e., the market for termination of calls or messages on their network). Given this, URCA imposed several obligations on the SMP Licensees. In particular:

- **All SMP licensees** shall comply with the SMP obligations specified in section 40(4) of the Comms Act and Condition 34 of the standard IOL. The remedies applicable to **BTC**'s call termination services pursuant to URCA's previous 2010 final SMP decision (ECS 11/2010) and other subsequent regulatory measures or decisions issued by URCA have been maintained.

- **All other SMP licensees (i.e., CBL and iPSi)** are subject to the following obligations:

    - The charges for terminating traffic on their respective fixed networks are subject to wholesale price control (to be determined by URCA[9]); and

    - Both licenses shall publish the tariff and non-price terms and conditions for fixed termination services within five (5) weeks.

CBL has since then published its fixed termination rates and non-price terms.[10] URCA notes that CBL's termination rates are set at the same level as BTC's initial URCA–approved RAIO charges, as set out in Table 1 above (i.e., BSD 1.98 cents /min for on-island calls and BSD 2.65 cents /min for off-island calls),

[8] ECS 13/2013, available at: http://www.urcabahamas.bs/download/084131300.pdf.
[9] During the transitional period, CBL and iPSi are prohibited from increasing the fixed termination charges from their current level.
[10] http://www.cablebahamas.com/files/files/Documents/SRG_Termination_Services.pdf.

which results in an asymmetry in termination rates between CBL and BTC. URCA is not aware of iPSi having published its tariff and non-price terms and conditions for fixed termination services to date. In ECS 13/2013 URCA set out its view that, in line with international precedents and best practices, fixed termination rates for all operators with SMP should reflect the cost of a hypothetical efficient operator and should therefore, absent exceptional circumstances, be symmetric (i.e., all SMP operators should charge the same rates for termination services on their respective networks).

URCA further considered that in the absence of industry bottom-up cost models to estimate the costs incurred by hypothetical operators in providing termination services, BTC's regulated fixed termination charges should form the basis for the symmetric fixed termination rates. This is because BTC's near-ubiquitous fixed line network is likely to provide the most reasonable basis for estimating the costs of fixed line services in The Bahamas, in the absence of an URCA-led exercise to estimate the costs of a hypothetical network operator.

However, URCA also recognised that there may be instances where symmetric terminations rates may not be appropriate. Further, where there are now substantial differences in fixed termination rates, there may be a need to gradually move to reciprocal termination rates over a period of time (i.e., via a multi-year glide path) to allow all licensees to adjust to the new levels of termination charges. As such, URCA deferred its final decision on the price control for CBL/SRG and iPSi fixed termination rates pending further consultation with market participants.

In this Preliminary Determination, URCA now sets out its preliminary views and proposals for setting the fixed call termination rates for CBL and iPSi.

1.3 Procedure for making a Determination

Section 99(1)(a) and (b) of the Comms Act collectively prescribe that if, on its own motion, URCA has reason to believe that a determination is necessary, it may make determinations relating to (amongst other things):

(i) any obligations on a Licensee regarding the terms or conditions of any licence, including obligations in licence conditions and regulations;

(ii) any activity set out in the Comms Act; and

(iii) where the Comms Act provides for URCA to "determine" or "to make determinations" as is the case under Section 39(1).

Under section 99(2) of the said Act, in making any determination, URCA has to have consulted persons with sufficient interest under section 11 of the Comms Act and provided written reasons for its determination. Section 11(2) of the Comms Act prescribes that regulatory instruments referred to in section 13(2) of the Act such as regulations, shall be considered regulatory measures of public significance and under section 11(1), URCA shall afford persons with sufficient interest a reasonable opportunity to comment on URCA's proposals.

URCA is therefore issuing this Preliminary Determination under section 100 of the Comms Act. This document constitutes URCA's formal notice to those licensees issued by URCA with IOLs of URCA's *"Wholesale Fixed Call Termination Price Control for SMP Licensees".* Specifically, this document contains URCA's analysis and proposals relating to relevant wholesale price control for CBL's and iPSi's call termination services.

1.4 How to respond to this Consultation

URCA invites written responses on this Preliminary Determination from all interested parties. Any responses on this Preliminary Determination should be submitted to URCA by 5 p.m. on **8 April 2014**.

Written responses or comments on this Preliminary Determination should be sent to URCA's Chief Executive Officer, either:

- by hand, to URCA's office at UBS Annex Building, East Bay Street, Nassau; or
- by mail to P.O. Box N-4860, Nassau, Bahamas; or
- by fax, to (242) 393-0153; or
- by email, to info@urcabahamas.bs.

Where a respondent believes that URCA's approach and/or proposals are contrary to relevant principles and objectives or outside the international mainstream, the respondent should clearly set out their reasoning for such objections, together with evidential information to substantiate their position. Persons may obtain copies of this document by downloading it from the URCA website at www.urcabahamas.bs.

URCA reserves the right to make all responses available to the public by posting responses online on its website. If a response is marked confidential, reasons should be given to facilitate evaluation by URCA of the request for confidentiality. URCA may publish or refrain from publishing any document or submission, in its sole discretion.

URCA will review responses and comments received on this Preliminary Determination before publishing a Statement of Results and Final Determination.

1.5 Structure of the remainder of this document

The remainder of this consultation paper is structured as follows:

Section 2: Discusses the appropriate framework for setting wholesale fixed termination rates;

Section 3: URCA's preliminary views on how to apply the framework to set fixed termination charges of other SMP licensees;

Section 4: Implementation options for symmetric call termination rates; and

Section 5: Conclusion and Next Steps.

2 Appropriate Framework for Setting Fixed Wholesale Termination Rates

In this Section, URCA describes the main economic principles behind the regulation of fixed call termination charges and the regulatory best practice in this area. URCA then presents what it considers to be an appropriate framework for setting fixed termination rates. Finally, and following on from this, URCA outlines the set of necessary conditions under which asymmetric rates could be justified in The Bahamas.

2.1 Economic theory and international regulatory precedent supports symmetry in wholesale termination rates

Below, URCA first discusses the economic rationale for regulating fixed call termination services. It briefly describes the most relevant international regulatory precedents with regards to setting fixed termination rates.

2.1.1 Economic theory finds symmetric rates more likely to be efficient

Economic theory suggests that symmetric rates based on the costs of a hypothetical efficient operator would lead to allocative and productive efficiency. Conversely, asymmetric rates can distort allocative and productive efficiency in the market. This is explained further below.

Allocative and Productive Efficiency

Allocative efficiency occurs when the price, and so the willingness of consumers to pay for the good or service, equals the marginal cost of production. If price was greater than marginal cost, there is a sub-optimal level of consumption and neither producer nor consumer surplus is maximized. Thus, if the termination rate is set above cost for some operators and this is reflected in higher retail prices for terminating calls on their network, this will lead to higher average call prices for consumers and could bring down the overall level of traffic. If termination rates were set at the marginal cost, the traffic volumes or consumption will rise to the optimum level, thereby ensuring allocative efficiency.

Productive efficiency occurs when a firm produces its output at minimum average cost, or lowest cost. In the context of termination rates, productive efficiency for each firm would be achieved if they lowered their costs to the level of a hypothetical efficient operator. Setting the termination rate for all operators at this level would incentivize them to reduce their own costs to this minimum level, thereby leading to productive efficiency.

As an example, each operator in a market could set their termination rate equal to their own costs, so less efficient operators with higher costs would have higher termination rates and vice versa. This could penalize the more efficient operators with lower costs, while unfairly benefiting operators that have higher costs. This is because the efficient operators have to pay more to terminate calls on the inefficient operators' networks. In order to recover these costs, the more efficient operator would need to increase their retail prices for calls made to the less efficient operator's network. Thus, the more efficient operators and their customers would in effect be subsidizing the less efficient operators and their customers, creating an allocative inefficiency (compared to the situation in a competitive environment where termination rates would be equal to an efficient cost level).

Further, in this situation, inefficient operators may have no incentive to lower costs in the long-term as their higher costs give them an advantage (as other operators need to set higher off-net call prices and the inefficient operator is able to earn higher termination revenues).

This comparative advantage for an operator with higher termination rates has been used in some cases to justify setting higher (asymmetric) termination rates for new entrants, at least for a temporary period. This is because, according to this reasoning, asymmetric termination rates can act as an incentive for new entry in the market and so lead to longer term competition in the provision of retail services. For example, there is some literature[11] which shows that under a certain set of assumptions, an asymmetry could be preferable to symmetric termination rates. This is because asymmetric rates could help increase consumer benefit, as measured by consumer surplus, as well as the profits of smaller operators and thus the level of competition in the long run.

URCA proposes to consider the relative balance of these effects on The Bahamas, with a view to determining the appropriate wholesale price remedy to impose on CBL and iPSi in respect of fixed termination rates. URCA begins, however, by summarizing international precedent in this area. For this, URCA focuses on the European Commission (EC) and the UK precedent as both authorities have considered this issue at length. This is elaborated on in the next Section.

2.1.2 International regulatory precedent favors reciprocal termination rates

Both the European Commission (EC) and Ofcom favour symmetric termination rates, with asymmetric rates requiring adequate justification.

The Common Position adopted by the European Regulators Group (ERG) on 28 February 2008[12] and the European Commission (EC) Recommendation[13] [14] of May 2009 regard as best practice symmetric termination rates reflective of forward looking long run incremental costs (LRIC) determined using a bottom-up modelling approach to reflect an efficient operator's cost of providing these services.

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[11]See for instance: Peitz, M. (2005a): "Asymmetric access price regulation in telecommunications markets", *European Economic Review* 49: 341-358; Peitz, M. (2005b): "Asymmetric Regulation of Access and Price Discrimination in Telecommunications", *Journal of Regulatory Economics*; 28:3 327–3.

[12] ERG's Common Position on symmetry of fixed call termination rates and symmetry of mobile call termination rates. ERG (07) 83 final 080312. (the "ERG CP").

[13]Commission Recommendation of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (2009/396/EC) (the "EC Recommendation").

[14]See also the Commission Staff Working Document accompanying the Commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU. Explanatory Note. C(2009) 3359 final. SEC(2009) 599. ("EC Explanatory Note").

This is because the EC recognises that while asymmetric rates could form part of an entry assistance policy, they may allow inefficient entry, as was explained in the previous Section. Further, by setting the termination rate at the efficient-cost benchmark acts as an incentive for firms to become more efficient.

Moreover, the ERG reasons that while asymmetric rates could contribute to dynamic efficiency, they distort prices downstream and result in allocative and productive inefficiency. Thus, ERG (now BEREC) argues that uniform termination rates that are dependent on costs incurred by a hypothetical, efficient operator are a preferable regulatory tool.

Ofcom recently conducted a consultation[15] on fair and reasonable charges for fixed geographic call termination and concluded that termination rates are presumed to be fair and reasonable where they are symmetric (i.e., no higher than the benchmark fixed termination rate, which is currently set based on the incumbent's (BT) termination rate).

Ofcom recognizes that termination rates above the benchmark of BT's rate might be justified if there are objective and exogenous cost differences between operators, or if it can be demonstrated that higher termination rates will lead to significant consumer benefits. At the same time, Ofcom concluded that these specific conditions are not justified in the UK and that all providers of fixed voice services should set termination rates at the benchmark termination rate.[16] [17]

Thus, it is clear that both the EC and Ofcom are in favour of symmetric termination rates, with a heavy burden of proof on operators if they demand a higher termination rate than the efficient cost level to demonstrate that such an asymmetry is justified and welfare enhancing.

2.2 Appropriate framework needs to explicitly set the necessary conditions under which asymmetric rates could be justified

As explained in the SMP Determination[18], URCA remains of the view that given the risk of excessive pricing being applied by an SMP licensee in the wholesale termination market, a price control obligation should be imposed on such licensees.

As stipulated in section 40(3)(a) and (b) of the Comms Act, URCA further considers that the price control should be set such that termination rates[19] reflect the costs of providing such services. In URCA's view,

[15] Fair and reasonable charges for fixed geographic call termination, A consultation on draft guidance, Ofcom, available at http://stakeholders.ofcom.org.uk/binaries/consultations/778516/summary/condoc.pdf and Fair and reasonable charges for fixed geographic call termination, A summary, available at http://stakeholders.ofcom.org.uk/consultations/fair-reasonable-charges/summary

[16] Fair and reasonable charges for fixed geographic call termination, Statement and final guidance, Ofcom, para 1.8, available at http://stakeholders.ofcom.org.uk/binaries/consultations/778516/statement/fair-reasonable-statement.pdf (the "Ofcom FTR decision")

[17] It should be noted that BT's termination rate is set on the basis of a bottom-up LRIC model in order to simulate the cost of a hypothetical efficient operator

[18] See ECS 13/2013 at page 24.

cost based termination rates reflect the economic costs of termination and this is therefore the method most compatible with competitive markets. Cost based rates provide operators with sound 'make or buy' investment signals, allow economically efficient pricing, which can be fair to both the seller and buyer of termination, encourage competitive entry and promote the overall objectives of the Comms Act. URCA also remains of the view that termination rates should be set reciprocally, (i.e., they should be symmetric).[20] As discussed above, this is in line with the economic principles and the international precedence from Europe

Furthermore, URCA considers that under a reciprocal charging regime, and in the absence of industry bottom-up cost models to estimate the costs incurred by hypothetical operators in providing termination services, BTC's regulated (and approved) termination charges, set on the basis of its cost accounting data and benchmark information (where have been deemed appropriate by URCA), should form the basis for such symmetric rates. This is because BTC's near ubiquitous fixed line network is likely to provide the most reasonable basis for estimating the costs of fixed line services in The Bahamas, in the absence of an URCA-led exercise to estimate the costs of a hypothetical network operator. This approach is broadly consistent with the one applied in the UK, where Ofcom sets fixed termination rates equal to BT's termination rate.[21]

Therefore, URCA considers that under the appropriate reciprocal regime, all SMP licensees will be required to set their termination rates to be equal to the tariffs set out and approved by URCA in BTC's RAIO (hereinafter referred to as *BTC benchmark rate*). However, URCA recognises that there may be instances where reciprocal termination rates may not be appropriate. In particular, if there are significant differences between the levels of efficiently incurred termination costs, and these are outside the control of operators, a temporary introduction of asymmetric termination charges might be appropriate.

In addition, it is important to ensure that the asymmetry will benefit consumers, (i.e., it will lead to a demonstrable increase in consumer welfare that would likely outweigh any additional cost or market distortion arising from the asymmetry in termination charges). In line with the economic principles and the international regulatory precedent, URCA considers that an asymmetry in fixed termination rates must be justified by reference to a number of factors and conditions in the local market; it sets those out next and then evaluates to what extent these conditions might be fulfilled by 'other SMP licensees'[22] in The Bahamas.

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[19] In this consultation document, URCA uses terms 'termination rates', 'termination charges' and 'fixed termination rates (FTRs)' as synonyms.

[20] For simplicity, URCA uses 'reciprocal' and 'symmetric' interchangeably throughout this document.

[21] Ofcom FTR decision, para 1.4.

[22] For simplicity, in this document URCA uses the term 'other SMP licensees' whenever we refer to SMP operators in fixed call termination other than BTC.

Question 1: Do you agree with URCA's preliminary view that BTC's RAIO termination rate should be used as a base for setting reciprocal termination charges?

2.2.1 Conditions under which a temporary asymmetry in fixed termination charges might be justified

URCA's preliminary view is that there may be exceptional circumstances under which a temporary asymmetry in termination charges might be justified, at least for a certain period of time. In line with the international precedent, URCA is proposing to set three conditions, of which at least one needs to be fulfilled to consider allowing other SMP licensees to set a fixed termination charge above the BTC benchmark rate:

- exogenous and objective differences in the cost of termination;
- barriers to entry and expansion that impede the ability of other SMP licensees to reach sufficient scale and lead to them facing a higher unit cost for termination; and
- significant traffic imbalances that impede the ability of other SMP licensees to compete in the long-term.

In URCA's view, only objective cost differences that are outside the control of other SMP licensees might justify asymmetric termination rates for a longer period of time. URCA considers that the other two conditions, if fulfilled, would only justify an introduction of asymmetric rates for a transitional period needed to support a later entrant to establish itself in the market.

These conditions are discussed in more detail below.

- **Exogenous cost differences:** Higher termination rates might be justified if there are objective and exogenous cost differences between operators and as a result, the efficiently incurred termination cost of another SMP licensee is higher than BTC's cost.

  In other words, only cost differences that are outside the control of other SMP licensees will be considered as relevant for determining the scope for potentially higher termination charges. This means that, for example, cost differences due to other SMP licensees having differently sized customer bases will not be considered as relevant, as the appropriate comparison of termination costs takes into account the cost of hypothetical operator of an efficient scale.[23] The same holds for other factors that might impact the unit cost of call termination, but are driven by commercial and strategic decisions of other SMP licensees. Finally, any cost incurred as a result of an inefficient operation cannot be considered relevant.

[23] EC Recommendation, para 16.

URCA recognizes that according to the EC recommendation, the exogenous cost differences are likely to play less important role in relation to setting asymmetric termination in fixed networks, compared to mobile networks:

"In setting termination rates, any deviation from a single efficient cost level should be based on objective cost differences outside the control of operators. In fixed networks, no such objective cost differences outside the control of the operator have been identified."[24]

- **Barriers to entry and expansion:** Higher termination rates might be justified if another SMP licensee is facing higher unit termination cost due to its late entry in the market and an inability to reach sufficient scale and scope, resulting from significant barriers to entry and expansion. In other words, if the higher costs are driven by the smaller scale of the other SMP licensee, but there are significant barriers preventing the other SMP licensee reaching the efficient scale, then a temporary period of asymmetric rates might be justified.

  At the same time, it is necessary to demonstrate that the asymmetric rates will improve the other SMP licensee's ability to grow its customer base and reach the efficient scale, thus improving its ability to compete in the long-run. Otherwise, the asymmetric termination rates might not be an optimal regulatory tool and other measures lowering the existing barriers to expansion might be required.

  URCA further notes that while the EC recommendation considers 15-20% market share is required to reach minimum efficient scale in mobile market, a significantly lower market share might be needed to achieve efficient scale in the fixed market:

  > *"New entrants in mobile markets may also be subject to higher unit costs for a transitional period before having reached the minimum efficient scale. […] This is distinct to the situation for new entrants in fixed markets which have the opportunity to achieve low unit costs by focusing their networks on high-density routes in particular geographic areas and/or by renting relevant network inputs from the incumbents."* [25]

- **Significant traffic imbalances:** If there are significant traffic imbalances between operators, resulting from specific pricing strategies aimed to impede the ability of smaller operators to compete, it might be justifiable to allow a smaller operator to charge higher termination rates for a limited period of time and help it overcome any potential disadvantage arising from its smaller size. This would only be the case, however, if it can be shown that the traffic imbalances are driven by pricing strategies of the larger operator and that they are negatively affecting the smaller operator.

[24] EC Recommendation, para 16
[25] EC Recommendation, para 17

For instance, if a late market entrant has a much smaller subscriber base, then in the presence of significant on-net/off-net differentials it is possible that the volume of calls from the large network operator that are terminated in the network of a small operator could be significantly lower than the volume of calls coming from the network of the smaller operator into the network of a larger operator. This could lead to net-losses from interconnection for a smaller operator under symmetric termination rates. If a smaller operator is not able to recover these losses elsewhere, e.g., by setting higher retail prices, it is possible that the interconnection imbalances could impede the ability of a smaller operator to compete, grow its customer base and gradually overcome any disadvantages arising from a smaller size.

URCA consider that, for this condition to support asymmetric termination charges, three further criteria all need to be fulfilled:

- First, the significant traffic imbalances should be negatively impacting the other SMP licensees;
- Second, BTC's termination charges should be significantly above cost; and
- Finally, the temporary termination asymmetry would generate demonstrable consumer benefits that outweigh the cost of this asymmetry.

Only where these criteria are fulfilled cumulatively, would URCA consider that it might be appropriate to allow another SMP licensee to set its fixed termination charge above the BTC benchmark rate.

Below, URCA considers to what extent these conditions are fulfilled in The Bahamas and whether there might be a justification for setting asymmetric termination charges (i.e., for allowing one or more other SMP licensees to set its termination charge above BTC benchmark rate).

Question 2: Do you agree with URCA's preliminary view on the conditions under which asymmetric rates might be justified?

3 Applying the Framework to set Fixed Termination Charges of Other SMP Licensees

3.1 Do any of the other SMP licensees fulfill necessary conditions to justify higher termination charges for a restricted period of time?

Based on the information available, URCA considers each of the three conditions set above and to what extent the other SMP licensees might fulfil these.

3.1.1 Exogenous cost differences

URCA has considered the different drivers of the cost of call termination. From this review, URCA has preliminarily concluded that while there are a number of factors influencing the unit cost of termination, the majority of these costs are likely to be within the control of another SMP licensee and therefore cannot be considered exogenous.

URCA identified two potential exogenous factors that might significantly impact the unit cost of termination: the typology of the underlying network and the geographic footprint of the network. Nevertheless, URCA's preliminary view is that neither of these factors suggests that the termination cost of other SMP licensees are significantly above BTC's efficiently incurred cost of termination.

First, URCA recognizes that there are differences in the type and structure of the networks operated by other SMP licensees compared with BTC's underlying infrastructure. At the same time, the key differences between the networks of other SMP licensees are likely to be in the access part, while the majority of cost related to call termination is going to be in the core part of the network. Therefore, it does not appear to URCA that there are any objective and exogenous differences that would imply the network structure of other SMP licensees' leads to significantly higher costs of call termination.

In fact, it is possible that the level of efficient termination cost of at least one other SMP licensee, namely the cable operator CBL, might be lower than the efficiently incurred cost of call termination faced by BTC. This is because cable networks in general are more concentrated towards the core, which implies that the network requires less equipment in the core part (e.g., routers, switches) compared to a traditional copper-based PSTN network of the same size. In addition, cable networks would further benefit from the fact that a significant proportion of its core network will be shared between TV, broadband and voice services. Therefore, the unit cost of termination could potentially be lower than in the traditional PSTN based network used to deliver only voice or potentially voice and broadband services.

Second, the geographic footprint of other SMP licensees' networks is very different to BTC's. Both CBL/SRG and iPSi have rolled out their network on a commercial basis in selected locations[26], while BTC's footprint is to some extent driven by its universal service obligations and covers a wider area, including smaller and less populous islands and cays in The Bahamas. This, implies that, if anything, the efficient cost of other SMP licensees is likely to be lower than BTC's, as their networks are (on average) based in more densely populated areas, which allows them to spread their fixed costs (e.g., cables, ducts and trenches in the core network) across a larger number of customers.[27] This particularly holds for CBL which has its infrastructure only on the four largest and most populous islands. By contrast, BTC's network is spread wider and covers also less densely populated islands.

As a result, URCA is of the preliminary view that there are no objective and exogenous cost differences between other SMP licensees and BTC that would justify asymmetric termination rates.

3.1.2 Barriers to entry and expansion

URCA has considered if it is possible that iPSi and CBL might have a higher unit cost of termination as a direct result of their later entry into the sector and their inability to reach sufficient scale and scope, as a result of barriers to expansion in the retail market for fixed voice services.

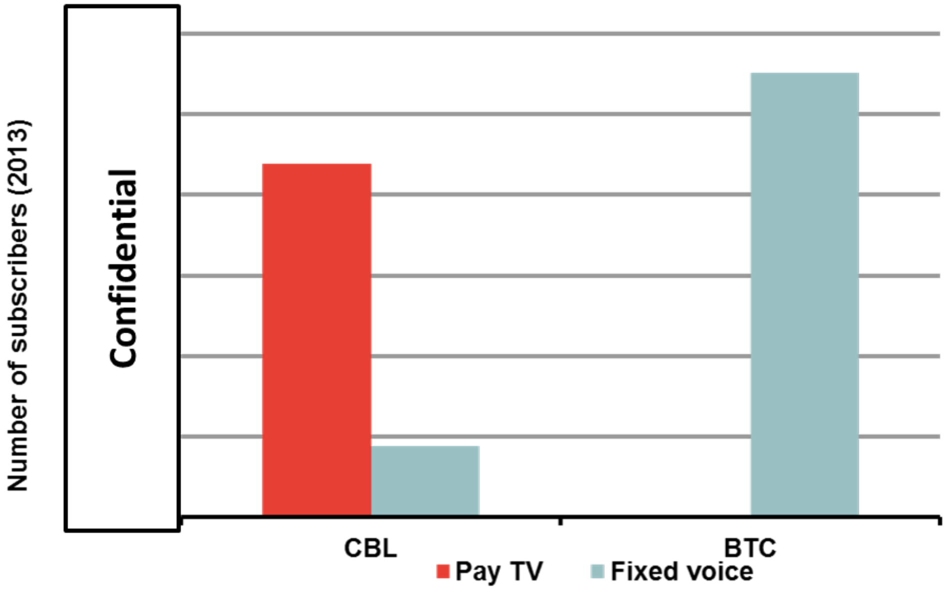
URCA recognizes that the retail market for fixed voice services is characterised by high barriers to entry and expansion. It does not appear, however, that these barriers are significant enough to effectively prevent other SMP licensees from reaching an efficient scale in a reasonable period of time.

Other SMP licensees have entered the retail market for fixed voice services and managed to gradually increase their customer base over time. In particular, CBL had almost **[confidential]** fixed voice subscribers at the end of 2012 just over 12 months after its entry into the market, which represents approximately **[confidential]** of the total market. CBL's affiliates (SRG) has been operating in the fixed telephony market prior to the Comms Act coming into effect in 2009. CBL is further benefiting from its existing base of cable TV subscribers to which it is able to provide fixed voice services as a part of double-play and triple-play bundles (see **Figure 1** below).

[26] CBL is present on the four largest islands, while iPSi's footprint is smaller and currently only covers New Providence and selective parts of Abaco (according to http://www.ipsigroup.com/_m1725/for-Internet-and-Telephone)

[27] In more densely populated areas, more customers can be covered by a single cable, which leads to lower cost on a per subscriber basis. At the same time, it is reasonable to expect that the cables carry more traffic on average in these areas, leading to even lower per unit costs.

Figure 1: CBL's subscribers of fixed voice and pay TV services



Source: URCA based on the data from CBL

Therefore, whilst URCA is of a preliminary view that barriers to entry and expansion in the market for fixed voice services exist, there is no clear evidence that these barriers are significant enough to prevent other SMP licensees, and in particular CBL, from reaching an efficient scale in a reasonable period of time.[28] As a result, URCA is of the preliminary view that asymmetric termination rates are not justified on the basis of barriers to entry and expansion. URCA's preliminary view is consistent with the international precedent.[29]

3.1.3 Significant traffic imbalances

Finally, URCA considers whether there are significant traffic imbalances between BTC and other SMP licensees that would justify a temporary asymmetry in the termination rates.

URCA looked at the three necessary conditions set out in the framework above and analysed if these criteria might be cumulatively met by one or both other SMP licensees. URCA's preliminary view is that it is unlikely that either of the other SMP licensees meets all three criteria.

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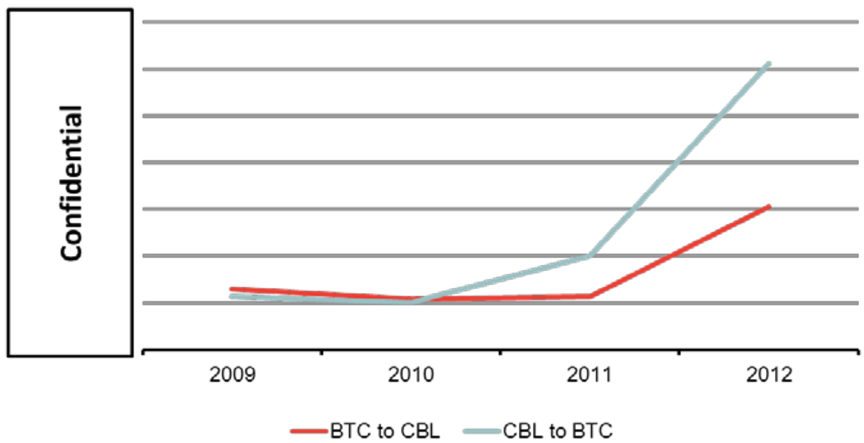
[28] URCA notes that the above has no bearing on its market review findings as the above is a weaker test than that applied in the context of SMP assessments.

[29] EC recommendation, para 17 and EC Explanatory Note, pages 19-20.

First, URCA recognizes that, based on BTC's accounting separation information, there are currently significant traffic imbalances between BTC and CBL and that the imbalance is increasing over time (see **Figure 2** below). This imbalance likely led to lower termination revenues for CBL compared to BTC. However, the difference in termination revenues is likely to have been partly mitigated after the reduction of BTC's termination rate in January 2013, which resulted in an asymmetry between BTC's and CBL's rates and implied that CBL could partly compensate for traffic imbalances by charging a higher termination rate than BTC. This is illustrated in **Table 2** below. At the same time, it is not clear that the current imbalances observed in the period 2010 to 2012 are having a negative effect on CBL's ability to compete with BTC, as CBL has managed to grow its retail fixed voice business and acquire approximately **[confidential]** market share over the period in which URCA observed the imbalance in termination traffic and revenues.

Figure 2: Call Termination Traffic between BTC and CBL



Source: URCA based on BTC's regulatory accounts

Table 2: Termination Revenues of BTC and CBL post January 2013

	Termination volume (min)	Average termination charge (BSD cents / min)	Termination outpayment (BSD)
BTC	[confidential]	[confidential]	[confidential]
CBL	[confidential]	[confidential]	[confidential]

Note: Termination volumes based on 2012 data. CBL charges assumed to be consistent with BTC's initial RAIO charges based on A/S results for 2009 (1.98 BSD cent/min for on-island service and 2.65 BSD cent / min for off-island service). BTC charges assumed to be equal to the regulated termination rates for 2012/2013 (0.938 BSD cent for on-island service and 1.40 BSD cent/min for off-island service)[30]. The share of on-island traffic assumed to be **[confidential]** % based on CBL data.

Source: URCA

Second, even with a significant traffic imbalance, an asymmetric rate would only be applicable if BTC's existing fixed termination rate was above cost. BTC's fixed termination rate is currently based on the combination of BTC's own accounting separation (A/S) data and international benchmarking conducted to give URCA a reasonable view of the likely range of the costs of fixed call termination in The

[30] Setting Regulated Interconnection Charges Of BTC Going Forward, Statement of Results to Public Consultation and Final Decision, http://www.urcabahamas.bs/download/068311100.pdf.

Bahamas.[31] Therefore, while it is possible to argue that BTC's current termination rate is not fully reflective of efficiently incurred cost, there is no evidence suggesting that this rate is significantly above efficiently incurred cost.

Third, URCA is not aware of any significant and demonstrable consumer benefits arising from the existing asymmetry in the termination rates between BTC and CBL. Ofcom, for instance, considers that such benefits might include "*lower overall end-to-end call costs*" or "*other benefits to calling parties related to, for example, quality of service*". Based on the limited evidence available, URCA is of the view that such benefits to consumers have not arisen as a result of the existing asymmetry. At the same time, the existing asymmetry in termination rates has likely resulted in relatively higher off-net retail prices for calls from BTC's network into networks of other SMP licensees. This could have had a negative effect on consumer welfare, as BTC's customers were forced to either decrease the volume of off-net calls to other SMP networks or keep the same volume of calls while facing higher call costs.

Given the above, URCA is of the preliminary view that the three necessary criteria are not fulfilled by either of the other SMP licensees (including CBL/SRG). Therefore, URCA is of a preliminary view that asymmetric termination rates are not justified on the basis of significant traffic imbalances.

3.1.4 Preliminary conclusion

URCA's preliminary views on the three necessary conditions for justifying a temporary asymmetry in termination rates are summarised in **Table 3** below.

Table 3: URCA's Preliminary View on the Justifiability of Asymmetry in Fixed Termination Rates

Condition	Key reasoning	Preliminary conclusion
Exogenous cost differences	No evidence of significant exogenous cost differences	Asymmetric rates **not** justified
Barriers to expansion	Limited evidence of significant barriers to expansion	Asymmetric rates **not** justified
Traffic imbalances	Traffic imbalances do not seem to affect other SMP licensees' ability to compete and there is lack of evidence of any consumer benefits arising from an asymmetry in termination rates	Asymmetric rates **not** justified

Source: URCA

[31]For more details, see Setting Regulated Interconnection Charges of BTC Going Forward, Statement of Results to Public Consultation and Final Decision, http://www.urcabahamas.bs/download/068311100.pdf.

Question 3: Do you agree with URCA's preliminary view that the conditions under which asymmetric rates might be justified are not fulfilled by either of the other SMP licensees?

3.2 Is there a case for promptly removing the existing asymmetry in fixed termination charges?

The analysis above suggests that there is no strong evidence supporting asymmetric termination charges (i.e., setting termination charges of other SMP licensees above the BTC benchmark rate). URCA is therefore of the preliminary view that termination charges of all current SMP licensees should be set at the same level. Given the current termination rates, this implies that for CBL/SRG, the SMP licensee that sets its charges above BTC's rate, termination rates should be decreased to the levels equal to the BTC benchmark rate.

URCA further notes that there is additional evidence suggesting that removing the existing asymmetry would be unlikely to have significant negative impacts on other SMP operators.

First, even if there is a justification for asymmetric termination rates, the international regulatory best practice suggests that the asymmetry should be preserved for a restricted period of time only.

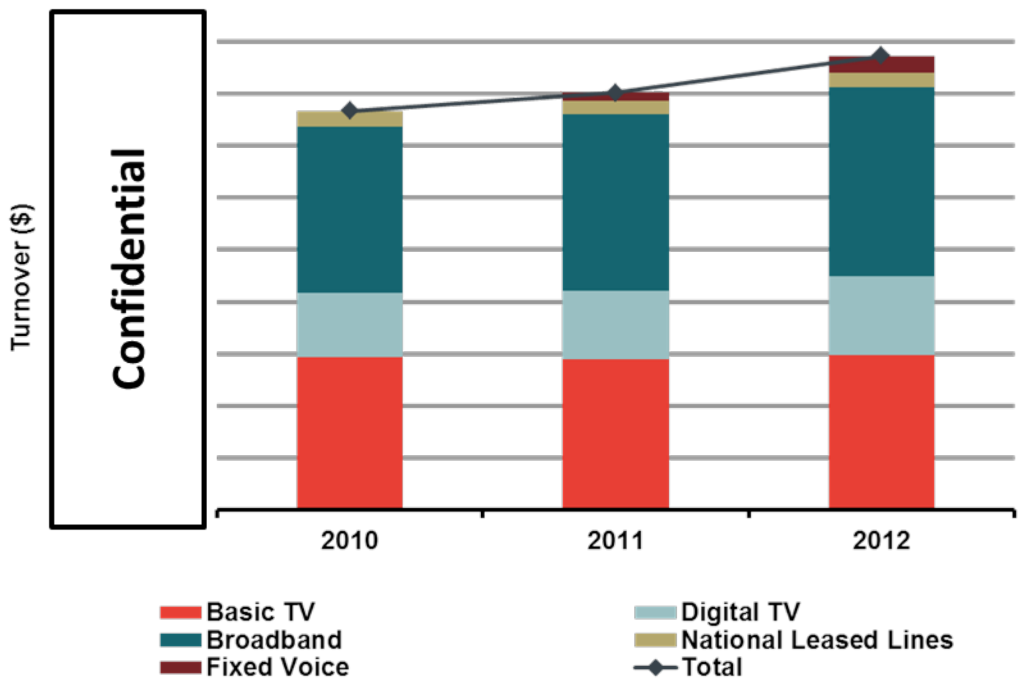
Whilst prior to January 2013, CBL and iPSi charged the same fixed termination rate as BTC, they were under no regulatory obligation to do so. Indeed, prior to the call termination market review decision in 2013[32], CBL and iPSi had not faced *ex-ante* regulation of their fixed termination rates. However, CBL has charged higher fixed termination charges since January 2013, when BTC's current termination rate glide path came into effect (see **Table 1** in **Section 1** above). BTC had to reduce its termination rates (fixed and mobile (international traffic only)) in accordance with the glide path set by URCA, whilst CBL and iPSi were not subject to any termination rate regulation at the time. Therefore, CBL was able to sustain its existing fixed termination rates at the time (i.e., equal to the level of BTC's rate, prior to the implementation of the glide path). URCA understands that iPSi has continued to set symmetric termination charges to BTC and thus, has decreased its termination rates in early 2013, in line with BTC's glidepath.

Second, there is no evidence to suggest that BTC's current fixed termination rate is significantly above efficiently incurred cost of termination. This is because BTC's termination charge under the interim regime is set on the basis of international benchmarking that uses BTC's historical cost as a starting point and sets the glide-path towards 'efficient' cost oriented charges. Therefore, if termination charges of other SMP licensees are set at the BTC benchmark rate, it does not necessarily imply that other SMP licensees will not be able to recover their efficiently incurred cost of termination, even if they objectively face higher unit costs than BTC.

[32] ECS 13/2013, available at: http://www.urcabahamas.bs/download/084131300.pdf

Finally, accounting information suggests that the introduction of symmetric rates, even if it negatively impacted CBL's revenue from fixed interconnection, is unlikely to significantly impede its overall ability to operate. As can be shown in **Figure 3** below, CBL's total turnover in 2012 was above BSD [confidential] million, of which approximately BSD **[confidential]** million were related to its fixed voice business and an estimated BSD [confidential] million from fixed termination revenues from BTC.

Figure 3: CBL's Turnover 2010-2012



Therefore, URCA is of the preliminary view that the existing asymmetry in termination rates of other SMP licensees should be promptly removed and that, going forward, CBL's and iPSi's call termination charges should be set in line with the termination rates set out and approved by URCA in BTC's RAIO.

Question 4: Do you agree with URCA's preliminary view that the existing asymmetry in termination rates should be promptly removed?

4 Implementing Symmetric Fixed Call Termination Rates

As a final step, URCA has reviewed the options for reaching symmetry in fixed termination rates across all SMP Licensees, taking into account its understanding of the current asymmetries. In particular, whilst URCA understands that there is currently symmetry in termination charges between iPSi and BTC, CBL/SRG currently charges BTC call termination rates in line with URCA-approved initial RAIO charges for 2011 for fixed call termination services (i.e., BSD 1.98 cents /min for on-island calls and BSD 2.65 cents /min for off-island calls).[33] This compares to BTC's current rates of BSD 0.93 cents /min for on-island and BSD 1.40 cents/min for off-island calls (i.e., a 53% and 47% difference). BTC is further required to reduce its fixed call termination charges to BSD 0.83 cents/min and BSD 1.26 cents/min, respectively (which will increase the asymmetry relative to their current level) in early 2014.

Taking into account the current level of asymmetry, BTC's current termination rate glide path and URCA's preliminary conclusions on the lack of evidence in support of the prevailing asymmetries in rates, URCA has preliminarily concluded that symmetric termination rates will be implemented within 90 days of the publication of the Statement of Results/Final Determination in this matter. This will be achieved based on the following steps:

- CBL will need to align their call termination rates to BTC's current termination rates (i.e., BSD 0.93/min for on-island and BSD cent 1.40/min for off-island calls) within one month of the publication of URCA's Final Determination.

- At the same date (i.e., within one month of the publication of URCA's Final Determination), BTC is required to implement the second step of the current termination rate glide path, reducing its fixed termination rates to BSD 0.83 cents /min for on-island and BSD 1.26 cents /min for off-island calls.

- CBL and iPSi will then need to fully align their call termination rates to BTC's termination rates (i.e., BSD 0.83 cents /min for on-island and BSD 1.26 cents /min for off-island calls) within ninety (90) days of the publication of the Final Determination.

- Thereafter, BTC and all other licensees with SMP in fixed call termination will be subject to the same price control for these services.

The resulting fixed termination rates for BTC and CBL and iPSi are presented in **Table 4** below.

[33] See Annex I in: http://www.cablebahamas.com/files/files/Documents/SRG_Termination_Services.pdf

Table 4: Proposed Fixed Termination Rate Glide paths (BSD cent/min)

	Current rate	One month after Final Decision	90 days after Final Decision	March 2015
Fixed call termination – BTC				
On-island service	0.93	0.83	0.83	0.75
Off-island service	1.40	1.26	1.26	1.13
Fixed call termination – Other SMP licensees				
On-island service	1.98	0.93	0.83	0.75
Off-island service	2.65	1.40	1.26	1.13

URCA sees merits in its proposed approach due to the following considerations.

- Under this option, all prevailing termination asymmetries and the market distortions and inefficiency arising from these asymmetries are removed quickly.
- The proposed reduction in rates for CBL are in line with those previously required by BTC.

Therefore, URCA is of a preliminary view that the existing asymmetry in termination rates should be removed within ninety (90) days of URCA's Final Determination and the revised termination rate glide paths set out in **Table 4** above should apply to all SMP licensees, until URCA determines alternative fixed termination rates.

Question 4: Do you agree with URCA's preliminary view that the revised termination rate glide paths set out in Table 4 should apply going forward?

5 Conclusions and Next Steps

Within the previous Sections URCA has set out its preliminary position on the wholesale price control for fixed call termination services for CBL and iPSi. This is summarized again in Section 5.1 below.

URCA invites interested parties to comment on its preliminary position by responding to the consultation questions set out in this document. The consultation process is outlined in Section 5.2 below.

5.1 Main Findings

URCA provides below a summary of its preliminary position on appropriate charge control for CBL and iPSi for termination services provided in The Bahamas.

Based on its review of the economic theory and international best practice URCA developed an analytical framework for assessing whether the need exists for asymmetric termination rates for CBL and iPSi (i.e., for allowing them to set higher rates than BTC). URCA then assessed the main criteria within this framework (i.e., the existence of justifiable cost differences, prevailing barriers to expansion and termination traffic imbalances leading to disadvantages for smaller licensees) in the context of The Bahamas. In doing so, URCA preliminarily concluded that insufficient evidence exists to justify any asymmetry in termination rates between SMP licensees.

Given this assessment, URCA has reached the preliminary conclusion to impose symmetric fixed termination rates on all current SMP licensees. As such, all current SMP licensees will be required to set their fixed termination rates to be equal to the tariffs set out and approved by URCA in Table 3 of ECS 25/2012 in respect of BTC's RAIO charges for the period up to 2014/2015.

As a final step, URCA considered the options for implementing symmetric termination rates, taking into account current asymmetries in rates. This resulted in URCA's preliminary view that the e**xisting asymmetry in termination rates should be removed within ninety (90) days of URCA's Final Determination in this proceeding** and the **revised termination rate glide paths as set out in Table 4 of this document should apply to all SMP licensees until URCA determines alternative fixed termination rates**.

5.2 Next Steps

URCA invites responses on this Preliminary Determination from all interested parties. Any responses on this Preliminary Determination should be submitted to URCA by 5 p.m. on **8 April 2014**.

URCA is encouraging all interested parties, including the named licensees to make written submissions on the consultation. URCA will review all responses and comments received to the consultation and issue a Final Determination.