

**CABLE AND WIRELESS (JAMAICA) LTD.
COMMENTS ON**

**ESTIMATE OF THE WEIGHTED AVERAGE COST OF CAPITAL
FOR TELECOMMUNICATIONS CARRIERS**

(Consultation Document 2016/TEL/006/CON.001)

June 10 2016

I. INTRODUCTION

1. Cable and Wireless (Jamaica) Ltd. (“**C&WJ**”) welcomes the opportunity to respond to the Office of Utilities Regulation’s (“**OUR**”) consultation on the approach to estimating the Weighted Average Cost of Capital (“**WACC**”) for fixed and mobile telecommunications licensees operating in Jamaica. This proceeding is significant in that the outputs—estimates of a WACC for fixed and mobile licensees—are critical inputs to establishing cost-based interconnection rates. Establishing accurate estimates of the costs of interconnection services, in turn, has important implications on economic efficiency and competition for telecommunications services in Jamaica.
2. Please send responses to this document to Charles Douglas at charles.douglas@cwc.com

II. **C&WJ’S RESPONSE TO OUR QUESTION 1: “DO YOU AGREE WITH THE APPROACH TO ESTIMATE SEPARATE WACCs FOR FIXED LINE AND MOBILE?”**

2. No, we do not agree with the approach to estimate separate WACCs for fixed line and mobile operators in Jamaica. There is no reason to believe that the cost of capital is different between fixed and mobile networks. First of all, the scope of operators’ service offerings in Jamaica include both a mix of fixed and mobile services. With Digicel having deployed a fixed-line fibre network, technology convergence is a reality for telecoms operators in Jamaica today. The companies that are sourcing capital for investment will be viewed as having similar service portfolios. Secondly, it is clear that the near future will witness greater convergence as technologies become increasingly seamless. The ability of

consumers to transition between fixed services, Wi-Fi and mobile services is no longer a perk, but a competitive advantage, if not a requirement, for operators. Thus, even if there were some risk difference between investing in a mobile and a fixed network, the entities that are deploying the networks are no longer distinguished along the lines of the two technologies. Thirdly, the means of delivering mobile services involves increasing amounts of fixed infrastructure. In many countries, the rapidly escalating capacity required to provide high-quality mobile broadband services is leading to decreasing cell radii (implying more fibre backhaul) and an escalating off-loading of traffic to fixed fibre networks. Thus, although the access networks are distinguishable, little else is. There is no logical reason why a technological difference in access networks would lead to a difference in cost of capital. Indeed, given the uncertainty concerning fixed broadband take up, it could be argued that the cost of capital of fixed access networks is increasing and will be higher than that of mobile access networks. Given the emphasis placed in the Consultation Document on establishing a forward-looking estimate of the WACC,¹ we believe it is necessary to establish a single estimate of the WACC for all telecommunications operators in Jamaica, in order to promote efficiency and provide a level playing field. Finally, as we discuss below, the data on the variables that the OUR uses to effectuate the difference in WACC (the beta and the gearing) are not convincing. Please see our responses to Questions 2 and 5.

¹ See, e.g., Consultation Document, ¶ 4.1 (“As the WACC is a forward looking methodology, it is important that the estimate of the cost of debt capture the cost of obtaining future debt financing”).

3. The importance of telecoms competition to this proceeding should not be underappreciated. In this regard, the OUR notes in the introduction of the Consultation Document that its estimation method will apply maximum input values across carriers in Jamaica in estimating the WACC. It concludes that this process will ensure that an individual operator's WACC is less than or equal to the regulated WACC and "[t]herefore, none of the companies in the industry will be at a disadvantage if [a higher] industry WACC is used in determining prices."² While it is true that termination rates are reciprocal, the OUR conclusion that leads to its leaning towards higher values for variables within the WACC is unfounded. As the OUR is aware, payments for interconnection services in Jamaica are far from equivalent amongst operators. Therefore, contrary to the OUR's assertion, operators that are net-receivers of interconnection payments are advantaged, and operators that are net-payers of interconnection payments are disadvantaged by this method of using maximum input values, and the competitive playing field becomes *less* level as a result.

III. C&WJ'S RESPONSE TO OUR QUESTION 2: "DO YOU AGREE WITH THE USE OF AN OPTIMAL GEARING APPROACH AND THE RANGE SPECIFIED?"

4. We do not disagree with the use of an optimal gearing approach. We do not agree with the ranges specified and do not agree with the use of different gearings for fixed and mobile.

² Consultation Document, ¶ 1.3.

5. With regard to the proposed gearing ranges of 10-20% for mobile and 10-30% for fixed, they appear to be based on stale data. From the citation provided to Table 1, however, it is not possible to identify which data were in fact used or determine their vintages. We believe the current data on gearing presented by Professor Damodaran are presented in the “Current Data” section of his website (<http://pages.stern.nyu.edu/~adamodar/>).³ The current data presented on the Damodaran website for emerging market gearings for telecommunications service providers and wireless providers are 26.75% and 26.16%, respectively. These figures are effectively the same and significantly higher than the 20.61% gearing for wireless presented in Table 1 of the Consultation Document.
6. It is also worth noting that a WACC study just recently completed by the regulator in Curacao estimated a gearing of 30% for all telecommunications providers; that is, using the current data at its disposal, the regulator in Curacao established a *single* gearing for all operators (fixed and mobile) that is *much higher* than the gearing percentages proposed by the OUR.⁴ Furthermore, half of the studies cited in Table 2 of the Consultation Document also use a single gearing percentage for both fixed and mobile, as does the Curacao regulator (which is not cited in Table 2).

³ From Damodaran’s homepage, select the link “Data”. Then from the pull-down menu labelled “Current Data” select the link “Risk/Discount Rate.” In the “Discount Rate Estimation” section of the table, select the link “Emerging Markets” under the subsection “Costs of Capital by Industry Sector”. The ultimate link to these data is:
<http://www.stern.nyu.edu/~adamodar/pc/datasets/waccemerg.xls>, downloaded 20 May 2016.

⁴ Bureau Telecommunicatie en Post Curacao, *Development of weighted average cost of capital (WACC) estimates for fixed and mobile services in Curacao*, August 2015.

7. In sum, there is no robust evidence that the gearing percentages for fixed and mobile are different or that the low gearing percentages presented in Table 2 reflect current data (which show much higher gearing percentages). Given the trend of technology convergence in Jamaica, there should be no differences in the estimated WACC based on technology. That is, on forward-looking basis, even if there are small technology-specific factors driving differences in capital structure today, those differences will likely disappear over time. And as the WACC is to be a forward-looking measure, the most appropriate assumption in this case is to forego from making technology-specific distinctions in estimating the WACC. We propose the OUR use a single measure of gearing based on the current gearing for telecommunications service providers in emerging markets of 26.75%.

IV. C&WJ'S RESPONSE TO OUR QUESTION 3: "DO YOU AGREE WITH APPROACH TO ESTIMATING THE RISK FREE RATE? PLEASE GIVE REASONS FOR YOUR RESPONSE WHERE CHANGES TO THE APPROACH ARE BEING PROPOSED."

8. We agree, the proposed approach to estimating the risk free rate appears to be appropriate.

V. C&WJ'S RESPONSE TO OUR QUESTION 4: "DO YOU AGREE WITH THE ESTIMATE OF THE DEBT PREMIUM? PLEASE BE DETAILED IN YOUR RESPONSE PROVIDING DATA TO SUPPORT YOUR CALCULATION WHERE A DIFFERENT APPROACH/VALUE IS BEING RECOMMENDED."

9. With regard to the debt premium, we do not disagree with the approach employed by the OUR.

VI. C&WJ'S RESPONSE TO OUR QUESTION 5: "DO YOU AGREE WITH THE APPROACH TO ESTIMATING BETA? PLEASE PROVIDE A DETAILED RESPONSE WHERE CHANGES TO THE APPROACH ARE BEING PROPOSED."

10. Please see our answers to Questions 1 and 2, above. As articulated in these answers, there is a trend towards technology convergence in Jamaica and elsewhere, which we believe explains the observed disappearance of significant differences between the WACC inputs for mobile and fixed networks. There is also a great deal of regulatory precedent in using a single beta for both fixed and mobile networks. Part of this regulatory precedent is due to the fact that it is very difficult to find reasonable data on pure play fixed network players. As a result, we believe the distinction between fixed and mobile betas is artificial and inappropriate, especially in the case of Jamaica where operators operate both fixed *and* mobile networks. We propose the OUR use a single measure of beta based on the average of the upper range of beta for fixed line providers and the lower range of the beta for mobile service providers presented by the OUR, or 0.71 (average of 0.67 and 0.75).

I. C&WJ'S RESPONSE TO OUR QUESTION 6: "DO YOU AGREE WITH THE APPROACH TO ESTIMATING THE MRP? PLEASE PROVIDE A DETAILED RESPONSE WHERE CHANGES TO THE APPROACH ARE BEING PROPOSED."

11. No, we do not agree with the approach to estimating the MRP. The OUR has chosen to apply an historical approach to estimating the MRP and justifies this approach by stating "it has been shown that this historical approach is more likely to overestimate the actual premium rather than underestimate it." The decision to establish an inflated estimate of the true WACC is not without costs, and as explained further in our response to Question 1 above, it can act to distort economic efficiency and competition. If the OUR chooses to apply its MRP estimate presented in Table 8 then we urge the OUR to select the lower bound estimate of 4.86% in order to counteract this overestimation bias.

II. C&WJ'S RESPONSE TO OUR QUESTION 7: "DO YOU AGREE WITH THE VALUES TO BE USED FOR EXPECTED INFLATION FOR JAMAICA AND THE UNITED STATES OF AMERICA?"

12. We do not disagree with the proposed method and reliance on IMF projections to estimate expected inflation.

III. C&WJ'S RESPONSE TO OUR QUESTION 8: "DO YOU AGREE WITH THE ESTIMATED WACC FOR FIXED AND MOBILE NETWORKS?"

13. We do not agree with the estimated WACC for fixed and mobile networks for all of the reasons articulated in our comments above. Instead, we believe a single estimated WACC applicable to all operators is appropriate. We also believe that, based on our responses to the above questions, adjustment should be made to the following WACC inputs:

- Gearing. The gearing should be equivalent for mobile and fixed networks and updated to reflect more recent data, i.e., set at 26.75%;
- Market Risk Premium. The mark risk premium selected should be on the lower end of the historic approach to estimation, i.e., 4.86%, and
- Beta. The beta should be equivalent for mobile and fixed networks and
- After making these adjustments, we believe a unified pre-tax WACC for operators in Jamaica ranging from 12.50% to 12.74% (with a point estimate of 12.62%) is appropriate.

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