July 30, 2009

Communications Consultation,
c/o KPMG,
5th Floor Montague Sterling Centre,
East Bay Street,
P.O. Box N-123,
Nassau.

Dear Sir,

Re: Public Consultation on Retail Pricing Regulation in the Communications Sector ("Pricing Consultation").

Please find below the comments of Systems Resource Group Limited ("SRG"), d.b.a. IndiGO Networks® ("IndiGO"), with respect to the above Consultation Paper.

Response to Public Consultation Questions

Question 1: Is there a need for further tariff rebalancing in The Bahamas?

SRG was somewhat surprised by the description in the Pricing Consultation of the history of so called tariff rebalancing by the Bahamas Telecommunications Company ("BTC"), which gave the misguided impression that this was a deliberate business strategy with measured implementation by BTC.

The reality is that in 2004 BTC had not reduced its prices for international or domestic long distance in memory. Then, in October 2004, immediately after IndiGO had launched competitive services, BTC chose to arbitrarily reduce its prices without the required approval of the Public Utilities Commission ("PUC"). With respect, this was no tariff rebalancing exercise. SRG contends that it was a deliberate strategy of BTC to lower the retail price so close to its wholesale price that it would hamper IndiGO's entry into the market, and thereby have the effect of distorting competition.

The fact that IndiGO was able to take action to negate the above is borne out by history, and it is undeniable that IndiGO has been the sole catalyst in bringing about dramatic consumer benefits in fixed voice telecommunications.

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IndiGO's entry into the market has given rise to the following:

- The cost of digital T1 business voice circuits has fallen by 32%
- The cost of inter-island domestic long distance calls has fallen by 57.5%
- The cost of international long distance calls has fallen by up to 83%
- Innovative new consumer VoIP services have been introduced with vastly reduced long distance calling plans that are on par with services offered in leading international jurisdictions
- New best-practices business services have been introduced
- Businesses have been able to reduce cost whilst taking advantage of redundant services from multiple operators, safeguarding their voice communications

In 2006, nearly two years after its initial action, BTC was able to win back some of its lost profits by substantially raising local access charges, with a slight further drop in long distance rates to follow. SRG does not have access to an analysis of BTC's costs, and therefore cannot say whether this subsequent rebalancing effort has created circumstances where tariffs are balanced. Indeed, the Pricing Consultation takes a similar position, stating that "In the absence of updated costing information from BTC, it is difficult to assess whether the increases in monthly access charges have … fully compensated BTC … and whether further rebalancing is required".

The Utilities Regulation and Competition Authority ("URCA") will need to judge the situation based upon accurate cost information, something that is by no means straightforward to obtain. As SRG indicated in its response to the Public Consultation on Access & Interconnection, the process of establishing cost is complex, and experience from other jurisdictions has shown that the self interest of those preparing the cost information for a competitive market can lead to manipulation of the outcome. As with that consultation, the Pricing Consultation is silent on who will be responsible for presenting cost information, how it will be independently audited by the regulator, and in what timeframe.

Question 2: Do you agree that the regulator should design a price regulation framework that enables tariff rebalancing? If you disagree, please state your reasons.

If the analysis of BTC's costs demonstrates that tariff rebalancing is necessary, then it must surely be introduced because to do otherwise would unfairly distort the market. The Pricing Consultation makes the point that "An approach to retail price control which pays no regard to the possible need for price increases for some services as part of an overall programme of tariff rebalancing risks unfairly penalising an SMP Operator". SRG would also point out that a failure to enable tariff rebalancing also unfairly penalises other operators because of the distortion to the sector in which pricing is at below cost.

Question 3: Are there benefits from introducing an option for monthly line rental at a lower price which excludes free local calls? If so, what type of plans for charged local calls would be most appropriate?

SRG respectfully submits that details of plans are a matter for the operator rather than the regulator, however SRG agrees with the position taken in the Pricing Consultation that "Free local calls may …result in levels of demand, and of network congestion, being higher that they would be if consumers were exposed to charges which reflected the costs imposed by their use of the network". This has two related implications:

1. Other operators will have to over-build their networks to provide for the expectation of free local calls and the associated higher levels of demand. This distorts the market because the SMP Operator has a sunk cost of infrastructure, whilst a new entrant will have to make new infrastructure investment in adhering to the business practices adopted by the SMP Operator.
2. The potential exists for lower productivity in the wider business community as a culture of free local calling allows calls to be made from the workplace at no charge.

One option not considered in the Pricing Consultation is that adopted by Bermuda. The Bermuda Telephone Company charges $26 per month for local access, which includes 50 free local calls, with additional calls being charged at 20 cents per call[1]. Flat rate charges per call of this type can help avoid significant billing system upgrades that may be required to rate local calls on a per minute basis. They also help smooth the transition to local call charges because the consumer knows what they will pay for every call and can budget accordingly.

Question 4: Should The Bahamas move to a caller-pays principle for all calls? If you disagree, please state your reasons.

SRG notes that the Pricing Consultation states that the existing charging principle for fixed-to-fixed calls is that calling party pays. With respect, SRG does not agree. Whilst that principle would hold for long distance domestic calls between islands, the fact that local calls are free does not allow for a reasonable conclusion that calling party pays. In such a situation, there is currently no way of knowing who is paying for the call, and at best it would be reasonable to surmise that the cost is somehow being shared between the calling party and the receiving party in the access charges that they each make.

The same can be said to exist in cases where a mobile customer either originates or terminates a call with a fixed line customer. Whilst it is certainly true that the mobile party is paying, so too, at least in part, is the fixed party paying through the local access charges that they have incurred. In such cases, BTC is effectively being paid twice for the same call.

[1] http://www.btc.bm/Residential/LocalPhone/Default.aspx

SRG agrees that The Bahamas should move towards calling party pays for all calls, but respectfully submits that such a move cannot be properly implemented in isolation of a proper understanding around the issue of free local calls.

Question 5: Do you agree that the historical approach to retail price regulation should be reformed in the newly liberalised environment? If you disagree, please state your reasons.

SRG does not agree that the current framework of retail price regulation is necessarily flawed and in need of reform. The existing framework is based on an approval principle, and it is within the power of the dominant operator to seek approval at any time based upon principles of transparency and objectivity that also promote fair competition in the market.

Where difficulty and/or delay has ensued in application of the historical approach to price regulation, SRG believes that it has done so due to the lack of application of the above principles by the dominant operator. In the five years since IndiGO entered the market, BTC has on various occasions chosen to either introduce new prices in the absence of seeking required approvals, or has made application with incomplete or inadequate information. The former action has led to discord with the PUC, and the latter to delay.

Nonetheless, SRG considers that any frustration arising from past application of the process lies not in the process itself, but the manner in which it was applied by BTC. Under the new regime, with URCA as a newly empowered regulator, SRG sees no reason to believe that URCA would not be in a position to guide the SMP Operator in making an application such that the process remained an efficient one.

Question 6: Do you agree with the objectives proposed for price control regulation? If you disagree, please state your reasons.

The Pricing Consultation omits to consider circumstances where an SMP Operator sets prices so low that they are predatory in nature or at least have the effect of bringing about an anti-competitive market. In such circumstances, a new operator may no longer be able to justify investment in infrastructure because the possible margin in the market will not provide a return on investment.

Low prices are highly desirable to the consumer when driven by free market forces, but when driven by the ability of an SMP Operator to control the market they are a short term gain that will bring about long term pain for the consumer as competition and service choice withers, and the SMP Operator is subsequently able to force up prices when competitors have been driven from the market.

Theorists may argue that price regulation as structured in the Pricing Consultation is “ex-ante” in nature; in other words something that happens before the event. Those same theorists may then argue that pricing behaviour such as that articulated above, that has the effect of distorting competition, can be managed through “ex-post” regulation; in other words after the event.

It is true that the Communications Act (the “Act”) provides in Section 69 for an abuse of dominant position, specifically in Section 69(2)(a) with respect to unfair selling prices, but SRG strongly believes that the ability of URCA to react after the event does not provide sufficient competitive protection in a sector that is far from mature. The SMP Operator has the ability to take pricing action that would irreparably damage a competitor in the time between the action being taken and URCA being able to respond, and whilst URCA has the power to impose fines on the SMP Operator after the fact, such fines would do little good for the other operator that has been damaged in the meantime. Indeed, in such a fledgling market, a rogue SMP Operator may take a conscious business decision that the risk of a fine is one worth taking to ensure that a new entrant does not gain a foothold in a market.

SRG believes that the objectives proposed should also accommodate the principle that pricing regulation must embrace Section 4(iii) of the Act, in encouraging and promoting sustainable competition.

Question 7: Do you agree with the Government’s view that wholesale price regulation alone may not be sufficient to protect consumer interests in the present and near future?

Yes.

Question 8: Do you agree with the proposal to adopt price cap regulation? If you disagree, please state your reasons.

SRG agrees, however, for the reasons articulated in response to question 6, SRG further believes that until such time as the market has matured, price regulation should include a floor, in addition to a ceiling. This Pricing Consultation itself accepts the concept of a price floor in paragraph 143.

Question 9: Do you agree with the proposal to introduce an Interim Pricing Framework in the short term? If you disagree, please state your reasons.

SRG believes it to be essential, and respectfully suggests that the Interim Pricing Framework remain in place until such time as the market is deemed to have matured sufficiently to allow sustainable competition, and in any event for not less than 24 months.

Question 10: What principles should underpin any Interim Pricing Framework for retail price regulation and on the nature of the interim arrangements?

As articulated above, SRG believes that the objectives proposed should also accommodate the principle that pricing regulation must embrace Section 4(iii) of the Act, in encouraging and promoting sustainable competition. In particular, all proposed changes in price by the SMP Operator, whether up or down, must be subject to approval by URCA.

Question 11: Do you agree with the proposed regulation of special offers and discounts? If you disagree, please state your reasons.

Whilst SRG agrees in principle with the proposed regulation of special offers and discounts during the Interim Period, SRG is concerned that the cited 10-day period is too short for URCA to properly consider the proposed terms and establish whether they are objectively unjustifiable and/or anti-competitive. Moreover, SRG believes that for URCA to make a reasoned judgment it must at least consult with other operators who will be affected by the decision.

A recent case in point will help serve as an example. BTC made request to the PUC to introduce a special offer/promotion in 2008, and based upon the information provided by BTC in its application, the PUC granted approval. When SRG became aware of the details at launch, SRG made representation to the PUC that certain components of the promotion were in its view anti-competitive, since they were priced below cost. SRG provided information in that regard to the PUC, which prompted an investigation by the PUC who acknowledged that the data supplied by SRG was "not consistent with information/data the Commission obtained from BTC" in the course of the original application.

Suffice it to say that when BTC requested an extension to the promotion it was declined by the PUC, however that neglects the fact that the damage to the competitive market had already been done, and could not be undone. Quite obviously, in any such circumstances the applicant has a vested interest in being economical with information that might not support its proposal, and no matter how good its intentions URCA cannot expect to be able to put itself in the shoes of the SMP Operator's competitors to make a assessment of the effect on the market of an application by the SMP Operator.

Notwithstanding the fact that it might appear to the disadvantage of the SMP Operator to have its promotional plans leaked in advance, past behaviour leads SRG to believe that affected operators must nonetheless be given the opportunity to comment on discounts and special offers to avoid history repeating itself. In fairness, the SMP Operator, as the applicant, should then be given the opportunity to respond to comments submitted by other operators. The 10-day time limit must be extended to allow URCA a reasonable time to conduct research and properly consider the circumstances.

Question 12: Do you agree with the proposed form of the price cap shown above? Do you have views based on experience with price cap regimes on the application of the price cap with this broad form?

No response given.

Question 13: Do you agree with the use of a ‘building blocks’ regime to determine starting prices under the price cap?

No response given.

Question 14: Do you agree with the use of CPI within the price control formula? If you disagree, please state your reasons.

No response given.

Question 15: Do you agree with the proposed use of the prior year’s inflation rate as measured in the All Bahamas Price Index? If you disagree, please state your reasons.

No response given.

Question 16: Do you agree with the use of an X-factor to reflect expected productivity gains over the period?

No response given.

Question 17: What price control period do you think should be used? Do you believe that the appropriate price control period is affected by the proposed phasing in of competition in The Bahamas?

No response given.

Question 18: Should a Z factor be included? If a Z factor is included what are some of the exogenous occurrences that should be considered?

No response given.

Question 19: Do you agree that quality control incentives should be built into price control regulation? What are the relevant key performance indicators (KPIs) that you consider could be utilised for monitoring quality?

No response given.

Question 20: Should operators be able to carry over out-performance in early years into the later years within the same price control period?

No response given.

Question 21: Do you agree with the initial thinking on the provision of information for use in price control regulation?

No response given.

Question 22: Do you agree with the views expressed above on the use of baskets of services in retail price control regulation? Do you have views on the appropriate form of the tariff baskets to be used?

SRG considers that the provision of free local calls would serve to distort any basket in which they were placed with other services, and local calls should therefore be isolated from other services. Likewise all mobile services must be separated from fixed services.

As already articulated, SRG agrees strongly with the proposal in paragraph 143 of the Pricing Consultation to protect the market by imposition of a price floor.

Yours faithfully,

Paul Hutton-Ashkenny
President