Response to Obligations on Bahamas Telecommunications Company Limited Under s. 116 (3) of the Communications Act 2009.

INTRODUCTION

LIME welcomes the opportunity to respond to **<u>Obligations on Bahamas Telecommunications Company Limited Under s. 116 (3) of the Communications Act 2009</u>** Consultation Document ECS 22/2010 issued 7th September, 2010. A response has not been provided to each question in the document, however where LIME has not responded this is neither acquiescence with positions proffered by the Utilities Regulation and Competition Authority (URCA) nor a waiver of any available right to comment at a later date.

Consultation Question 2:

Do you agree that the BTC should remove any obligations on other operators which are inappropriate and unnecessary to manage the interconnection regime in the Bahamas?

The BTC should not be required to remove clauses which impose reciprocal charging on the access seeker and access provider. There can be no basis for commercial negotiation of Other Licensed Operators (OLO) call termination rates as call termination is a monopoly. BTC could not get a competing or substitute product for the termination of a call to an OLO's customers and the obligations on BTC to provide access removes any potential countervailing buyer power to an OLO, because there is no substitute for call termination, dominance exists and URCA would be forced to intervene in the rate setting discussions to prevent the OLO from exploiting this dominance. Moreover, OLO pricing should be justified by costs, in the same way as BTC and the most appropriate benchmark are BTC's approved rates.

It is important that the principles of liberalisation are established in a manner that fosters a level playing field, resulting in competition built on factors such as service and prices rather than on regulatory loopholes created by asymmetrical rates.

Consultation Question 3:

Do you agree that the BTC should fully justify any reciprocal clauses that remain in the RAIO?

LIME reiterates its position set above and refers to response to Consultation Question 4.

Consultation Question 4:

Do you agree that BTC should remove from its RAIO any reciprocal charging obligations on other operators?

LIME submits that interconnection rates are fundamental to any interconnection arrangement and having the clarity and equitability of reciprocal rates will provide the transparency and certainty necessary for the effective management of the interconnection regime in The Bahamas. Leaving OLOs to set rates unilaterally or allowing asymmetric rates could lead to:

- Differential on-net and off-net retail prices; and in particular higher charges for BTC's customers to call those customers who switch to competitors. Not only is this contrary to customers' expectations of the benefits of liberalisation it will also lead to less transparency of prices.

- Subsidisation of inefficient competitors (with the subsidy coming from increased charges to BTC retail and business customers) and the crowding out of genuine, sustainable, efficient competitors. This is clearly quite contrary to URCA's objective of supporting the development of effective competition.

The arguments for reciprocity are well documented and compelling. Reciprocity of interconnection is something that the European Commission has fought hard to apply. Each operator is found SMP on the market for calls terminating on their respective networks (on which they have an effective monopoly). There are no exceptions. It is LIME's considered view that BTC should be allowed to include in its RAIO the conditions requiring reciprocity of rates.

Consultation Question 5:
Do you agree that BTC should include in its RAIO the ability of OLOs in The Bahamas to terminate incoming international calls on BTC's network?

BTC should not be required to include in its RAIO the ability of OLOs in The Bahamas to terminate incoming international calls on BTC's network. This service should remain available through commercial negotiations.

URCA says that it is not its intention to regulate the settlement rates charged by BTC to operators outside The Bahamas, as it rightly points out, how such operators are treated does not raise any issues on the domestic market i.e. it does not discriminate against any end-users in The Bahamas. LIME views as prudent that URCA does not intend to regulate settlement rates; income from settlement rates provides a welcome boost to The Bahamas economy and for BTC a source of funds to help sustain the Universal Service Obligations (USO). However, what URCA proposes would have the same effect as regulating the settlement rates down to cost oriented levels. With few barriers to entry to becoming an operator licensed in The Bahamas and competing in the market for transiting international calls to The Bahamas, any settlement premium to the domestic termination rate would rapidly be competed away.

Although prices for international transit and termination do get combined, there are in fact two markets that should be considered; 1) the market for the transit of international incoming calls to The Bahamas, and 2) a separate market for the termination of international calls in The Bahamas. The settlement rate, which URCA agrees should not be regulated, is a feature of this second market; the termination of international calls in The Bahamas. The first market is one in which there is active competition, and BTC has direct and indirect agreements with many international carriers established through commercial negotiation. There is no market failure here that would warrant intervention by URCA. If operators licensed in The Bahamas wish to compete in this market there are no barriers imposed by BTC.

The Jamaica liberalization experience in which regulators imposed the provision of international incoming services at cost based rates, by December 2003 in the wake of full liberalisation, the settlement rates to the fixed network were averaging US$ 0.14 from US$0.19 in January 2001[1]. An examination of the relationship between the termination rates and the settlement rates will reveal that the settlement rates trend towards the termination rate as the newly licensed carriers simply negotiate settlement rates at a margin above the termination rate. Accordingly, the new entrants became "margin gatherers" and in early January 2004 when the termination rate was decreased to $0.01 following the removal of the Access Deficit Charge (ADC), the settlement rate plummeted to a low of US$ 0.017. The overall revenue losses to Jamaica were significant, in fact at the end of 2003 the annualised hard currency revenue loss to the economy was US$21.6 million. The country suffered from a decline in revenue inflows from international settlements, for instance when compared to 1998 the national loss of hard currency generated from international settlements to the PSTN was in the region of US$144 million per annum. Moreover, for every 1c decline in the settlement rate the country lost over US$300,000 per month of foreign exchange inflows.

[1] The settlement rates to the PSTN in Jamaica fell dramatically from a high of US$0.625 in 1999/2000 to a (US imposed) unilateral reduction to US$0.19 effective January 2001, arising out of the Report & Order on International Settlements, issued by the Federal Communications Commission (FCC).

Without prejudice to the foregoing, if URCA proceeds to direct the provision of this incoming international service then it should restrict cost-based interconnection to those operators that have invested in network development as this is critical to the objective of promoting sustainable competition. If service providers that have made little or no investment in infrastructure are able to obtain access at the same cost based rate as network operators, there will be no incentive for operators to develop any network of their own. This will result in competition in name only – as numerous service providers effectively resell the services of network operators without contributing to the development of the telecommunications infrastructure in The Bahamas. This kind of competition will not be sustainable in the long run and in the absence of regulation and will deliver little added value to the Bahamian economy. In Jamaica for instance, the non- facilities based OLOs have all fallen out of the market having decimated the settlement rates to the extent where margins are completely eroded and will seek from time to time to rejoin the market when there is an upward shift in the settlement rates by the remaining facilities based operators. The non facilities based operators will then seek to re- enter the market only to erode the profits and then fall out again, with zero attendant benefits to local customers and in fact a big negative to them in eroding much needed funds for network development and sustenance.

It may be necessary to have a separate regulatory debate about the management of the settlement rate in a liberalised market, and the use of profits from the settlement rate. In other jurisdictions the principles have been that no operator has the unilateral right to reduce the national settlement rate and that any profits go to the final terminating operator; i.e. the providers of infrastructure. If these principals are applied in The Bahamas, OLOs will be able to profit from the settlement rate as they gain customers in The Bahamas on their own networks. However, if instead URCA requires BTC to offer cost-oriented termination for international incoming calls there will be no such profits available for any operator. The consumers in The Bahamas would, not benefit from lower rates; it would be consumers in markets outside The Bahamas that would benefit from lower rates, consequent upon the erosion in settlement rates.

Consultation Question 6:

Do you agree that the international call transit RAIO service should be made available to OLOs and that the charge should be based on:

- a cost based charge for call conveyance on BTC's network (including BTC's international facilities); and
- the relevant international settlement rate, passed on to OLOs at cost?

International Call Transit can be understood by examining separately the three elements that make up the cost of supply in this market; 1) transit to an international hub, 2) call conveyance to the destination country and the 3) payment for termination at an international destination.

Capacity to the nearest international hub in Miami is freely available; through self provision of leased capacity from operators including BTC. With such competition and substitution, BTC clearly cannot exert dominance in this market.

The transit and termination of traffic from any international hub is a dynamic and fiercely competitive market. BTC does not own the facilities for this service but will have contracts with several international carriers for the supply of this service. Other operators licensed in The Bahamas are free to also negotiate such arrangements. In relation to the scale of global traffic, BTC is a very small customer to each of these suppliers and holds no significant negotiating power that would provide BTC with any significant advantage over any other operator licensed in The Bahamas.

The third component of the price of services in this market is the payment for termination in the destination country; which in some countries can include payment of a premium (above domestic call termination) for the bottleneck service of termination of international calls in the destination country, as is the case at present for calls terminated in The Bahamas. Typically, these bottleneck charges are not subject to negotiation, as allowing preferential rates would provide arbitrage opportunities and merely serve to lower the effective charge across all traffic. BTC therefore does not have any dominance in this element of the market nor does it have the ability to gain any significant advantage in this market over other operators licensed in The Bahamas.

Furthermore, the erosion of BTC's market share of outgoing international calls in the face of competition from international VoIP in The Bahamas highlights BTC's lack of dominance in the market for international call transit and certainly demonstrates that BTC's position in the market for international call transit is no barrier to competition in the retail market for international outgoing calls.

On the basis that there is no evidence of BTC having dominance in the market for international call transit; either from analysis of the elements of supply or from the effect on the associated retail market, BTC should not be required to include in its RAIO the international call transit service, and in any case this service should not be the subject of regulated prices.

Consultation Question 7:

Do you agree that URCA should periodically review the relevant international settlement rates charged by BTC to OLOs for the international call transit RAIO service, to ensure that such charges are passed on to OLOs at cost?

On the basis of the analysis and arguments that we set out above, URCA should not regulate the prices for the international transit service. Furthermore, there are practical limitations in both identifying the cost and reviewing this cost to wholesale services in a timely manner. Prices in the market for international transit are dynamic and complex; with suppliers offering prices across a range of destinations dependent upon volume that are designed to entice small operators such as BTC to route a greater share of their traffic through that supplier, and to make commitments for longer periods. In response, operators such as BTC will often multi-source to provide both resilience and strengthen their negotiating position in the future. Therefore, at any particular time, it may not be possible to identify the cost for any particular destination. Even if URCA were able to establish the relevant cost for a particular destination, with prices potentially changing by the day URCA it would be impractical for URCA to review these costs with sufficient frequency to align costs with prices.

Consultation Question 8:
Do you agree that BTC must:
(i) add a RAIO call termination service for calls to freephone numbers on its network; and
(ii) remove the RAIO charge for call origination from BTC's mobile network to freephone numbers on an OLOs network if BTC charges for such airtime?

BTC should not be obliged to add a RAIO call termination service for freephone numbers rather this should be subject to separate commercial negotiations via service provider agreements.

Consultation Question 9:
Do you agree that BTC must include a service for terminating calls from OLOs to premium rate numbers in its RAIO?

BTC should not be obliged to include a service for terminating calls from OLOs to premium rate numbers in its RAIO. OLO's are in a position to make their own arrangements with international carriers for access to premium numbers as such there is no significant practical barrier to entry. Accordingly, any service for terminating calls from OLO's to premium rate numbers should be subject to commercial negotiations outside the parameters of the RAIO.

Consultation Question 16:

Do you agree that BTC should continue to offer free local calls given the non-zero RAIO charge for intra-island interconnection?

BTC should be allowed to continue to offer free local calls despite non-zero RAIO charges for intra-island interconnection.

As URCA points out, there are examples of other markets in which all local calls are included in retail access charges in which non-zero local interconnection charges apply. Furthermore, even in markets characterised by a history of metered local calls, competition is forcing retail prices to move towards unmetered through the introduction of unlimited packages bundled with access charges. These markets continue to have non-zero local interconnection charges. From this it is clear that in a competitive market consumers increasingly value of a bundle or combination of services and there need be no specific link between the retail charging mechanism for calls and the mechanism for local interconnection.

Furthermore, there is a clear risk in The Bahamas that the retail prices for access and local calls do not cover the substantial costs of providing these services in a geography such as in The Bahamas, and requiring BTC to offer intra-island interconnection would increase the distortion created by this mismatch between prices and costs, to the detriment of the economic efficiency that liberalisation seeks to bring. It would therefore be contrary to the interests of the consumer to impose local interconnection rates below the cost of supplying this service.

Consultation Question 19:
Do you agree that mobile termination charges should not be included in the final RAIO except for incoming international calls to mobiles (delivered via an OLO)?

Both the USA and Canada which are geographically relevant to The Bahamas have successfully used the MPP system. In the Caribbean, the regulators in Barbados have also taken the view that with unmetered local calling, RPP was suitable for the market. As there are no other mobile network operators in The Bahamas, off-net mobile to mobile calls are not relevant at this time. However, where BTC is in fact able to set its mobile retail rates at a rate which is above cost then LIME opines that an MTR from the fixed line OLO to mobile would not be essential. Moreover, when competition in the mobile market is introduced this should be subject to a separate consultation and consideration of interconnection obligations.

Consultation Question 22:
Do you agree that for its final RAIO, BTC should develop revised charges based on the amendments to its Accounting Separation model?

BTC should not be required to develop revised charges for RAIO services. LIME notes that URCA's justification for revised charges is based on:

- The use of a capacity rather than traffic volume approach to cost allocation;

- The allocation of regulatory operating costs to non interconnection products.

BTC uses a traffic volume approach to cost allocation, and URCA proposes that a capacity approach be used. However, such use of capacity to allocate costs is being found to be distortive and fundamentally flawed as the usage and requirements of voice and data services diverge. The result of such a capacity approach implies costs for data services that are much higher than prevailing prices for these services. If Accounting Separation (AS) costs are used to set pricing messages then the result would be a substantial increase in the price of data services and a curtailment of demand in particular for broadband. This would cause tremendous disruption to the market and The Bahamas would stand out as unique in the world as a market where regulation sought to discourage adoption of broadband services. LIME would expect that this most certainly would not be the intention of URCA. There is no economically perfect way of allocating common costs; the very nature of common costs is that they cannot be attributed to just a single service. The economic literature suggests revenue allocation approaches such as Ramsay Pricing are the most economically efficient, but many regulators have concluded the use of Ramsay Pricing is at present, impractical. Notwithstanding, the principle behind such an approach is sound; in that the allocation of costs should seek to maximise consumer welfare. Of the two approaches considered; traffic or capacity, a traffic approach is far less distortive to the market and does not suffer from the same negative impact on consumer welfare as would result from an enforced increase in data and broadband prices. LIME is therefore submitting that the traffic approach should be used.

With regard to the allocation of costs to points of interconnection network, URCA highlights the allocation of a large proportion of the operating costs of the legal and regulatory function to interconnection costs and questions whether this is appropriate. One of the primary tasks and functions of regulation is to regulate the interface between competitors; of which interconnection is a key component. Absent regulation of interconnection, much of the costs of legal and regulatory department would be avoided. Therefore even under the most stringent application of the avoidable cost principle, these costs should be allocated to interconnection.

Consultation Question 23:

Do you agree with URCA's approach that where BTC has used the AS model for developing interconnection tariffs, these tariffs be used for 2010 (with appropriate adjustments for the cost allocation issues highlighted by URCA) and adjustments for efficiency be incorporated, in parallel with production of the AS model based on 2010 financials, from Summer 2011 onwards?

BTC should not be required to further adjust downwards its tariffs. BTC's tariffs should be based upon its costs as set out in the separated accounts. URCA has sought to use benchmarks to establish whether BTC's rates are efficient. URCA highlights the need to select markets that are comparable to The Bahamas for its benchmark comparator set, and chooses Caribbean islands and the European islands of Jersey, Guernsey and Malta. However, it is not sufficient that a market is an island for it to be appropriately comparable to The Bahamas; for the costs of terminating local calls it is the traffic density that is important, and for inter-island and transit charges, scale is by far the dominant factor in determining average costs. For instance, Manhattan is an island, yet no-one would expect the costs of terminating traffic within Manhattan to be at all comparable to those costs in The Bahamas; the scale and density of traffic demand would result in much lower costs in Manhattan.

LIME accepts that URCA has not proposed to include Manhattan in the comparables set but this example does serve the purpose of highlighting the risk of relying upon limited similarities between markets to justify their use as comparators.

BTC is obliged to service many dispersed and remote local markets across the islands that it serves and will most likely have a traffic density far lower than that in any of URCA's comparator markets. Indeed, this highlights one of the major challenges faced by BTC; maintaining universal service across a unique geography. This uniqueness renders any such benchmarking largely irrelevant and it should therefore not be used to justify lowering BTC's rates.

URCA goes on to use a different set of comparable markets to benchmark BTC's operational efficiency; including Macau, which is more likely to exhibit similarities to Manhattan than to The Bahamas. Furthermore, the measures of efficiency that URCA uses include lines per employee. This is a notoriously dangerous measure to use as the different degrees of outsourcing used by different operators renders comparison largely meaningless. URCA does state that this initial analysis does not necessarily imply that BTC is inefficient as these differences in average costs and operational performance could be driven by the operating environment in The Bahamas. With this we concur.

URCA does go on to say that the benchmarking analysis indicates that there is a need for an in-depth assessment of whether BTC's AS results used in its draft RAIO charges represent an efficient level of costs. LIME submits that the benchmarking analysis does not achieve this; as URCA states, the differences could be attributable to the operating environment in The Bahamas.

In the absence of any simple comparators, establishing the efficient level of operations at BTC would be an extremely costly and somewhat subjective exercise. There is clear asymmetric risk associated with any adjustment; any adjustment would leave BTC with additional profit for a short period of time whereas any over-adjustment could encourage inefficient entry and undermine BTC's ability to sustain service, particularly to remote customers. Any adjustment would therefore have to be limited to avoid this risk. Furthermore, to the extent that BTC's AS costs represent its actual costs, by including these AS costs as the basis for RAIO charges BTC is acting non-discriminatorily. An efficiency adjustment to prices therefore does not improve competitive conditions; it is just more likely to favour inefficiency.

Under private ownership, the profit motive will drive operational efficiency at BTC which in turn will feed into AS costs and regulated prices. BTC needs no additional stimulus to seek operational efficiency, and the interests of consumers are not served by forcing reductions to prices below BTC's actual costs.

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