



Comments to Industry Responses to  
Cost Model for Mobile Termination Rates  
Second Consultation

## **1. Introduction**

Digicel welcomes the opportunity to provide the OUR with its Comments to the Industry Responses to the Cost Model for Mobile Termination Rates – Second Consultation.

The succeeding comments are not exhaustive and Digicel's decision not to respond to any particular issue raised in the Responses submitted by its Industry counterparts does not necessarily represent agreement, in whole or in part with the position taken on these issues; nor does any position taken by Digicel in this document mean a waiver of any of Digicel's rights.

Digicel expressly reserves all its rights. Any questions or remarks that may arise as a result of these comments by Digicel may be addressed to:

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## 2. Detailed Response

1. As to paragraph one of LIME's submission, the reference to Digicel as being "super-dominant" is as farcical as it false. The mobile market in Jamaica currently reflects one where retail prices are now among the lowest in the world and would perhaps be best characterised as 'hyper-competitive' as opposed to you harbouring a provider that is 'super-dominant'. Certainly if Digicel is super-dominant in the mobile retail market in Jamaica it ought to be able act independently of its customers and its competition. That is clearly not the case and the supposition of 'dominance' let alone the comical 'super dominance' label falls on any measure of economic activity in the Jamaica mobile market.
2. Nevertheless in providing some leeway to LIME's fanciful 'super dominance' characterisation. It goes without saying that if LIME were to exhibit any semblance of consistency, it must certainly regard itself as 'super dominant' or even 'super-super dominant' in the provision of landline services in Jamaica. Indeed the Authority and the FTC has recognised the complete lack of competition in this market for years but have continually failed to address it. LIME continue to control 95% of this market where there is clearly a market failure and where unlike the mobile market, that exhibits vibrant pricing and innovate developments, the fixed line market is stagnant, under invested in and contrary to international norms, has a pricing structure where customers actually pay more than for mobile services. Under the new legislation it is now clear that in accordance with the provisions of the act fixed interconnection rates "**shall**" be subject to the 'pure LRIC' standard. Furthermore, in accordance with the 'non-discrimination' provisions of the act once 'pure LRIC' is imposed on mobile operators it must concurrently be imposed on fixed operators. Pure LRIC must also clearly be applied to fixed origination retention rates for fixed to mobile calls.
3. One can only conclude that LIME's urgency in relation to fast tracking pure LRIC equally must apply to LIME's fixed interconnection rates also given LIME's position that it regards charges above pure LRIC as 'subsidies'. It is therefore surprising that LIME have ignored the new legislation in terms 'pure LRIC' being applied to all termination services.
4. The supposition that rates above 'pure LRIC' constitute a subsidy from the operating availing of the services ignores that 'pure LRIC' rates are in fact designed to ensure that the full cost of a service is not recovered. Rates above 'pure LRIC' therefore do not imply operators are recovering above cost rents. In fact where an operator is obliged to sell interconnection services based on pure LRIC, that operator is forced to subsidise such services with revenues from other services and from its own customers i.e. Digicel customers would be forced to subsidise termination services being provided to LIME and other operators. This poor policy is in fact in tension with the provisions of the Act that prohibits unfair cross subsidisation and will no doubt have a negative long term implications for the industry in Jamaica. Indeed LIME is fully cognisant of the detrimental of effects of 'pure LRIC'. As noted by LIME in submission to the Turks & Caicos regulator:

*“LIME agrees with Digicel’s opinion that the European Commission’s decision to adopt a pure LRIC approach – an approach to measuring a cost-based MTR that does not allow for recovery of common costs – is a bad policy”.*<sup>1</sup>

5. LIME therefore clearly recognise that (a) pure LRIC does not permit recovery of relevant costs and so the subsidising operator is in fact not the interconnecting operator but the operator providing the interconnection service and (b) pure LRIC is ‘bad policy’. Consequently, it is hypocritical for LIME to suggest that a ‘glide path’ ought not be adopted in order to fast-track this disruptive ‘bad policy’ in Jamaica.
6. LIME does of course understand that pure LRIC is a destructive and bad policy but its very public campaign of special pleading the Jamaican Government and the Authority for a number of years now has been necessitated by woeful mismanagement of the company for well over a decade. Blaming all its woes on an unfair regulatory environment – one that actually continues to allow them maintain a virtual monopoly in the fixed line market without impunity – is needed to mask their managerial problems. Mr. Tony Rice, Chief Executive of Cable and Wireless Communications needs excuses to justify a salary of over US\$ 1m per annum + 75% bonus + benefits plus face value shares of US\$3m, while shareholder value continues to fall at the company<sup>2</sup>. Blame for poor performance needs to be deflected elsewhere and in Jamaica LIME has chosen to put that blame on the regulatory regime. LIME has pursued every avenue possible to have mobile termination rates reduced in Jamaica while completely shielding itself from greater competition in the fixed line arena.
7. It should be noted that The European Commission recommendation, heavily relied on by both LIME and the Authority makes the exact same demands in terms of pricing of fixed interconnection rates as it does mobile. The current wording of the amended Telecommunication Act in Jamaica is even more emphatic in this regard. The same EU Commission recommendation also clearly acknowledges the importance of allowing a period of adjustment for business forced to implement the below cost pure LRIC reality.
8. AS the Authority are aware from Digicel’s response to the consultation, Digicel are deeply sceptical about the impact pure LRIC will have on the Jamaican telecommunications industry and the wider economy. However, Digicel is not alone in its scepticism about the supposed positive impact of pure LRIC. In February 2012 the UK Competition Commission noted:

*“...we are not persuaded that setting MTRs at [pure] LRIC would reduce mobile retail prices overall, and it is not clear that doing so will increase mobile usage”*

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<sup>1</sup> Review of Mobile Termination Rate – LIME TCI, 17<sup>th</sup> of September 2010

<sup>2</sup> See Cable & Wireless Communication Plc annual report 2010/2011

9. A report by Frontier Economics<sup>3</sup> – currently assisting the Trinidad & Tobago regulator, TATT on developing a cost model for T&T - produced a report in May of this year that made the following observations about tumbling MTRs in Europe:

- There is no evidence that lower MTRs have led to lower mobile prices
- Mobile prices have declined at a slower rate since accelerated falls in MTRs
- There is no evidence to suggest that countries with higher MTR cuts have greater falls in retail prices (this was examined using correlation analysis).
- There is no evidence that MTR cuts in Europe are increasing phone usage [which was one of the Commission aims and expected outcomes from the moving to ever lower MTRs]
- The report found that despite a drop of more than 35% in MTRs from 2009-2011, usage increased by just 4.2%, which was about the same level of increase from 2007-2009 which corresponded with a 12.8% drop in MTRs in that period.
- There is no evidence of a convergence in consumer outcomes between the US and Europe [also something the Commission aspired to when recommending pure LRIC]
- There is little evidence that lower MTRs leads to market share increases of smaller operators.

10. In relation to the detrimental impact of pure LRIC the report also concludes:

*“MTR cuts could also affect other areas that are important for consumer outcomes. In particular, MTR levels could impact mobile penetration rates and mobile operators’ investment levels. We find that it is too early to conclude whether the accelerated MTR cuts are having a detrimental impact on mobile penetration rates and investment (capex), but there is some evidence of a risk.”*

11. Although Competition Appeals Tribunal (February 12, 2012) upheld Ofcom’s proposed implementation of pure LRIC through a glide path it noted that some vulnerable customers were likely to be worse off as a result of pure LRIC. If that represents even something of a footnote of a concern in a wealthy country like the UK, it should raise much greater concerns in a developing country like Jamaica. It is inevitable that having to now cross subsidise mobile termination services from other revenue sources will put pressure on expenditure and investment elsewhere e.g. Digicel has for years provided service to a large volume of customers who only use their mobile phone to receive calls (or at best make very few outgoing calls). Many of these customers were not profitable for Digicel and as such Digicel has for all intents and purposes, been providing a subsidised universal service to these less well-off customers. The extent to which this continues to be a viable business proposition is questionable under the pure LRIC approach which prohibits full cost recovery for the termination service. As termination was essentially the only service these customers used, they have little or no expenditure on other

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<sup>3</sup> The impact of recent cuts in mobile termination rates across Europe – May 2012, Frontier Economics

services with which to cross subsidise below cost termination – they become ever more loss-making for operators.

12. We note that pure LRIC is in fact probably significantly less detrimental to fixed line provision since by their nature fixed lines are not built out to reach anything like the extreme rural areas in which mobile access is made available, and because fixed lines are more likely to be used more symmetrically in terms of calls made versus calls received. Therefore reducing fixed termination rates to pure LRIC levels will require less cross subsidy from fixed retail revenues.
13. Whatever view LIME, Digicel, the Authority or others might have on pure LRIC, no one can argue that there are not grave uncertainties associated with the implementation of pure LRIC in Jamaica and the impact it will have. Under these circumstances it would be foolhardy in the extreme to ignore international best practice in adopting a glide path in Jamaica. A glide path will give the Authority an opportunity to observe what is happening in other countries where pure LRIC has been implemented and take on board any lessons learned in those countries as a consequence e.g. if there is evidence that vulnerable users are now being excluded from the market during the glide path phase, the Authority can take steps to intervene and protect such customers in consultation with the industry. It should be noted that Digicel are cognisant of non-discriminatory requirements of the act which mean that if a glide path is adopted for mobile termination rates moving to pure LRIC, this must also apply to fixed termination rates. Digicel would therefore not make the unreasonable proposal to immediately adjust fixed interconnect rates to 'pure LRIC' while advocating a glide path for mobile termination, notwithstanding that it would be commercially advantageous to Digicel to seek such an outcome. In addition such an anomaly would not be legally permissible. Consequently, if there is any move to 'pure LRIC' in respect of mobile termination, not only must it apply to fixed termination also, but in both cases a glide path must be adopted before moving to what are taken in isolation unsustainable "pure LRIC" rates.

#### **Comments on Common Cost Recovery**

14. One might conclude that LIME's urgency in relation to fast tracking pure LRIC would also apply to LIME's fixed interconnection charges, since if LIME is to be believed, any excess above 'pure' LRIC prices are unwarranted 'subsidies'. That however is not the case. LIME's opportunism is also evident in relation to the position it takes in Section II of its Response, where it claims that there is no benefit to competition or consumer welfare from delaying the implementation of pure LRIC-based rates. Lime queries whether the OUR model can feasibly derive a total LRIC rate, or in other words, some level of recovery of common costs in the calculation of the increment. In that regard, LIME seeks to rely on para. 3.11 of the Second Consultation Document which claims that all common costs should be allocated to other services. Despite its own recovery of common costs in regulated areas of its business, LIME is presumably prepared to support a fundamental departure from proper cost recovery simply on the basis that it will lower its total interconnection payments. To that end, LIME argues that a move to pure LRIC of

itself excludes the recovery of common costs. That is mistaken as a matter of straightforward statutory construction and in the light of various Constitutional protections, including the rule against unlawful deprivation of property.

15. The basic error of interpretation behind LIME's position (and the OUR to the extent that it shares it) is to assume that simply because the Stand Alone Cost Standard is no longer to be used (with LRIC) to set the price for wholesale termination charges, that means that the recovery of common costs is to be significantly restricted or even entirely precluded. This however is a complete *non sequitur*. The SAC standard could in principle see the recovery of all of the common costs of an operator, including those entirely unrelated to the provision of call termination services. Conceivably, that could lead to over-recovery of common costs. By contrast, a move to pure LRIC is not to be equated with recovering little or no common cost. This is not an 'either or' situation. Indeed economic theory (reinforced by a proper reading of section 33 of the Act) would at the very least support the recovery of a proportion of common costs, since interconnection services invariably draw upon shared network elements and resources, and not to permit their recovery gives rise to irrecoverable losses. That is why in many jurisdictions the use of LRIC variants (such as TELRIC in the United States) has entailed separate provision for some allocation of common costs to interconnection services.
16. The imperative of recovering common costs is supported by a proper reading of sections 33(1)(g) and 33(3)(b) of the Act. Section 33(1)(g) provides that charges are to be set "on the basis of forward looking incremental cost", and it specifies that that is to be only "avoidable" costs. That formulation does not preclude the recovery of a proportionate level of common costs, since on any reasonable view, while "avoidable" costs would exclude any common costs that would not be incurred if the relevant service was not provided, it must include those that arise regardless. This is confirmed by the actual definition of "avoidable costs" contained in section 33(3)(b) which provides that it represents the difference between total long run costs of a carrier providing its full range of services and the total long run costs of said provision less wholesale call termination services. It is noteworthy that in both instances the qualifier "total" is used, a point that has been ignored by both Lime and the OUR. In that sense, LIME's point that the OUR may not have "a well defined total LRIC rate to implement in stage one", while intended to make the case for 'pure' LRIC is inadvertently illuminating. It draws attention to the fact that the provisions of the Act, which define avoidable costs in terms of the delta in total incremental costs, may be about to be ignored. That would be unlawful.
17. Moreover, to understand the T-LRIC (total LRIC) standard set out in the Act as not allowing for the recovery of a fair level of common costs is to entirely misunderstand what this kind of pricing model is claimed (if only by its proponents) to simulate, namely the outcome in perfectly competitive markets, where common costs are nevertheless recovered all the time so as to help keep firms solvent. In that regard, the claim that those common costs are to be 'allocated' elsewhere is nonsense, since to speak of 'allocation' is to give the impression that a regulator

ensures their recovery by some other means, which is not the case, except possibly for Lime which will presumably continue to be permitted to recover its common costs by relying on the SAC-LRIC approach retained for other interconnection services. Furthermore, there is no indication either from LIME or the OUR as to how those common costs can be recovered either at all, or in such a way as would not undermine the claimed purpose of wholesale price regulation by prejudicing consumers through price rises elsewhere if that was feasible. In short, Lime's contention that 'pure' LRIC precludes common cost recovery is mistaken.

18. A failure or refusal to allow an appropriate level of common cost recovery has significant constitutional implications. Quite apart for the failure to treat like situations (and persons) equally and in accordance with due process, in that without any objective justification, common cost recovery will be permitted for certain interconnection services but not for others (wholesale termination services), not to allow the recovery of common costs that should be shouldered to some extent by all services would amount to a regulatory taking in contravention of provisions of Chapter III of the Constitution of Jamaica. In that regard, and separate and apart from other constitutional frailties of sections 33(1)(g) and 33(3)(b), even if the OUR was to regard the statutory language as open on this point, then applying a presumption of constitutionality and as an agency of Government, the OUR should interpret the relevant statutory provisions as permitting a fair level of common cost recovery in the pricing of wholesale termination charges. Moreover, the reckonable common costs should be those reasonably connected with the provision of all wholesale termination services, including self-provision which is a very important element of interconnection.