

Digicel

The Bigger, Better Network.

**Response of
Digicel Turks and Caicos Islands,
to the invitation by**

**Turks and Caicos Islands
Telecommunications Commission**

**to comment on the
“Price Caps Consultation Document”**

November 13, 2008

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1 INTRODUCTION

The Commission has put forward an outline of a price cap that does not lack in ambition. This document constitutes the response of Digicel Turks and Caicos Islands to the invitation by the Turks and Caicos Islands Telecommunications Commission to comment on the “Price Caps Consultation Document” of September 30, 2008. Digicel wishes to thank the Commission for being accorded an opportunity to provide Digicel’s views on this very important consultation document.

2 DIGICELS COMMENTS ON QUESTIONS RAISE

2.1 Objectives of the Price Caps Regime

<p>Question #1: Please comment on the price caps objectives proposed above including, as may be applicable, suggested modifications to the listed objectives and/or alternative objectives.</p>
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Digicel’s understanding of price caps is that they do not foster competition. We believe the evidence supports the opposite position; markets that are largely monopolised are more likely to remain so if retail price caps are applied to any service in that market. This is also supported by the fact that in the liberalised European market the occurrence of price cap is very rare and in principle only remains in markets which have virtually no competition, e.g. the fixed monthly fee for fixed telephony (PSTN). Price caps are also, to our understanding, need to make allowances for inputs that are not determined by the dominant entity. In other words cost elements that are outside the control of the dominant player and/or the jurisdiction of the regulator need to be allowed for when analysing prices. In the case of outgoing international calls, for example, the cost of landing station access, backhaul, transmission and termination must be factored in, i.e. price capping is aimed at preventing the dominant operator from charging a price that would render him super or monopoly profits.

Because of this Digicel believes that price capping must be limited to those services that are largely monopolised and analysis suggests that in the short to medium term future, significant competitive entry is pretty unlikely. We say ‘significant competitive entry’ as effective competition may take a little longer to evolve, but if effective competition appears to be a real possibility in the next 2 or so years, then the service ought to be removed from an existing price capped basket. If it is politically necessary to price cap, say, to guarantee that the price of a service will not rise sharply, then a sub-cap or separate ‘basket’ and cap could be used and a relatively permissive ‘X’ chosen.

Digicel’s recommendation is based on the importance of not killing the signals unregulated prices provide for potential new competitive investment; i.e. investment in liberal economies is

orchestrated by the price system and regulatory control of prices tends to undermine the functioning of that system.

2.2 C&W's Licence

Digicel believes there are several features to C&W's license which suggest less than best regulatory practice and which ought to be amended.

The finding of 'dominance' in C&W's license is based on service provision and not in a 'relevant market'. It is agreed by competition economists and regulators in best practice jurisdictions that dominance represents a potentially socially harmful level of market power which must be held in relation to a specific 'relevant' or 'antitrust' market. As defined in C&W's license, C&W is deemed to be dominant in the provision of certain services but as no market is defined it is not possible to prove or disprove such a claim.

Digicel believes it is import to specify those markets in which C&W is considered dominant and ex ante regulations are to be imposed. This does not therefore require the arduous task of defining all markets in which C&W is considered dominant – only those in which C&W will be subject to ex ante regulation.

Almost every adult in the Turks and Caicos Islands has a mobile phone and thus the vast majority of people who make international outgoing calls are in a position to do so via a fixed or mobile network. However, Digicel acknowledges this will depend on the degree to which on the margin, outgoing international calls from a C&W fixed lines and similar calls from mobile phones are substitutes given prevailing prices.

Digicel currently provides a substantial share of international outgoing calls from Turks and Caicos via capacity we have recently purchased from Columbus Networks. This should put us on a much more favourable cost basis compared to C&W and along with the purchase of IslandCom by CellularOne, we believe that competition in the market for international outgoing calls (and competition for customers between mobile networks) will be getting significantly hotter in the next 6 months.

Thus, in regard to paragraph 3.2 of C&W's license, Digicel believes the evidence suggests that a forward-looking market definition would likely conclude that the market is for the provision of outgoing international calls, whether from fixed or mobile phones. In this case C&W would almost certainly not be dominant.

If Digicel is correct in its belief that there is but one market for international outgoing calls whether from fixed or mobile phones, then international outgoing calls from C&W fixed should be removed from the price cap.

2.3 Proposed General Approach to New Regime

Question #3: Please comment on the general approach the Commission should adopt for the purpose of establishing the New Regime, including, but not necessarily limited to, the guiding principles, objectives and/or practices and the application of the principle of proportionality.

Price capping suffers from 4 main categories of related problems:

- The inability of the authorities to commit to the a price cap contract and indeed to abide by price capping principles as outlined in the economics literature;
- The inability of the authorities to withhold from price capping those services that are potentially competitive in the medium term if not today (regulatory creep). Where this has occurred it will almost certainly have lowered the levels of competitive investment and helped to maintain the market power of incumbents;
- Regulators commonly price cap retail services where regulated access to a crucial upstream (wholesale) essential facility input controlled by the incumbent would solve the retail market power problem in time by allowing competition to develop, and
- Many if not most regulatory authorities that price cap do not have the institutional capability to design implement and operate a price cap on its merits.

Price capping is an aggressive form of regulation involving complex economic issues. Digicel asks that the Commission take the above problem areas into account when drafting the price cap contract.

Please also see Digicel's comments to Question 1 above.

2.4 I-factor

Question #7: Please comment on the proposal to use the Bahamas CPI as the I-factor. If you disagree with this proposal, please provide alternative proposals, including rationale.

Digicel appreciates that it seems unavoidable for a non TCI index to be used in the price cap. However we believe the price cap needs to outline in writing what would need to happen for the index to be judged as being no longer suitable or in need of adjustment during the price cap period. Digicel also suggests that principles of fairness are outlined which would enable the situation to be addressed.

2.5 X-factor

Question #8: Please comment on the appropriateness of using the Forward-Looking Approach, as described above, to calculate the X-factor(s). If an alternative approach is proposed, provide all relevant details of the approach and supporting rationale.

Digicel is concerned that the sort of modelling envisaged in the Consultation under the forward-looking approach will be an expense that can not be justified due to the small size of the market; it will push up regulatory costs substantially and require an extended time period in which there will be ample opportunity for debate and reasonable disagreement. We doubt that such an approach would pass a social cost-benefit analysis when compared to the next best alternative.

Trying to determine whether a company is “expected to be able to earn a specified rate of return for the relevant services during the price cap period”, is extremely difficult and typically not without controversy. If this is “done by formally modelling a rate of return glide path (...)” there will inevitably be a great deal of uncertainty about the results. Such a task would need to be undertaken by fully independent specialists who are in a position which enables them to draw attention to weaknesses in their own work. In this context regulation also needs to address the fact that international rates are to a large extent subject to competition and that for several destinations there exists a “spot market” and that international rates in general are subject to daily, weekly or at least monthly changes all depending on quality, volumes and length of contract.

In practice a less ambitious and more pragmatic approach has usually prevailed. The price cap has simply required that real prices decline by a modest amount over time. This is acceptable if there is enough evidence that if the price capped firm was reasonably efficient it would be earning at least a fair rate of return overall going-in.

Given the very small population of the Turks and Caicos Islands Digicel contends that where retail price regulation is unavoidable, a pragmatic and low cost approach is to be preferred.

In this regard we note that the regulatory costs involved in designing and implementing any price cap would presumably be recovered through annual license fees or perhaps other sector specific taxes, such as for frequency. Economists tell us that such fees or taxes raise licensees’ costs and are ultimately passed onto end-users in the form of higher prices.

2.6 Pricing and Baskets

Question #9: Please comment on the view that the Price Cap Services for the New Regime should be based on the services included in the Dominance Finding.

Digicel respectfully disagrees with the analysis provided by the Commission in section 5.1.1 of its Consultation. A finding of dominance must relate to a relevant market. Defining dominance in

terms of individual services and not markets is not valid and any finding of dominance is then arbitrary. When a market is defined it can then be decided whether the market is correctly defined and thus whether dominance does it fact exist.

As necessary precursors to a finding of dominance, a market definition and analysis is required. It is the approach used by competition economists and lawyers in all respectable competition law authorities, and is similarly used by regulators in order to decide whether dominance exists.

Digicel urges the Commission to press the government to reform the way dominance is determined in the Turks and Caicos Islands.¹

Please also see the above section “C&W’s license”.

Question #10: Please comment on the appropriateness of the proposed Price Cap Services for the New Regime, as listed above.

Digicel suspects that a market definition and market analysis would point toward the market being for the provision of retail international outgoing services and that C&W is not dominant in this market. This is supported by the pricing data which shows that the pricing of international calls whether from fixed or mobile phones is almost the same. Indeed, C&W price list shows that on average international calls from prepaid mobiles are cheaper than they are from fixed lines. Base prices are the same for mobile and fixed but there is a 20% discount on five international numbers for mobile users but we could not see a similar offer for fixed users.²

It may also suggest that the market in which international leased lines fall is for something a little different than simply “international leased lines”, and that perhaps landing station and backhaul are wholesale bottlenecks and that if regulated access to these occurred international leased lines may then be subject to competitive provision. These are obviously elements that help explain retail prices for international outgoing calls. Digicel urges the Commission to look into investigating these issues by following international best practice in the definition and analysis of markets that are potentially subject to ex ante regulation.

Payphones have traditionally been mandated for reason of universal service/access. However, with mobile penetration at over 100% Digicel’s view is that the regulation of payphone provision warrants review. We suspect that the current treatment of payphones is out of date.

¹ See for example the DOJ’s Merger Guidelines at <http://www.usdoj.gov/atr/public/guidelines/hmg.htm>; and the European Union’s “Guidelines on market analysis and assessment of significant market power (SMP)” at the EU’s website for its Telecommunications Regulatory Framework http://ec.europa.eu/information_society/policy/ecom/article_7/index_en.htm;

² The information can be found at: <http://www.cwcaribbean.com/content/15>

Question #11: Please comment on the appropriateness of the number, content and specification of the proposed Price Control Baskets described above. If an alternative approach is proposed, provide all relevant details of the approach and supporting rationale.

Digicel intends to roll out a Mobile WiMAX broadband service in many parts of the Caribbean in the short to medium term. We have already done so in other parts of the Caribbean and have quickly captured a sizable market share from C&W. This technology enables us to compete head on with C&W across all segments of the market from corporate to consumer to provide high quality voice and data/internet access at fixed locations anywhere within the coverage area. Digicel's equipment uses 2.3Ghz and 2.5Ghz spectrum for its Mobile WiMAX offerings in urban/suburban areas. To move away from "hot zone" coverage of cities/towns towards ubiquitous WiMAX coverage will require affordable access to the 700Mhz range of the radio spectrum. WiMAX, along with similar technologies that are in an advanced stage of development, will effectively counter C&W's market power for residential and business fixed access to voice and data services in many parts of the Caribbean.

Digicel is thus concerned that any relevant retail price controls adopted in regard to "residential and/or business access and domestic calling services" are not so aggressive as to undermine incentives to invest in these new access technologies. We are also concerned not to see the Commission adopt a policy of price capping any service below the full economic cost of its provision. Such a politicised approach to price controls is not in the overall public interest, although it may be attractive to certain interest groups; it would certainly not pass a public welfare cost-benefit test.

The closely related issue of affordability raise several conflicting and complex issues. Digicel believes the costs involved in regulating for affordability can quickly get out of hand especially for a country as small as Turks and Caicos. These include the very costly problems associated with service subsidisation, and large scale crowding out of private investment solutions by public (subsidised or tax funded) solutions. The evidence suggests that political pricing does not work and indeed undermines the development of the sector.³ Moreover, to the degree that price caps are politically determined, it will poison the incentive aspect of the price control mechanism making it little if any better than the cumbersome and flawed rate-of-return regulation. Political pricing raises the risk felt by private investors. Digicel urges the Commission not to get involved in "policy" or political price capping. Such an approach to regulation represents an investment disincentive, results in the discrimination treatment of competitors, and the cost of the resulting

³ See for example, Prieger, J. (1998), "Universal service and the Telecommunications Act of 1996: The fact after the Act". *Telecommunications Policy*, 22, 1. See also the following 2 studies for the European Commission in which there are a wealth of references dealing with the problems caused by political price setting: <http://ec.europa.eu/archives/ISPO/infosoc/telecompolicy/en/wikuso2.pdf>
http://ec.europa.eu/information_society/topics/telecoms/international/universal_service/annexes_30jun00.pdf

regulatory complexity ought to result in such an approach being rejected for Turks and Caicos Islands.

Digicel is also a little concerned by the use of several narrowly focussed baskets. There may be good reason to separate some services in this way to prevent politically damaging price rises, but this can be done through the judicious use of sub-caps. On paper we agree that an argument can be made in favour of several narrowly focussed baskets where the authorities have a good idea about: (i) expected differences in productivity growth rates, or (ii) has information suggesting significantly different levels of service profitability "going in"; but in practice regulators rarely have this information and we would not expect the Commission to have it either. If the regulator has significantly less information than the regulated firm about costs and cost changes (virtually always true) then a down-side of having multiple baskets is that it tends to also prevent cost driven rate rebalancing and indeed gives rise to prices that diverge from cost.

The Commission has briefly outlined the problem of strategic pricing as a reason for multiple baskets. Putting competition issue to one side for the moment, in the case of possible excessive price increases of the most price inelastic services, we believe this to be a second order problem which can be partly addressed by sub-caps or with more sophistication through removing the incentive to do this in the design of the price cap mechanism.

Changing prices so as to take advantage of differences in price elasticity would be expected to result in an increased price being charged to businesses relative to residential users, in contrast to the Commission's concern which is for the opposite. Digicel agrees with the Commission that C&W reduce business prices by more than those for residential customers but not for the same reason as the Commission has outlined. Rather Digicel suggests that C&W's actions would likely be due to the existence of competitive pressure in the provision of service to businesses. If there is a real risk of this occurring it would suggest that the time may be approaching when such services should be removed from price controls. Alternatively, perhaps a sub-cap floor could be attached to business services to last for a short period.

Digicel thus urges the Commission not to get involved in using multiple baskets with different X factors. The judicious and sparing use of sub-caps should be considered instead. An exception would possibly arise in the unlikely event that the Commission has all the information necessary to do this in a way that the use of multiple baskets would improve the national economic welfare.

Digicel has already stated its doubts over the inclusion of payphones in a price cap (see our reply to Question 10), and that a fresh look is needed at whether C&W is dominant in the (forward-looking) market that includes outgoing international call services (see our comments on C&W's license and in reply to Question10).

2.7 Other pricing constraints

Question #12: Please comment on the need for, nature of (if any) and proposed general criteria for the other pricing constraints.

Digicel has commented on the issue of over-intricate price caps directly above in regard to Question 11. We believe that without quality information about (i) expected differences in productivity growth rates of certain services, or (ii) information suggesting significantly different levels of service profitability “going in”, Digicel believes a simpler approach to price capping is to be preferred.

2.8 Exogenous Cost Factor

Question #19: Please comment on the proposal to include a Z-factor in the price cap index formula.

Digicel does not agree that ‘Z’ should only include exogenous events that are unique to the telecommunications sector. Macro events or those that impact firstly on other sectors will typically also impact on the telecommunications sector. In some cases ignoring such events will not be justifiable. Digicel therefore suggests that this aspect of the Commissions proposal should be reconsidered.

3 CONCLUSION

Digicel is most appreciative of this opportunity to comment on the Commission’s price cap consultation document. Digicel believes there are some important aspects of the Commission’s proposals that would benefit from reconsideration, in particular: relating dominance to a defined relevant market; reviewing the proposals with a view to avoiding intricacy where there is a lack of information to justify it; looking closely at the potential for competition to develop in markets where the Commission’s initial instinct is to price cap a service or services; explicitly outlining price cap principles and a commitment to fairness, and reassessing the strengths and weaknesses of price capping in practice.