



**SETTING REGULATED INTERCONNECTION CHARGES OF
BAHAMAS TELECOMMUNICATIONS COMPANY LIMITED
(BTC) GOING FORWARD**

CONSULTATION DOCUMENT

ECS 21/2012

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1 Introduction

On 22 April, 2010, the Utilities Regulation and Competition Authority (URCA) published its Final Decision on the Obligations Imposed on Operators with Significant Market Power, ECS 11/2010 (the “SMP Final Decision”), which requires BTC, as an operator with Significant Market Power (SMP) to, amongst other obligations, offer cost oriented interconnection to its network and to publish a reference access and interconnection offer (RAIO).¹ URCA’s Access and Interconnection (A & I) Guidelines further make reference to the fact that cost oriented interconnection charges should only reflect the efficiently incurred cost of providing these services.²

A further obligation placed upon BTC as an operator with SMP is the requirement to, annually, produce to URCA separated accounts in accordance with URCA’s Final Guidelines for Accounting Separation and Cost Accounting issued to BTC, ECS 12/2010.

BTC published its first (approved) RAIO in June 2011. In this document, it set interconnection charges for a number of services, which are based on its 2009 Accounting Separation (A/S) unit cost results. This followed a detailed review by URCA of these charges and the A/S results. This RAIO remains in place to date. However, the RAIO is expected to change over time as the Bahamian electronic communications sector evolves and the RAIO needs to reflect any changes such as further liberalisation or new costing data becoming available.³

At the time they were set, BTC’s current RAIO charges were considered to be cost reflective (i.e., based on its initial set of accounting separation results), but not fully reflective of an efficient cost level.⁴ This motivated URCA to conduct a cost efficiency study of BTC, which confirmed the need for further efficiency adjustments to BTC’s 2010 A/S results to ensure that any resulting RAIO charges are reflective of efficient cost levels.⁵

¹ ECS 11/2010, available at URCA’s website: www.urbahamas.bs

² ECS 14/2010, available at URCA’s website: www.urbahamas.bs

³ ECS 14/2010, available at URCA’s website: www.urbahamas.bs

⁴ As part of URCA’s review of BTC’s draft RAIO, URCA determined that the charges contained in BTC’s current RAIO are, for the most part, cost oriented. However, as BTC’s A/S is undertaken on a top-down, historic cost accounting (HCA) basis, it may be the case that the resulting RAIO charges are not fully reflective of an efficient level of costs required to deliver these services. This was further confirmed by some high-level benchmarking of BTC’s costs relative to those of a range of comparator operators.

⁵ ECS 20/2012 “URCA Consultation: BTC Cost Efficiency Study-Statement of Results to Public Consultation and Final Decision”, available at URCA’s website: www.urbahamas.bs

Following the completion of the efficiency study, URCA considers it is appropriate to review the continued reasonableness of BTC's RAIO charges. More generally, URCA believes there are merits in reviewing BTC's RAIO regularly to ensure that it reflects the current market environment and the charges remain cost oriented. This may result in periodic reviews by URCA as, for example, revised accounting separation (A/S) results for BTC become available. In particular, there are two recent developments which motivate URCA's current review of how to set BTC's RAIO charges going forward:

- The availability of BTC's second set of A/S results (based on 2010 costing data), which show significant movements in unit costs relative to the 2009 accounts.
- The conclusion of URCA's efficiency study of BTC, which, using data from BTC's 2010 A/S results, concluded that BTC's business was not reflective of efficient costs and that there was a need therefore to apply further efficiency adjustments to BTC's A/S unit costs results when setting RAIO charges so as to ensure they are in line with the requirements of the A & I Guidelines

Given these factors, URCA believes it is necessary to put in place a clear policy for how RAIO charges should be updated. In selecting an approach URCA believes that it is important to promote certainty in the market, so it has explored longer term solutions to setting interconnection rates, taking into account the latest A/S results and the efficiency study results. This consultation seeks to receive comments on the proposed approach and URCA's estimates of the resulting RAIO charges.

URCA is therefore inviting comments and submissions from members of the public, licensees and other interested parties on this consultation document, using the questions posed by URCA throughout this document as a guide and reference to the contents of this document.

Upon conclusion of this consultation, URCA will issue a statement on the results of the consultation and next steps, taking into account responses received from stakeholders on this consultation document. The statement will also include a decision on how BTC's RAIO charges will be updated going forward.

1.1 How to Respond to this Consultation

Responses to this consultation document should be submitted to URCA by 5:00 p.m. on 3 September 2012. Persons may send their written responses or comments 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) 323-7288; or
- by email, to info@urcabahamas.bs.

URCA reserves the right to make all responses available to the public by posting responses online on its website at www.urcabahamas.bs. 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, at its sole discretion.

1.2 Structure of the Remainder of this Document

The remainder of this consultation document is structured as follows:

- Section 2 provides an overview of the rationale for updating BTC's RAIO charges on a regular basis;
- Section 3 reviews potential approaches to updating the RAIO charges; and
- Section 4 presents URCA's proposed approach to setting BTC's RAIO charges and reviews the likely impact on the level of charges going forward.

2 Rationale for Regular Updates of RAIO Charges

2.1 Current Basis for RAIO charges

BTC's RAIO charges are required to be cost oriented and reflective of efficiently incurred costs only:

- URCA's Final SMP Decision requires BTC to set cost reflective RAIO charges⁶; and
- The A & I Guidelines make reference to BTC's RAIO charges being reflective of efficiently incurred costs only⁷.

In line with the cost orientation requirement, BTC's current RAIO charges are based on its initial A/S results for the 2009 financial year. However, URCA's review of the draft RAIO concluded that further analysis was required to ensure that, going forward, BTC's RAIO charges would reflect efficient costs.⁸ As noted above, URCA has since undertaken an efficiency study of BTC for this purpose.⁹

2.2 Current Situation

To ensure charges remain in line with the principle of cost orientation, the RAIO charges ought to be reviewed on a regular basis, taking into account the latest available A/S costing data from BTC. As such, BTC is in principle required to update the current RAIO charges based on the audited 2010 A/S results which have recently been made available to URCA. However, the current situation is more complex, as set out below.

BTC's 2010 A/S results

BTC's latest A/S results differ significantly from those based on the 2009 costing data. In particular:

- (i) the 2010 accounts revealed that the cost of the Point of Interconnection (PoI) network component was substantially lower in 2010 relative to 2009; and

⁶ ECS 11/2010

⁷ ECS 14/2010

⁸ ECS 01/2011, available at URCA's website: www.urbahamas.bs

⁹ ECS 20/2012 "URCA Consultation: BTC Cost Efficiency Study-Statement of Results to Public Consultation and Final Decision", available at URCA's website: www.urbahamas.bs

- (ii) the audit revealed significant underlying concerns such that it is not clear whether the 2010 A/S results provide a sound basis for any revised RAIO charges, as this would lead to significant fluctuations in RAIO charges going forwards.

URCA is of the view that the first item should be reflected in the revised RAIO charges going forward. However, whereas some changes in A/S unit cost results are not uncommon during initial years that cost estimates are prepared, updating RAIO charges annually, based on the latest set of A/S results, could therefore lead to significant fluctuations in these charges in the near future. This is likely to result in great uncertainty for both BTC and other market players.¹⁰

Efficiency considerations

Although updating the RAIO charges to reflect 2010 A/S results will ensure that they remain reflective of the A/S results, this does not necessarily imply that the revised charges are also reflective of an efficient cost level (as required by the Access and Interconnection Guidelines).

Indeed, URCA's recent study of BTC's efficiency has confirmed the need for further efficiency adjustments to BTC's 2010 A/S results to ensure that any resulting RAIO charges are reflective of efficient cost levels. In particular, the study concluded that the following further efficiency adjustments would need to be applied to the 2010 A/S unit costs when setting RAIO charges to make them more reflective of efficient costs:

- 19% overall efficiency target for fixed network RAIO services; and
- 69% overall efficiency target for mobile network RAIO services.

Further considerations

In general, although URCA appreciates the importance of ensuring that RAIO charges are reflective of efficiently incurred costs, URCA also considers that there must also be for a reasonable degree of certainty in the market. As such, URCA is seeking to implement an approach now which will identify changes in RAIO rates to be made up to the next stage of market liberalisation, that is, liberalization of the mobile market which is anticipated to occur by 2015/16.

¹⁰ For example, other licenced operators offering call services to end users are likely to take account of, amongst others, BTC's call termination RAIO charges when setting their (off-net) retail call prices.

Consultation Question 1:

Do you agree with URCA's stated rationale for the need to review BTC's RAIO charges on a regular basis in the current market environment?

3 Potential Approaches to Setting BTC's RAI0 Charges

Given the current situation outlined above and its more general recognition of the need to confirm a policy for the setting of interconnection charges, URCA has considered several options to updating the RAI0 charges going forward. These fall into three main categories:

- Setting RAI0 charges annually through price determinations;
- Setting RAI0 charges now for a number of years (i.e., based on a 'glide path' to a given level of charges in a given year in the future); and
- Setting RAI0 charges based on benchmarking of cost oriented charges from the region.¹¹

Below URCA discusses the three potential approaches, including the key advantages and disadvantages associated with each of them.

When reviewing the options set out below, URCA has taken into account the current market environment and the following wider objectives:

- The need to ensure that RAI0 charges move towards an efficient cost level.
- The need to provide certainty to the market by minimising annual fluctuations in charges where possible.
- To provide a clear policy statement for how charges will be set.
- To ensure that RAI0 charges should not prevent BTC from recovering its efficient costs and create incorrect signals by falling below an efficient cost level.
- A desire to minimise the degree of regulatory burden on the sector.

3.1 Annual Updates

Under this approach BTC's RAI0 charges would be updated annually to reflect the latest available A/S results. Separately, an annual efficiency adjustment value will be determined based on the final results of the current study and a reasonable time horizon for BTC to achieve – either in full or in part - the required overall efficiency adjustments identified by the study.

The advantage of this approach is that it would ensure that RAI0 charges are reflective of efficient costs only. The charges would further reconcile to BTC's latest

¹¹ There is also the possibility of keeping the current RAI0 charges unchanged; however, URCA does not consider this a viable option given the issues highlighted above.

available annual cost data. Further, once the annual efficiency adjustment value is determined there is certainty on required efficiency adjustments and no additional regulatory processes are required to those currently already in place.

However, URCA notes that due to issues regarding availability of reliable data within BTC and ongoing significant restructuring changes at BTC, BTC's A/S results continue to display a high degree of instability. Therefore this approach, especially in earlier years, could lead to fluctuations in the RAIO charges on a year-on-year basis (including potential future increases) until BTC's A/S results stabilise over time. This is likely to increase uncertainty for the market.

There is further a conceptual issue of how to set an annual efficiency target going forward based on the current efficiency study results. The efficiency study is based on BTC's current (2009 and 2010) costing data. As such, the resulting efficiency adjustment factors are best applied to RAIO charges based on this costing data (rather than future A/S results).

Finally, any annual update of RAIO charges would also result in a significant regulatory burden for both BTC and URCA each year, with a potential for delays in updating the RAIO charges to allow for the conclusion of the annual review.

For these reasons, URCA does not consider annual updates of RAIO charges as the most suitable option for setting BTC's RAIO charges over the next few years.

3.2 Multi-year Glide Path

Under this option URCA would set RAIO charges now for a number of years. This would be based on cost information currently available and the results of the efficiency study, with the aim to move towards an efficient cost level over the period considered.

A key advantage of such an approach is that it provides certainty on RAIO charges going forward and ensures that these follow a stable path. This would increase the level of certainty in the market in the short and medium term. Determining the RAIO charges for several years to come also minimises the regulatory cost for operators and URCA during the period where the glide path applies.

However, as the glide path would be set based on the current A/S results, any prevailing shortcomings of these results will feed into RAIO charges for several years. This can be partly mitigated by adopting a shorter glide path of two to three years only.

There is further no guarantee that RAIO charges will be cost based at the end of the glide path as they are based on historic A/S data, rather than the most recent cost data available by then.¹²

3.3 Benchmarked RAIO Charges

Instead of setting RAIO charges based on A/S results (with or without further efficiency adjustments), URCA could determine the RAIO charges based on regional benchmarks. This would require collecting information on the current (and expected) interconnection charges across the region and potentially some further suitable comparator countries. BTC's RAIO charges would then be set equal to, for example, the average or lowest quartile of rate(s) in the region.

The benchmarking exercise could be updated on a regular basis (i.e., annually or biennially) to ensure that any downward trends in interconnections rates elsewhere are reflected in the RAIO charges.

This approach removes any uncertainty on RAIO charges due to underlying changes in A/S unit costs. However, it would also not result in the RAIO charges being cost based and reflective of efficiently incurred costs only. This is likely to be a result of several factors. For example, the (regional) interconnection charges included in the benchmarking sample may not all be based on efficiently incurred costs only. But even if they are, the cost base of those comparator operators may differ significantly from BTC's cost base due to, for example, the level of asset depreciations of each operator, differences in traffic volumes and natural geographic factors affecting the costs of providing electronic communication services in each jurisdiction.¹³

For the reasons above, URCA does not consider updating RAIO charges based on benchmarking as the most suitable option for setting BTC's RAIO charges over the next few years.

¹² URCA notes that a potential way of overcoming this issue is to develop a multi-year glide path using cost forecasts, which are informed by a bottom-up cost model. However, developing such a model would involve significant resources and time for BTC and URCA. As such, URCA has not considered this as a viable option at this point in time.

¹³ As within the efficiency study one could attempt to control for these exogenous cost differences by applying an adjusted benchmarking approach.

3.3 Summary Overview

The main advantages and disadvantages associated with each of the three options for setting RAIO charges going forward are set out in Table 1 below.

Table 1. Main Advantages/Disadvantages of approaches to setting RAIO charges going forward

Approach	Main advantages	Main disadvantages
Annual update	<ul style="list-style-type: none"> • Could ensure that RAIO charges are reflective of efficient costs only • Reconciles to BTC's annual cost data • Does not require additional regulatory processes 	<ul style="list-style-type: none"> • RAIO charges may fluctuate year-on-year (including increases) until the A/S results stabilise over time, increasing uncertainty for the market • Not possible to apply an annual efficiency target going forward based on the current efficiency study results • High regulatory costs and potential for delay
Multi-year glide path	<ul style="list-style-type: none"> • Certainty on RAIO charges going forward, ensuring they follow a stable path • Low regulatory cost once glide path is set 	<ul style="list-style-type: none"> • Any prevailing shortcomings of the current A/S results will feed into RAIO charges for several years • No guarantee that RAIO charges will be cost based at the end of the glide path if based on historic A/S data
Benchmarking	<ul style="list-style-type: none"> • Removes uncertainty on RAIO charges due to underlying changes in A/S unit costs 	<ul style="list-style-type: none"> • May not result in RAIO charges being cost based and reflective of efficiently incurred costs

Consultation Question 2:

Please comment on the options for setting BTC's RAIO charges going forward, including their merits in the current context of the electronic communications market in The Bahamas.

3.4 Proposed Approach

In discharging its duties and powers under the Communications Act 2009, URCA must have regard to the broad objectives of the sector policy:

- to further the interests of consumers by promoting competition; and

- to further the interests of persons in The Bahamas in relation to the electronic communications sector.

URCA recognizes that regulatory measures must be efficient and proportionate to their purpose and introduced in a transparent, fair and non-discriminatory manner.

URCA has reviewed carefully the merits of the options set out above taking into account the current market environment, the Electronic Communications Sector Policy, and its wider objectives discussed earlier. Given these parameters, URCA proposes to apply the glide path approach for setting RAIO charges going forward.

URCA considers that its preferred approach outlined above achieves all of the foregoing objectives.

Implementation

URCA proposes to apply the multi-year glide path approach based on two main principles:

- (i) BTC's existing RAIO charges should be taken as the basis, with an amendment to update the Pol network component unit cost; and
- (ii) BTC should be allowed to achieve its overall efficiency targets over several years. Each of these two elements is discussed further below.

Thus, instead of updating the RAIO charges annually to reflect the latest A/S results, URCA will set a cap for RAIO charges for the next three years (i.e. until BTC's exclusivity on mobile services expires). URCA considers this approach to be the most suitable option at this point in time as it:

- Removes the uncertainty arising from the fluctuations in A/S unit cost results;
- Allows implementing the efficiency adjustments gradually;
- Reduces the regulatory burden; and
- Provides certainty to the market, with the next charge review prior to a step change in the market.

Further, URCA considers the above benefits to outweigh the potential short term divergence from BTC's A/S results.

Consultation Question 3:

Please comment on URCA's proposed approach on setting BTC's RAIO charges going forward.

4 Indicative Charges based on the Proposed Approach

4.1 Indicative Charges

Below URCA sets out the indicative RAIO charges resulting from its proposed approach by providing more details on the two main elements underlying the approach: (i) revised A/S unit cost results; and (ii) further efficiency considerations.

As URCA's proposed approach requires BTC to update its A/S unit cost data, any charges presented in this document are indicative only. However, as part of its consultation response, BTC will be required to prepare and provide to URCA and the market revised RAIO charges based on the approach proposed below.

Revised A/S unit cost results

Having reviewed the relevant costing data based on the 2009 and 2010 A/S results, URCA is of the view that the 2010 A/S results are not sufficiently robust as a basis for RAIO charges going forward. Although BTC corrected the 2010 A/S results for the methodological issues URCA raised on the 2009 A/S data, there are further differences in the results relative to the 2009 data which are likely to be attributable to limitations in the underlying data.

Thus, instead, BTC should revise its current RAIO charges by taking into account the corrected PoI unit costs. Based on information provided by BTC, URCA expects this to lead to reductions in RAIO charges of circa BSD 0.84 cents per min.

Table 2 illustrates the expected impact of these adjustments on BTC's call termination RAIO services. For example, fixed call termination charges should reduce by 30% to 40%, relative to the current RAIO rates. The international mobile call termination charge should fall by 12%, relative to its current value.

Table 2. BTC's call termination RAIO charges, excluding efficiency adjustments (BSD cent / min)

	Current RAIO	Corrected values*
<i>Fixed call termination</i>		
On-island service	1.98	1.14
Off-island service	2.65	1.81
<i>Mobile call termination</i>		
International traffic	7.24	6.40

* Indicative only

Further efficiency considerations

As stated previously, URCA's efficiency study has confirmed the need to make adjustments to BTC's A/S based RAIO charges to ensure they fully reflect an efficient level of costs. In particular, the following overall efficiency targets have been determined:

- 19% overall efficiency target for fixed network RAIO services; and
- 69% overall efficiency target for mobile network RAIO services.

Given the magnitude of these total adjustments, URCA will not apply these as a one-off adjustment in a single year but instead phase these overall targets in over multiple years, based on the profiles set out in **Table 3** below. For the fixed RAIO services the overall efficiency targets will be phased over a three year period and a five year adjustment period will apply to BTC's mobile RAIO services. This is due to the overall size of the total efficiency target for mobile network RAIO services. This implies that only part of the overall efficiency target for mobile network RAIO services will be applied up to 2014/2015 (i.e., when BTC's mobile exclusivity is due to expire). As such, the last two stages of the glide-path (i.e., post 2014/2015) will be subject to review as part of the wider process of determining the regulatory regime for the period post liberalisation of the mobile market.

Table 3. Efficiency adjustment profile for fixed and mobile RAIO charges

	2012/13	2013/14	2014/15	2015/16	2016/17
Fixed RAIO service	-10%	-19%	-19%		
Mobile RAIO service	-14%	-25%	-35%	-50%*	-69%*

* Subject to review when developing the regulatory regime after mobile liberalisation

URCA wishes to stress that the values presented in the table above are not cumulative and will be applied to the corrected 2009 A/S unit costs (set out in **Table 2** above) to derive the relevant RAIO charges in each year. For example:

- In 2012/2013, a -10% efficiency adjustment will be applied to the correct revised A/S unit cost value for fixed on-island and off-island call termination service (i.e., estimated as BSD 1.14 cents and BSD 1.81 cents), resulting in indicative RAIO charges of BSD 1.03 cents and BSD 1.63 cents, respectively.
- In 2014/2015, a -19% efficiency adjustment will be applied to the correct revised A/S unit cost value for fixed on-island and off-island call termination

service (i.e., estimated as BSD 1.14 cents and BSD 1.81 cents), resulting in indicative RAIO charges of BSD 0.92 cents and BSD 1.47 cents, respectively.

Resulting indicative RAIO charges

Table 4 sets out the indicative RAIO charges up to 2014/2015 based on the two adjustments set out above. As shown in the table, BTC’s RAIO charges are expected to fall by up to 55% (relative to their current values) over the next three years. For example:

- On-island fixed call termination charges would reduce from BSD 1.98 cents to approximately BSD 0.92 cents in 2014/2015, a 53% overall reduction.
- Off-island fixed call termination charges would fall by 45% from BSD 2.65 cents to approximately BSD 1.47 cents in 2014/2015.

Table 4. Indicative RAIO charges for the period up to 2014/2015 (BSD cents / min)*

	Current RAIO	2012/13	2013/14	2014/15
Fixed call termination				
On-island service	1.98	1.03	0.92	0.92
Off-island service	2.65	1.63	1.47	1.47
Mobile call termination				
International traffic	7.24	5.52	4.80	4.16

* Subject to confirmation from BTC

URCA will review the RAIO charges again upon liberalisation of the mobile market in 2014/2015 or prior to that, at its discretion, depending on whether representations are received on why the RAIO charges are no longer appropriate.

4.2 Comparison of Indicative Rates to those Elsewhere

Despite preferring not to use benchmarks to set RAIO charges going forward, URCA still considers these to be useful to provide a ‘sense check’ of the indicative charges.

Figure 1 compares the proposed fixed call termination RAIO charges in 2014/2015 to the current RAIO charges and those currently in place elsewhere. Despite the proposed significant reductions, BTC’s fixed termination charges would remain in line with those across the region. This is particularly the case when taking into account that the interconnection charges in the other jurisdictions are also likely to fall between now and 2014/2015.

Figure 1: Comparison of BTC’s current and potential fixed termination charges to those elsewhere (BSD cent/min)

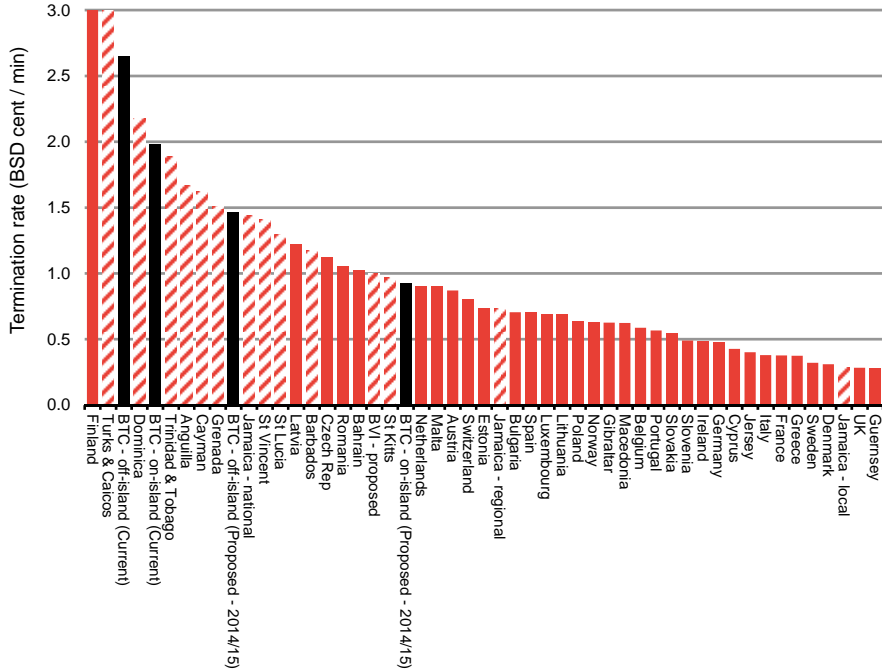
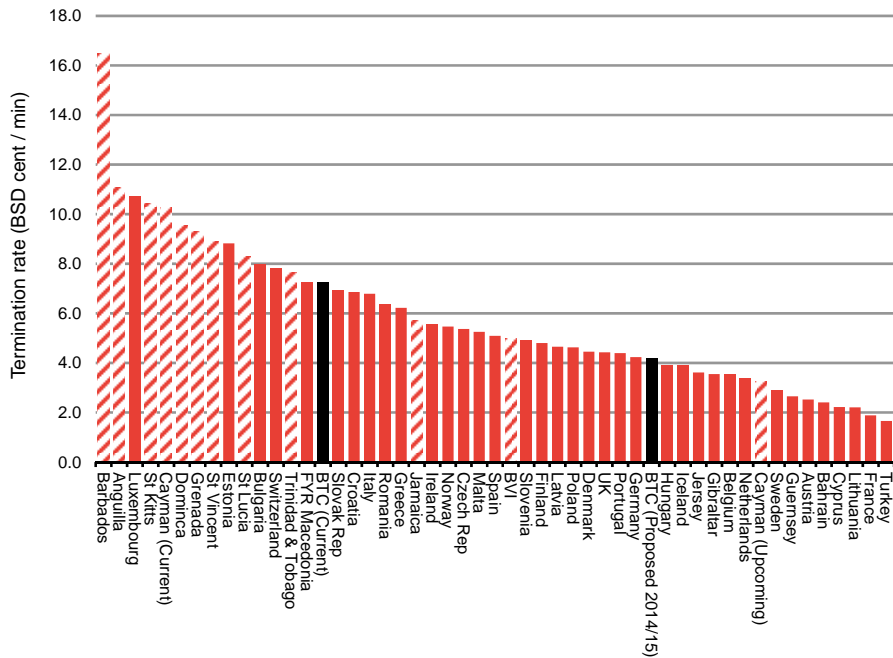


Figure 2 compares the proposed mobile call termination RAI0 charges in 2014/2015 for BTC to BTC’s current RAI0 charges and those currently in place elsewhere. The proposed glide path set out above would align BTC’s mobile termination rates in 2014/2015 with those currently experienced in Europe. However, it is again to be expected that mobile termination rates in the comparator countries are likely to fall relative to their current levels over the next few years. For example, this is best illustrated in the case of the Cayman Islands, where ICTA has recently determined a new mobile termination rate equivalent to BSD 3.26 cents, which is due to replace the current rate of approximately BSD 10.29 cents.¹⁴ The proposed 2014/2015 RAI0 charge for BTC would be significantly above the revised rate in the Cayman Islands. URCA is also aware that the OUR in Jamaica has recently announced a reduction in mobile termination charges as an interim rate pending the completion of its ongoing long run incremental cost (LRIC) modelling exercise for mobile networks¹⁵

¹⁴ ICTA Cayman Decision 2012-2 ‘Decision for the FLLRIC (Phase III) follow-up proceeding’ dated 17 May 2012, available at: http://www.icta.ky/docs/FLLRIC/PhaseIII/2012_05_17_ICTA_Decision_2012-2_FLLRIC_follow-up_proceeding.pdf

¹⁵ OUR Jamaica ‘Interim Mobile Termination Rate Determination’, dated June 05, 2012.; available at: <http://www.our.org.jm/images/stories/content/Telecommunications/DeterminationNotice/Decisions/4.6.12-%20Interim%20Mobile%20Termination%20Rate%20Determination.pdf>

Figure 2: Comparison of BTC’s current and potential mobile termination charges to those elsewhere (BSD cent/min)



4.3 Next steps

The indicative, proposed RAIO charges set out in this consultation document are estimates only since finalising them relies on BTC updating its A/S unit cost data and resulting RAIO charges. As such, without prejudice to its other views and URCA’s final decision, URCA has requested BTC to prepare and submit to URCA revised RAIO charges based on the approach set out above as part of its consultation response.¹⁶ This will facilitate URCA’s and all other interested parties’ understanding of, and thus allow commenting on, the actual charges going forward.

Consultation Question 4:

Please comment on the expected level of RAIO charges up to 2014/2015 based on URCA’s proposed approach.

¹⁶ As part of this submission, BTC further has to provide to URCA – under confidential cover - the underlying costing data and an overview of the approach taken.