CABLE & WIRELESS
JAMAICA

RESPONSE TO NOTICE OF PROPOSED DECISION ON SETTLEMENT RATES AND TERMINATION CHARGES

Introduction

Cable & Wireless Jamaica Limited (C&WJ) welcomes this opportunity to respond to the Office of Utilities Regulation (OUR) Document Number Tel 2004/05 entitled **Notice of Proposed Decision on Settlement Rates and Termination Charges**. The issues involved are critical to the telecommunications industry as they involve the sustainability of the market for the provision of international voice services and have serious consequences for the availability of funds to maintain the domestic network. As such it is important for the OUR, prior to taking any further action, to clearly set out the issues involved and address them decisively and in a methodical and objective manner. C&WJ is aware that the issues in this debate have been contentious. However, many of the issues are not new, and in fact are familiar to regulators around the world who have been through the initial stages of liberalisation. C&WJ hopes it can assist the OUR in arriving at a solution that is fair, transparent and acceptable to the local and international community.

Background

The Minister of Commerce, Science and Technology (the Minister) issued two Directives to The Office of Utilities Regulations (The Office) in January 2004. In relation to the international settlement rates, the Minister directed the Office to:

> *"with immediate effect, undertake and implement such acts of regulatory intervention in the market for international voice services as will establish an appropriate international settlement rate at which licensed operators shall provide such services, whilst continuing to maintain sustainable, effective competition among carriers and service providers".*

With regard to mobile telephony the OUR was directed to:

> *"undertake and implement such acts of regulatory intervention in the mobile (cellular) market (howsoever defined) as will stimulate sustainable, effective competition among carriers and service providers."*

These Directives were prompted by the concern expressed by the Minister that '*the decline in the international settlement rates has not resulted in the anticipated increased demand and traffic volumes such as to offset the reduction in national foreign exchange receipts from the termination of incoming international calls."* It is significant that the steep decline in international revenues has reduced in a very short timeframe, funds which have previously been used to support domestic investment and maintain fixed telephone rates at an affordable level.

The Office responded by issuing a document on January 23rd, 2004 entitled the **Decision on Settlement Rates** (the January Decision). By virtue of this document the Office established a margin of US$0.031 between the Termination Charge and the Settlement Rate for both the fixed and mobile networks. This decision appeared to be a response to the Minister's Directive. The OUR subsequently modified the January decision on the February 20th, 2004 by virtue of a document entitled **Modification of Decision on Settlement Rates.**

In the document entitled **"Notice of Proposed Decision on Settlement Rates and Termination Charges"** (the Notice), to which responses have been invited, the Office is proposing to remove the minimum settlement rates and the maximum termination rates that were approved and/or established in the January decision.

Neither the Ministerial Directives, nor the real concerns underlying those Directives, have been removed. C&WJ therefore respectfully submits that it is imperative that in its final decision the OUR responds to the Directives by setting out clearly what these underlying issues are and how it will address them in a manner consistent with international best practice.

Key issues

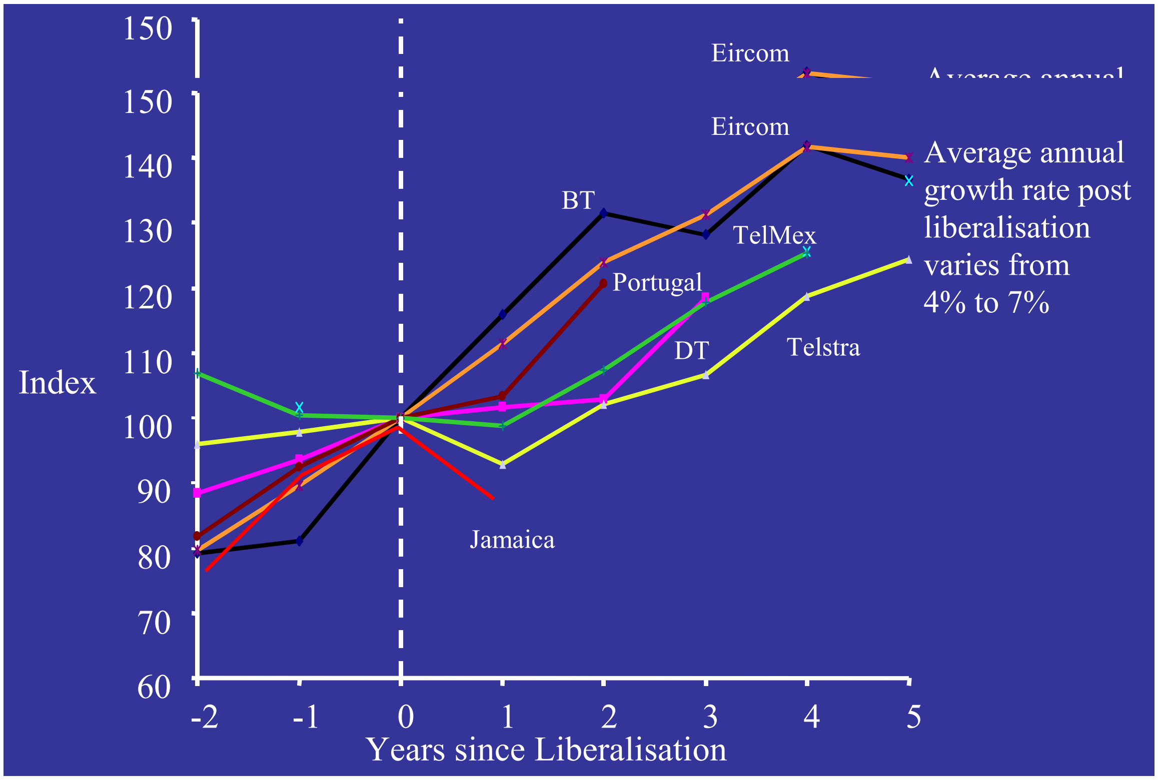
C&WJ understands that the OUR's decision to withdraw its original decision on international settlement rates is mainly due to the adverse reaction it has had to those proposals from national and international operators. C&WJ itself recognizes that, in some respects, the original proposals may not have been ideal. However, if – as has been proposed in its latest consultation – the OUR fails to take any action at all, the OUR will leave unresolved the underlying issues, which goes to the heart of sustainable telecoms development in Jamaica.

The OUR did not set out the rationale for its proposals in its original decision. However, in establishing a termination rate and setting a minimum margin, C&WJ believes that the intention was to respond to the Ministerial Directives by:

- Ensuring that the international settlement market was sustainable and thereby contributed to foreign exchange inflows and domestic investment.
- Preventing a margin squeeze occurring between the termination and settlement rate

These are very important issues, which remain to be resolved. Firstly, as regards domestic investment: from a position where previously, a large proportion of Jamaica's telecoms revenues came from international inbound and outbound traffic, these revenues have now been dramatically reduced without corresponding increases in domestic fixed revenues. This has resulted, as can be seen from the graph below, in a sharp decline in C&WJ's performance. This contrasts with the performance of national carriers in other countries which have allowed full rebalancing or have provided alternative mechanisms (such as ADCs) to fund the domestic network and potentially has serious consequences for C&WJ's ability to continue maintaining and investing in the national network which is so critical to the Government's information society and broadband objectives. This sharp deterioration in revenues coincides with the introduction of international competition (phase 3 of the liberalization process) and is due in no small part to the unsustainable manner in which competition was introduced in this sector.

Performance of national carriers following liberalisation



Secondly, as regards the margin squeeze, due to the absence of a reasonable margin between the international settlement rate and the rate for terminating on mobile networks of Other Licensed Operators (OLOs), it has become increasingly difficult for operators to compete in the delivery of inbound international traffic.

C&WJ believes that there are solutions to these issues which are legally robust, reflect international best practice and will not attract the same level of criticism as the solutions originally proposed. C&WJ hopes that it can work with the OUR to develop and implement these solutions so as to maintain investment in the national network and preserve the quality and affordability of telephone services that Jamaican consumers have come to expect.

<u>The Role of the Regulator</u>

The Telecommunications Act 2000 (the Act) provides that the Office is responsible for the regulation of the Telecoms industry and *inter alia* *" to promote competition among carriers and service providers"*.

Section 6 of the Act states that the *" The Minister may give to the Office such directions of a general nature as to the policy to be followed by the Office in the performance of its* *functions under this Act as the Minister considers necessary in the public interest and the office shall give effect to those directions".* It would appear that the Office has not and does not intend to challenge this direction. Accordingly, and in view of the importance of the issues highlighted to competition, domestic investment and consumer welfare, C&WJ respectfully submits that the Office has a duty to adhere to these Ministerial Directives and react in a decisive manner to ensure that the telecoms framework is sustainable.

Sustainable competition in international settlement

The main objectives of the Telecommunications Act 2000 (The Act) as asserted in section 3 are

- *"promoting fair and open competition in the provision of specified services and telecommunications equipment"*; and
- *"promoting the telecommunications industry in Jamaica by encouraging economically efficient investment in, and use of, infrastructure to provide specified services in Jamaica"*

This implies that, in line with international best practice, the ultimate aim of regulation in Jamaica is **sustainable** competition in which operators are encouraged to compete at the network level, and not only the service level – in order to ensure that competition can persist in the absence of detailed regulation. Unfortunately, as can be seen from the current situation in the international settlement market, it appears that the objective of promoting sustainable competition and investment in infrastructure has not been met.

Full liberalization of the industry was effected in March 2003 and sixty-seven (67) international licences have been issued to new telecoms operators. Cable and Wireless Jamaica Limited (C&WJ) in keeping with its obligations under the Act as the dominant PSTN carrier has signed twenty-two (22) interconnection agreements with licensed carriers and of the signatories, fourteen (14) are up and running.

There are presently three mobile operators that have invested heavily in building networks that allow them to attract and maintain a customer base. C&WJ and Gotel remain the fixed network operators. However, it is important to note that the newly licenced operators that have entered are solely engaged in the international incoming call market . These newly licenced international carriers have not made any significant infrastructure investment nor have they provided material employment to Jamaicans. Furthermore, they do not have subscribers and as such they carry calls into the island for termination only on the networks of C&WJ, Digicel, Oceanic and Gotel.

The Act provides at section 29(2) that:

> *"A public voice carrier shall provide interconnection in accordance with the following principles-*

a) *any to any connectivity shall be granted in such a manner as to enable customers of each public voice network to complete calls to customers of another public voice network or to obtain services from such other network;*
b) *end to end operability shall be maintained in order to facilitate the provision of services by an interconnecting carrier to the customer notwithstanding that the customer is directly connected to a different network."*

The intention of the statutory obligation to interconnect is to ensure that after having made the choice to subscribe to a network, customers are able to complete calls to customers of another network. A literal interpretation of the statute suggests that the intention of this obligation to interconnect, is built on the premise that interconnecting carriers are operators of a public voice network and that they have customers.

Similarly, in the Caricom region the Barbados Telecommunication Act 2001 at section 36 interprets interconnection as:

> *"the linking of <u>public telecommunications networks</u> to allow users of one licensed carrier to communicate with users of another licensed carrier."*

This approach would be consistent with that laid down in Article 2(b) of the EU Access Directive which defines Interconnection as a specific type of access implemented between public network operators :

> *'interconnection' means the physical and logical linking of public communications networks used by the same or a different undertaking in order to allow the users of one undertaking to communicate with users of the same or another undertaking, or to access services provided by another undertaking. Services may be provided by the parties involved or other parties who have access to the network. Interconnection is a specific type of access implemented between <u>public network operators</u>;"*

This provision in the Access Directive follows on from a provision in the previous Interconnection Directive (Annex II), which listed out more specifically the requirements that operators would need to meet in order to be eligible for cost-based interconnection.

However, despite the wording of the Jamaica Act and international support for a structure which distinguishes between public network operators and service providers and restricts cost-based interconnection to the former, the Office has continued to request that C&WJ provide interconnection indiscriminately to all new licensed operators.

C&WJ respectfully suggests that, given recent developments, it would be advisable to review this policy. Restricting cost-based interconnection to those operators which have invested to some degree in network development is critical to the objective of promoting sustainable competition. If service providers which have made little or no investment in infrastructure are able to obtain access at the same low rate as network operators there will be no incentive for operators to develop any network of their own. This will result in competition in name only – as numerous service providers effectively resell the services of network operators without contributing to the development of the telecommunications infrastructure in Jamaica. This kind of competition will not be sustainable in the long run and in the absence of regulation and will deliver little added value to Jamaican consumers.

Indeed, the negative impact of allowing access to cost-based interconnect for service providers without any significant network can already be seen in Jamaica where it has resulted in margins between the international settlement and termination rate of as low as **US$0.007** with little direct benefits to Jamaicans in terms of infrastructure investment or jobs.

C&WJ's strong recommendation is that the OUR issue a Direction to clarify the definition of 'public voice carrier' so as to make clear the extent of network required to meet that classification. This is consistent with practice in the UK and elsewhere where traditionally the demarcation between service providers and network operators has been made explicit and should ease the pressure created by the existing culture of 'margin trading' on settlement rates.

C&WJ is aware that it may be difficult in practice to reverse the OUR's current policy of granting cost-based interconnection to all new licensees. However, one solution would be to phase in implementation of a new definition of 'public voice carrier' allowing sufficient time for existing licensees to further develop their infrastructure capability. The OUR could also sanction a differentiation in products such that cost-based interconnection is made available only to operators with networks, whilst alternative service provider products (perhaps priced on a retail minus basis) could be made available to those without networks.

It is noteworthy that territories such as the OECS have not experienced to the same degree the collapse in the settlement rate and retain fixed network settlement rates in the region of US12.5c to US13c. This is because the regulators there have been prudent in issuing international carrier licences only to domestic infrastructure operators thus ensuring that margins from international settlement feed through to domestic investment and the development of network competition.

Absence of justification for findings

C&WJ has highlighted above the seriousness of the issues that gave rise to the January Decision. In this context it is extremely concerned that the OUR has given no explanation as to why it has concluded that no action is necessary.

The Office has pointed out that the January Decision was "geared to a) stabilize the market pending investigation and consultations on further measures that may be necessary b) allow the Office time to obtain further information relevant to the operation of the sector which it was envisaged would put it in a position to issue a final determination on the issues raised in the Decision".

The Notice does not provide evidence of the information that the Office has gathered that puts it in a position to determine that the best way forward for the industry is to effectively set aside its original decision. The January Decision had a reporting requirement, which would mean that the Office should be in possession of at least two sets of reports from all the operators dated February 5th and March 5th. The Office has not stated whether the operators fulfilled these reporting requirements, and if they were fulfilled, the findings that they have made based on these reports.

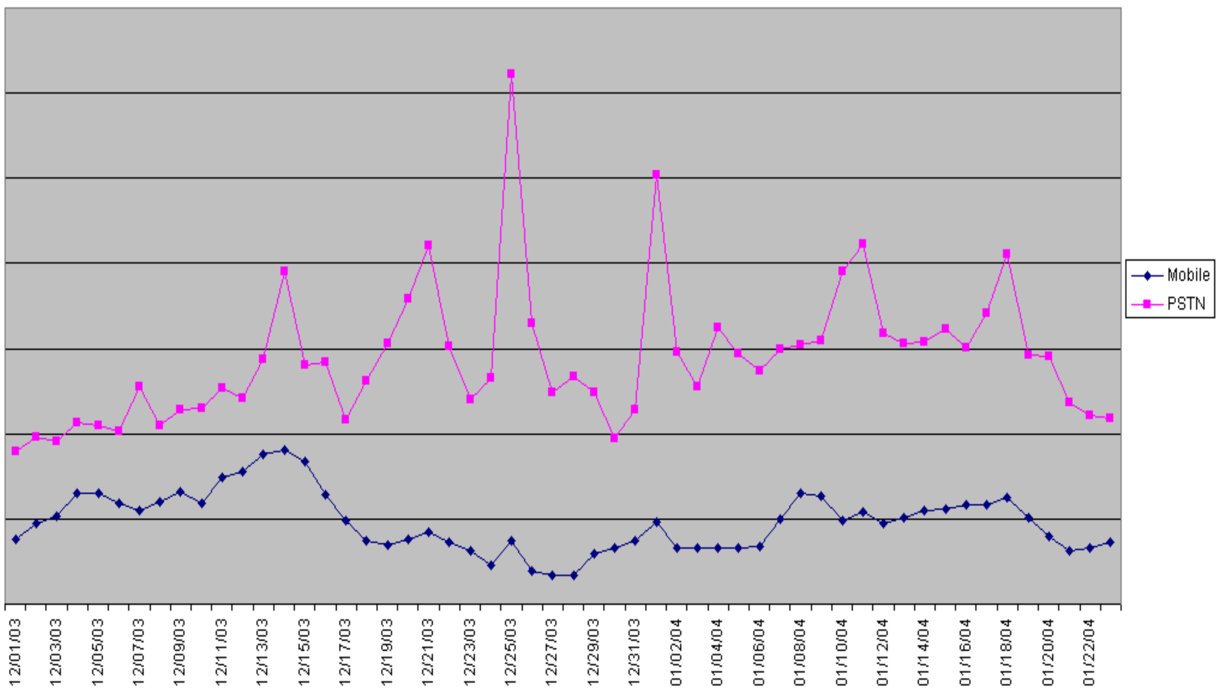
In the January Decision, the Office pointed out that it did not have costing information in relation to the termination rate to the fixed network and that it did not have *" reliable information to ascertain whether US$0.061 was the lowest trading rate or if special circumstances influenced this rate"*. The Office however will by this notice institute reporting mechanisms such that all the relevant market data would be available to make decisions." C&WJ is unclear as to whether the Office obtained this market data, and it has certainly not demonstrated how or why such data has caused it to conclude that there are no problems in the market which require its attention.

Additionally, the Office has stated that its *" staff has been engaged in ongoing consultations via meetings and oral and written communications with various interest groups"*. The Office has also failed to present the results of these meetings and just how these results have affected its position. The Office is seeking to substantiate its proposed decision based on these findings and as such C&WJ is requesting that the Office publish the findings for consultation/review by the public before it proceeds to implementation.

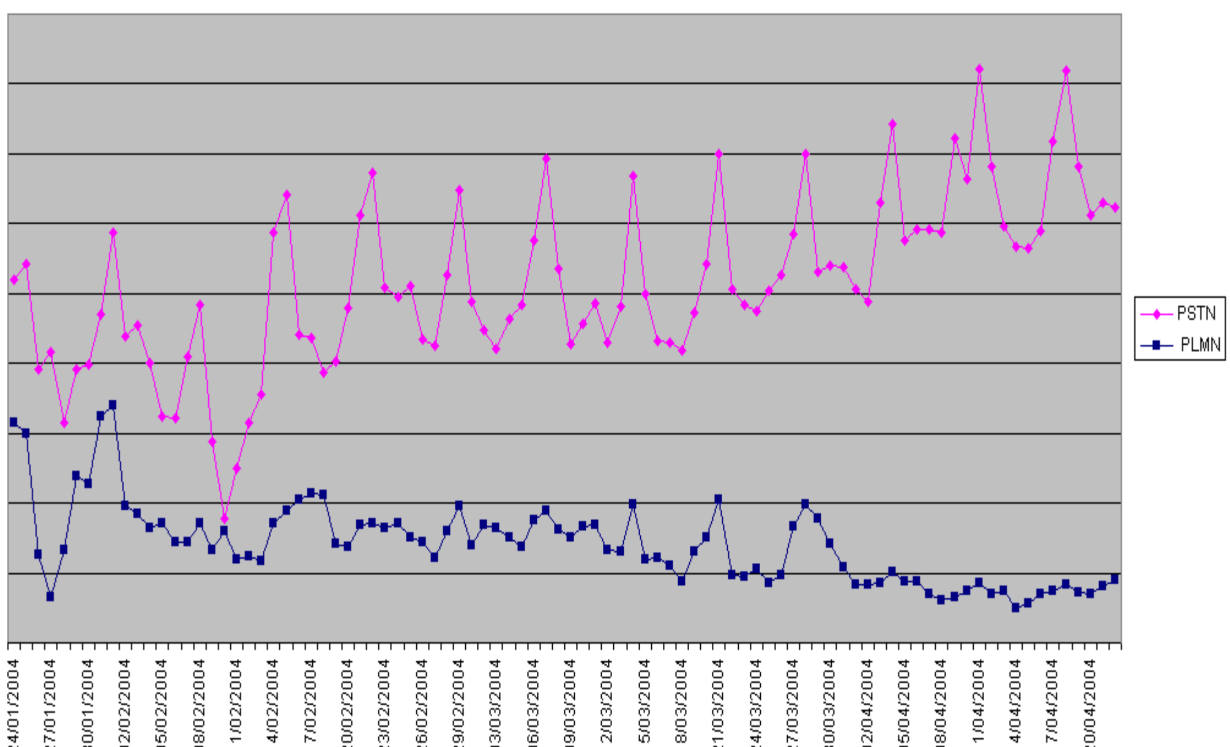
Below are two graphs which show the overall pattern of third party International carrier fixed and mobile terminations. A third graph shows C&W's direct fixed and mobile terminations. PSTN volumes were generally trending upwards except for the week of January 19th, that was as a result of the uncertainty with regard to the impending January 23rd decision. Pre- January 23rd mobile terminations (shown blue) fluctuated over the period from December 1st. A declining pattern also emerged during the week of January 19th.

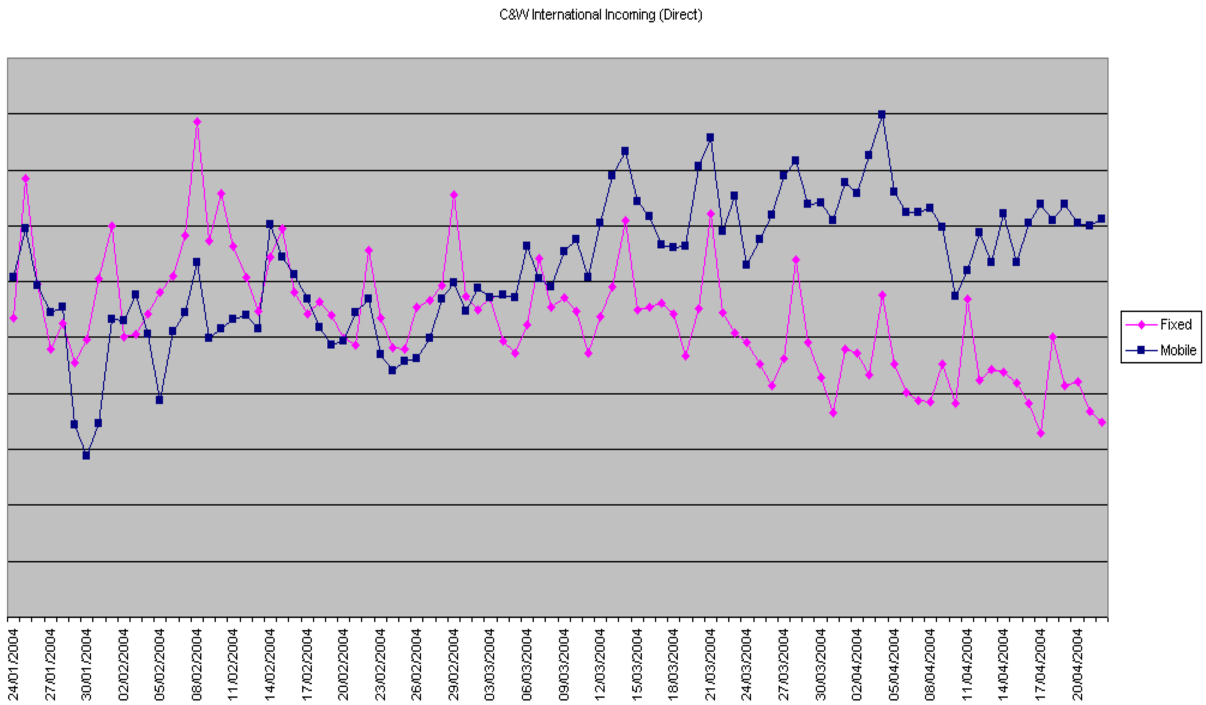
The post January 23rd graph also reveals a steady increase in PSTN (pink line) but decline in mobile terminations during the period to April 22nd. In other words, a clear increase in traffic to the PSTN but decrease to mobile from new carriers in the post January 23rd period. C&WJ's direct termination of PSTN traffic declined during the period as 3rd Pty Carriers' share of this segment increased. The graphs clearly indicate that rather than having an adverse effect on the new entrants, the decisive move taken by the OUR in issuing the January decision, has had a positive impact on the international incoming call market, especially as it relates to fixed network termination by 3rd party international carriers.

3rd Party Carriers - Pre Jan 23rd



3rd Party Carrier - Post Jan 23rd





<u>Decisions Slated for Implementation on May 3rd, 2004</u>

1) <u>The minimum settlement rate of US$0.081 for international calls terminating on a fixed network BE REMOVED. As of that date parties involved in such transaction shall negotiate their own terms.</u>

C&WJ recognizes that there are difficulties in policing the minimum settlement rate. In fact one of the major obstacles is that there are operators that are affiliated to US entities that will always be in a position to undercut the other players and report otherwise.

New entrants have alleged that C&WJ did not adhere to the January decision on the floor settlement rate for the fixed network and that following the stay of this floor C&WJ negotiated rates below the US$0.05 termination rate. **C&WJ would like to state unequivocally that it maintained settlement rates above the US$0.081 floor before and after the February Decision** and that the documented proof of same was submitted to the Office pursuant to the reporting requirements.

2) <u>The minimum settlement rate of US$0.169 for international calls terminating on a mobile network BE REMOVED. As of that date parties shall negotiate their own terms.</u>

Whereas C&W does not take particular issue with this decision, it does have concerns. The mobile market currently accounts for over 75% of all active telephones in Jamaica and over 60% of all international inbound traffic. It therefore stands to reason that any effective regulation of the international termination market consistent with the Minister's directive must of necessity include mobile.

It is noteworthy that notwithstanding the above statistics less than 15% of all international minutes from the new entrants terminate on the mobile networks. C&WJ believes that this is fundamentally an issue associated with the market power of mobile operators in terminating traffic on their own networks. This allows them to leverage this market power into the international settlement market and impose a margin squeeze, thereby preventing other operators from effectively competing. In other words the mobile operators will be in a position to "ring-fence" their respective networks. C&WJ urges the OUR to explicitly prohibit the operation of a margin squeeze between mobile termination and the international settlement rate and require that mobile operators conduct an imputation test to demonstrate that they have complied with this requirement.

3) <u>The Office's interim approval of Cable & Wireless Jamaica's application for a termination rate of US$0.05 for incoming international calls on the fixed network BE REMOVED.</u>

The fixed network is essential to not just telecommunications in Jamaica but the development of the country. The fixed network is the backbone of competition in Jamaica. It is the hub to which all competitive networks in Jamaica are interconnected. Without the fixed network, competition as envisaged in liberalization could not be achieved. Therefore all stakeholders, in the industry, as well as policymakers have a vested interest in the viability of this network, on which all services are dependent, inclusive of mobile, voice and data and advanced service offerings.

Prior to the introduction of competition, a significant proportion of C&WJ's revenues came from international settlement rates and outgoing traffic. This was the primary source of revenues for investment in and maintenance of the access network. This source of funding has now all but disappeared. Between 1997 –2001 the settlement rates declined from US$0.625 toUS$0.19 due to unilateral FCC action. This resulted in annualized hard currency losses to Jamaica in the region of US$144 million. The further decline from US$0.14 in January 2003 to a low of US$0.035 in December 2003 has resulted in an additional annualized national hard currency loss of approximately US$21.6 million. With no additional contribution sanctioned on the termination rate, it is likely that the price for terminating an international call will fall even further to a level just above the termination rate such as US$0.0025 resulting in a further national hard currency losses of some US$1.3m per month and further reducing C&WJ's scope to ensure continued maintenance and affordability of domestic access.

At the same time, realistically, C&WJ is unable to increase domestic telephony tariffs enough to compensate without causing significant affordability issues for Jamaican consumers and driving more customers off the fixed network.

Should the OUR withdraw its approval for the US$0.05 termination rate without proposing an alternative mechanism to replace the lost revenues, C&W's ability to continue to maintain the standard of network that Jamaican customers have come to expect, and to meet the Government's objectives of extending access to Internet and broadband services will be jeopardized.

The situation in Jamaica is exacerbated by the fact that some licensees are direct affiliates of foreign-based entities and as such their only payment is the termination rate, which becomes the *de facto* settlement rate. This was demonstrated following the OUR's decisions as with a PSTN termination rate of US$0.05 the settlement rates - in the absence of a floor - were in the region of US$0.055. Furthermore, reference is made to the Federal Communication Commission's document dated the 30th March, 2004 (FCC04/53), in which, the FCC indicates that it will view as unfavourable, floor rates and increases in settlement rates. This C&WJ respectfully submits, supports the view that the unreasonably low settlement rates to the fixed network that will result from the proposed decision will be virtually impossible to reverse.

4) <u>The maximum termination rate of US$0.138 for international calls for a mobile network BE REMOVED.</u>

C&WJ is pleased to note that the OUR has issued a supplementary consultative document proposing that mobile operators are dominant in their own termination markets. If, as C&WJ hopes, the OUR confirms these conclusions, this should provide a sound basis through which to ensure that the mobile termination rate is not set at an anti-competitive level. As mentioned under (2) above, it is important that such a decision is accompanied by a requirement that there is no margin squeeze between the termination rate and the international settlement rate. This will ensure that mobile operators do not foreclose the international settlement market to other operators by allowing insufficient margin for other operators to be able to compete.

<u>Conclusion</u>

C&WJ has identified several major issues associated with international settlements which need to be addressed. These include the need:

- To ensure that the international services market is sustainable by requiring those that benefit from cost-oriented interconnection to have made some investment in infrastructure themselves.

- To ensure that there is no margin squeeze between termination rates (particularly mobile) and the international settlement rate so as to allow for effective competition in the international settlements.
- To ensure that there is sufficient funding available to support the national network

Failure to address these issues is liable to result in competition that achieves little apparent benefit for Jamaican consumers and a decline in domestic investment, possibly putting at risk the Government's objectives of promoting access to Internet and broadband services.

C&WJ believes that fair and non-discriminatory solutions can be found to these problems and would welcome the opportunity to discuss further with the OUR how this can be achieved. In view of the above C&WJ respectfully asks that the Office maintain the current termination rate regime while it conducts the necessary evaluation as necessitated by the prevailing conditions, towards a long-term solution.