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John Williams
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Turks and Caicos Telecommunications Commission
Business Solutions Building
Leeward Highway
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Dear Mr Williams

Second Review of Mobile Termination Rate Consultation Document[1]

Question 1: Parties are welcome to provide comments on the Commission's review of and conclusions relating to the Initial Responses and Reply Responses received in response to the questions raised in the Initial Consultation Document.

Comments on Paragraph 1: Background and Purpose; and the Commission Recommendation to Government on Amendment of the Interconnection Regulations

By reducing the mobile termination rate through regulation independently of other rates the Commission would strip away any bargaining power that Digicel would have in negotiations with LIME about fixed line termination and fixed line transit/link prices. Consequently Digicel is unlikely to be unable to negotiate any reductions with respect to these rates since LIME will have no commercial incentive to agree to any reductions.

The Commission has proposed making a recommendation to Government that section 19(2) of the Interconnection Regulations be amended to establish reduced MTR maxima in accordance with the Commission's conclusions in this proceeding. Taking account of the above, and in this event the section also needs to be amended to allow the Commission to override provisions within LIME's interconnection contract with Islandcom with respect to fixed line termination and transit/link rates as it may well be necessary for Digicel to go to dispute with LIME on these matters.

[1] The comments in our response are not exhaustive and Digicel's decision not to respond to any particular issue does not necessarily represent agreement, in whole or in part with the Commission's position on these issues; nor does any position taken by Digicel in this document mean a waiver of any sort of Digicel's rights in any way. Digicel expressly reserves all its rights.

Comments on Paragraph 2.2: Efficiency Considerations for Setting MTRs

While we agree at a top level that LRIC plus is the right way forward for assessing costs, there are of course still many variables which can lead to significant variation in what a LRIC output is. For example, with respect to the cost of capital it must be noted, as indicated in our original response, that typical assumptions about the cost of capital suffer from survivorship bias, and assume that the risk to surviving firms in the market is the right level of risk to assume when arriving at a LRIC cost.

In its reply response to Digicel's comments during the previous consultation LIME stated in response to this point that:

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> *the sample of comparable firms employed in telecommunications cost of capital studies typically operate in markets with a limited number of players and with little or no history of bankruptcy. In this setting survivorship bias is unlikely to be a significant factor. Therefore, with regard to cost of capital, there is no basis for Digicel's assertion that a LRIC cost model inevitably understates true cost of an efficient operator.*
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> "

In its response LIME has in fact identified another major flaw with cost models: frequently, when assessing the cost of capital for LRIC purposes, larger and more stable comparator firms are chosen for cost of capital assessments simply because information about them is more readily available. These firms are unrepresentative and not suitable for an assessment of the risks and therefore the cost of capital of operators attempting to launch provide services in small islands. This is just one problem with typical cost of capital assessments.

In addition, it is of course and in any event not true that large firms do not go out of business. When the number of smaller telecommunication companies that collapse is also taken in to account it demonstrates even more starkly just how misleading it is to rely on a model that assumes there are no such failures. While Digicel does not have an exact count of the surviving versus bankrupted companies from the telecoms crash around year 2000 for example, it is clear that huge numbers of firms were wiped out. Markets are subject to shocks and bankruptcies, among more day to day reasons for company failures, and these are risks that need to be accounted for if a true cost of capital is to be calculated. But they are not accounted for in LRIC models simply because currently no satisfactory means of approaching this issue through a modeling approach has been established. Therefore inevitably LRIC plus models will underestimate the true long run costs of an efficient operator. Real world factors require higher figures to be used.

Comments on Paragraph 2.4: Potential End User Benefits from Reducing MTR

We should like to provide some points of clarification with respect to the Commission's summary on page 9. Our questioning of LIME's claims of enhanced welfare did not say that there will be no consumer benefit in terms of those customers who choose to use FTM services and who see reduced FTM retail prices from reduced MTRs. But what we are saying is that the key way to benefit consumers of FTM calls is to reduce the extremely large fixed call origination retention. The only reduction in the FTM retail rate that will result from a reduction in the MTR is likely to be the compulsory 1:1 reduction. This is a minor part of the equation for fixed line customers.

We did not suggest that mobile and fixed termination rates were not coming closer to each other. We stated that currently there remain significant cost differences even according to models originating from LIME sources and being used for current or imminent regulation in other jurisdictions e.g. the Cayman Islands and ECTEL countries.

Our issue with the lack of accounting separation is as follows: given a huge fixed origination retention, and a complete absence of accounting separation, there is nothing to stop LIME from cross-subsidizing its mobile network with revenues from its fixed network. This would distort the market. The Commission cannot reasonably suggest that Digicel provides evidence of this: we have no access to LIME's internal accounting information. The Commission exists partly because only an entity like it is in a position to obtain the information to investigate and to make a determination in this respect. Given that the Commission has allowed an enormous fixed retention for FTM calls there must be a clear and present danger that a fixed to mobile cross subsidy is taking place. Therefore we feel that it is incumbent on the Commission to investigate this matter before tipping the playing field further in LIME's favour by cutting at just the mobile termination element from the menu of interconnection rates.

LIME's suggestion that reducing the MTR can only lead to increased economic efficiency is over simplistic in our view. Given the enormous profits in fixed network origination provision, and if the share of the overall revenues from fixed to mobile will be tipped more towards fixed (which is what will happen if the mobile termination rate is reduced without more than a 1:1 decrease in fixed origination), that sends a message to investors more in favour of fixed than mobile investment than should be the case. That is how potential investors will see the market. Potential investors, of whom there are naturally a limited supply, are rational, and will generally look for the highest potential returns. Investors should be encouraged to invest in a way that will add most value to the lives of citizens. But a contrary message is being sent out in terms of the relative levels of FTM retail and termination rates, and the impact that high fixed origination costs are having on the volumes of calls to mobile networks, and therefore the amount of revenue received by mobile networks in terms of termination revenues.
The Commission stated as follows:

> "
> *While Digicel recognized that LIME's FTM rate is subject to a price cap under the current price cap regime, the Commission notes that it is important to also recognize that FTM calling is just one of many services subject to that regime. In establishing the full set of price cap constraints under LIME's current price cap regime, the Commission took into account LIME's aggregate rate of return on its regulated services subject to price caps. No attempt was made however to ensure that each and every price capped service generated the same profit margin, nor was service-specific profit regulation an objective of the price cap regime.*
> "

We are aware of these facts. However in return we believe that the Commission must acknowledge that the huge fixed origination rate for FTM calls that it has allowed, and which LIME has taken advantage of by pricing at least up to the price cap ceiling, if not above that level, is inevitably:

1/ significantly reducing the volume of fixed to mobile calls below where they would be if LIME priced fixed to mobile calls at a cost based level[2]. The cost of fixed origination would probably be no more than about 4 cents even assuming that fixed origination cost as much as 3 cents and allowing a roughly 30% uplift to cover retail costs (which we imagine the Commission's own consultants can confirm as reasonable). This would result in a FTM retail rate of 19 cents per minute but billed per second if mobile termination was priced at 15 US cents, and not 46 cents per minute but billed per minute[3]. This would clearly increase fixed to mobile call volumes significantly and we assume that the Commission would not dispute this. As the Commission is aware we were not proposing such a significant shock as this in terms of a reduction in the fixed origination rates and were suggesting a fixed retention of up to 10 cents billed per minute initially. But this would still raise call volumes significantly and again we assume that the Commission would not dispute this;
2/ as a consequence significantly reducing FTM call volumes and therefore the amount of revenue that mobile operators receive for terminating calls from fixed networks; and

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[2] we assume given that it is general regulatory knowledge that the Commission accepts that termination rates equal the cost of origination on the same network and therefore that the fixed origination cost is at most 3 cents per minute.
[3] Billing per minute at the start of each minute significantly uplifts revenues as illustrated in our previous submissions on this matter.

3/ leaving mobile operators with significantly lower revenues than should otherwise be the case with which to invest in networks and services and therefore making them less able to compete against the dual fixed/mobile operator that LIME represents.

We are very concerned therefore that the Commission intends to move ahead regardless of these significant issues and that there would then apparently be no prospect of a reduction of the fixed origination retention until 31st March 2013. The market will become even more distorted in favour of LIME if this happens.

In the light of all these concerns therefore is difficult to see how the Commission can suggest in respect of FTM termination that it:

> *"considers that Digicel has not provided any compelling evidence or rationale to delay reductions in the MTR"*

We have demonstrated the existence of the huge fixed origination retention (1,500% of the cost of provision as indicated in our previous response) and the inevitable effect on call volumes, and therefore total mobile termination payments, and the consequent tipping of the market even more in favour of LIME, and the impact on competition, if mobile termination rates are reduced in isolation. We are not sure what could be more compelling than this.

It appears to us that the issue here is with the price capping approach that was taken previously which appears to have locked in place FTM retail rates for the period in question. Digicel will be forced to pay the penalty for this price capping approach if mobile termination rates are regulated without a similar approach being adopted in respect of fixed origination rates. This will in our view unfairly weaken our ability compete with LIME. If it was proposed that such a state of affairs would exist for a few months only it would be less of an issue, but based on the Commission's proposals, it would be the case for two years at least. We are very concerned about the impact this would have on our business and our customers.

MTR Symmetry

We are also concerned about the Commission's approach with respect to the LIME transit/link service. A competitor should not continue to be afforded a competitive advantage simply because it was clever enough in negotiations in the past to inflate what amounts to a miniscule service (the transit/link) in to one which is sucking significant amounts of money out of competitors.

By reducing the MTR in isolation, the Commission removes any real prospect Digicel has of reducing the transit/link rate by negotiation since LIME has no incentive to reduce the price of a service on which it makes a return of thousands of per cent. Digicel should not be forced in to a dispute on this matter in our view. Instead the Commission should undertake its own investigation in to the transit/link rate if it has decided to reduce the revenues of the competing mobile operators though downwards regulation of the mobile termination rate.

Sample Average Selection for Benchmarking Purposes

Digicel remains unclear on what basis the Commission is suggesting that those jurisdictions with the lowest MTRs must represent best practice. Surely what constitutes best practice is what will lead to the most benefits for consumers overall and over time? Lower prices can be bad as well as good if they result in less benefits over time.

It is not best practice to, without further analysis, say that the lowest or the highest rates, represent best practice approaches in any particular case therefore. Digicel has offered analysis however. Unit costs in the Turks and Caicos are higher – we have provided specific examples eg with respect to minimum switch capacities. The risks of investing in a small island like Turks and Caicos are higher. Therefore permitted returns on investment should, if tilted in any direction, be higher than elsewhere.
We are not clear what the Commission means by stating that:

> *"....the Commission is not persuaded by Digicel's counter-proposal that an average of the highest MTRs should be used. Such an approach, in the Commission's view, would move away from the Commissions objective of establishing MTRs that are closer to LRIC than to stand-alone costs."*

A good benchmark sample will represent a reasonable cost based rate. The benchmark rate does not lie somewhere between two other costs. What the Commission states above is predicated on the assumption that a LRIC rate will always produce a lower figure. But this may not be the case, especially if the cost of investing in Turks and Caicos is properly allowed for. Indeed perhaps it would lead to a higher rate if conducted well. Therefore it is not in Digicel's view a counter argument to say that the average of the highest MTR should not be used because the Commission is assuming that a LRIC rate will be lower. The Commission should allow for the possibility that a LRIC rate would produce the same or a higher outcome than a benchmark rate, including the benchmarks submitted by Digicel.

Selection of Benchmark Sample

Based on our response immediately above, we have to continue disagree that all the countries within the Commission's sample are reasonably comparable. The larger countries will in fact have lower costs than a small island like the Turks and Caicos. We have provided examples of why this is the case in terms of equipment for example - significant components such as switches, at the minimum size that can be purchased, have far more capacity than is needed to cater for every person in the Turks and Caicos. These are facts and to the extent that any visible rates conflict with these facts, we believe that those rates have to be called in to question.

Where for some reason in a small island such as BVI domestic termination rates differ markedly from the generality of other small islands, and represent half the price of international termination in the same country, this represents a clear outlier, and outliers are generally excluded from benchmarks. We have already explained the peculiar nature of the developments in the BVI and why therefore in our view we are sure that it is not a valid benchmark, and should be ignored. Clever commercial maneuvering cut the rate just prior to Digicel's market entry, and four years before would have been the case if Digicel had not been about to enter the market. If it was possible to prove that this was below cost of course the regulator in the BVI would no doubt have stopped it, but regulator did not have sufficient information to base such a refusal on since it would require a significant costing exercise. No such exercise had been undertaken in the BVI by that time. But this does not make the rate a reasonable one for the purposes of the benchmarks in the Turks and Caicos.

Other Issues

As indicated previously Digicel believes it inappropriate and will tip the playing field unfairly if the Commission proceeds to reduce the mobile termination rate without visiting the fixed termination rate (and the transit/link rate) at the same. While we can understand that the Commission wishes to move forward expeditiously, it would not be fair to do so in a way which prejudices the position of particular operators compared to others.

We suggest therefore that the Commission could use the same benchmark countries for setting the fixed termination rate as the mobile termination rate. It is difficult to see how this could be objectionable. A consultation could be brief and consulted on in short order as the selection of benchmark countries, and the rationale for choosing them would already have been laid out by the Commission.

As intimated previously we believe that it is for the Commission to take this initiative without Digicel submitting a dispute. By reducing the mobile termination rate in isolation the Commission will strip away Digicel's ability to negotiate the fixed and transit/link rates down itself, and will leave Digicel in a competitively disadvantaged position.

Question 2: Please comment on of the Commission's Revised MTR Proposal that would reduce the MTR maxima in TCI to USD $0.1075, USD $0.0950 and USD $0.0825 over the course of the next three fiscal years, starting in April of 2011. To the extent Respondents believe an alternative MTR proposal would be more appropriate, please describe any such proposals in detail and include supporting rationale and data as may be relevant.

Digicel stands by its original comments in this respect and the proposals we made previously. In particular it is our view that the Commission should not cut at one element only of the interconnection matrix of prices. This will tilt the market unfairly in the direction of particular operators.

If the Commission is intending to go ahead with the mobile termination rate reductions proposed above we believe that it should use the same benchmark countries for fixed termination rates and reduce fixed rates those concurrently with reductions in mobile termination rates as it should be possible to do this in quick time. Transit and link rates may require more investigation. But in any event we believe that the onus should be on the Commission to do this work and it should not be necessary for Digicel to go dispute, since the Commission will undermine our ability to negotiate in respect of fixed and transit/link rates if it slices up mobile termination rates in isolation.

Question 3: Please provide comments on the Commission's Proposed Recommendation to Government, along with supporting rationale for any proposed changes to the recommendation.

As the Commission is aware from previous responses we have a difference of opinion with respect to some of its proposals. However, we will not repeat our earlier comments on the approach to be adopted with respect to mobile termination rates. We simply stand by them.

What we should like to point out at this juncture is, given that the Commission intends to ask for regulation to let it intervene in mobile termination rates within an existing contract, it will have to request the power to override the existing fixed and transit/link rates in the same agreement between LIME and Islandcom. In this way it will ensure that the Commission could take action to reduce them either based on its own investigation, or in response to a dispute raised by another operator.

We therefore suggest a new clause 20 as follows:

> *"A carrier that is licensed to own and operate a fixed line telecommunications network is presumed to be dominant in the market for wholesale fixed line voice termination services over such network and presumed to be dominant in any fixed line transit or link service leading to such fixed line voice termination service, except insofar as the Commission, upon demonstration by such carrier, determines otherwise.*
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> *Notwithstanding any contract between two or more carriers nothing shall prevent the Commission from establishing new interconnection rates for fixed line termination, fixed line transit, or any fixed line link service."*

Question 4: Please provide comments on the Commission's Proposed Directive, along with supporting rationale for any proposed changes to the directive.

We have no additional comments to make on the Commission's proposals in respect of this Directive and stand by the views we expressed earlier in the consultation process on the regulation of mobile termination rates.

Annex A: French West Indies Figures

Digicel does not perceive a basis for splitting the figures in to two separate elements for the French West Indies. These are the decisions of a single regulator in respect of a group of islands. The rates for Orange and Digicel in the various islands are the same. This means presumably that the islands are not being treated separately for the purposes of the costing exercise. It seems to us therefore that splitting the FWI in to two groups for the purpose of this exercise would be arbitrary and give excessive weight to the views of one regulator. This is even more of an issue because of the, to us certainly, bizarre decision by the EC to make a non binding recommendation in respect of the so called pure LRIC approach.

We believe that the “pure LRIC approach”, in our view more aptly described as a “bare LRIC approach if we put aside the EC’s verbal window dressing, is fundamentally flawed. It forces a network provider to sell services to a competitor at a rate below that at which it can provide services to itself since it must recover its fixed and common costs across its own services. This is inimical to competition and sends a dreadful message to current and potential network investors. We consider that it is driven more by short term political considerations than longer term regulatory ones. The EC recommendation – which was no more than that, and was non- binding even on EU member states – should be firmly rejected as a policy. Consequently, we believe that the French West Indies should not form a part of any benchmark used to set rates in the Turks and Caicos to the extent that those figures are being used as a glidepath towards such BLRIC rates, or based on BLRIC rates.

The EC recommendation seems to be an outlier in terms of regulatory thought. It comes from one body only, and would be extreme in its impact. It is a mere non-binding recommendation in any event. Best benchmarking practice usually results in outliers being excluded, and we regard this policy to be an outlier.

Annex C: Qualitative Analysis of Cost-Based MTRs

The table produced in the consultation on pager 50 appears to contain a number of errors.
The Commission also states that it:

> *“....continues to be of the view that underlying per unit costs of interconnection have been declining and will continue to decline. Therefore, the Commission is of the view that if the costs models in the jurisdictions included in Table 11 were updated based on current Second Review of Mobile Termination Rate Consultation Document information and traffic volumes, the average resulting cost-based MTR would likely be significantly lower than $0.0808. Therefore, a downward adjustment to the $0.0808 average would be appropriate.”*

In respect of the ECTEL countries it should be noted that the rates now in place were approved in a Ministerial decision on 13th March 2009. The figures, which incorporate a glidepath, were deemed correct then for the period for which they will apply.

In respect of Trinidad and Tobago it should be noted that there is no FAC, or any other cost model, basis for the MTR. The basis for the current rate is a dispute panel decision derived from the personal views of the panel on considering the evidence submitted by the two sides. Both sides submitted models during the dispute but both were rejected.

Furthermore, as a result of the global downturn, volumes of traffic may well have decreased on average across the sample countries selected. Certainly for example it is public information that ECTEL has reported falling industry revenues in some of its jurisdictions. The Commission offers no evidence that minute volumes have risen on average across the sample.

We cannot therefore discern any logic in the Commission's statement reproduced above. Is the Commission for example questioning ECTEL's decisions? If that is the case, and as indicated previously, Digicel can also, and with much greater basis as mentioned previously, call in to question the ECTEL numbers. The model that ECTEL used (which was derived originally from LIME), only includes the cost of one mobile switch for 5 countries. Clearly, based on the ECTEL approach, it would not be possible for a new entrant which wished to operate in one country and which had set up a switch there to recover its costs of termination based on the ECTEL rates. Only a regional operator will have a chance of matching the cost base in that region and only if it uses just one switch. The ECTEL approach is therefore highly unusual and indeed unprecedented to the best of our knowledge in terms of cost modeling. It understates costs and is not in the interests of national security given that failure in a single switch would cause service loss in five countries. In consequence the ECTEL rates are at the best a minimum possible floor and in our view they do not even "reach a floor" for the reasons described. Digicel believes that most regulators would refuse to adopt an approach which costs five countries based on a switch in just one of them.

Furthermore the rate implemented rate in Trinidad and Tobago was extremely low, lower even that cost model rates. The rate was put in place for the <u>duration</u> of the interconnection agreement. The agreement remains in place. If the Commission is including the Trinidad and Tobago rate in the benchmark therefore it has no basis for suggesting that the rate is too high. Indeed, the rate is even lower than the other party to the dispute TSTT argued for (45 TT cents), and TSTT were trying to get the mobile termination rate as low as possible. Digicel is sure that the rate that was finally put in place in Trinidad and Tobago was in fact far too low, and is a major reason why additional network investment has not taken place and competition has not been more effective in that country. However, we are where we are, and we believe that the Commission must simply accept or reject the rate in Trinidad and Tobago for the purpose of the benchmarks.

Yours truly,
Digicel (Turks & Caicos) Limited

for [signature]

E Jay Saunders
General Manager
Digicel (TCI) Limited.