



CABLE & WIRELESS
JAMAICA

**C&WJ'S PRICE CAP PLAN SUBMISSION 2005
IN RESPONSE TO THE OUR'S PUBLIC NOTICE OF
A PROPOSED CONSULTATION**

INTRODUCTION

C&WJ welcomes the opportunity to respond to the Office of Utilities Regulation's (OURs) invitation to make a submission on "...whether the (price cap) regime should be continued and if so the changes that may be required ...", in accordance with the Public Notice placed in the daily papers and dated April 7, 2005.

C&WJ welcomes the OUR's invitation and is pleased to know that the OUR is cognizant of that fact that the development of the telecommunications market may warrant a complete removal of this price control mechanism. It is four years since the price cap regime was established and C&WJ believes that competition is sufficiently established to even warrant the removal of C&WJ's price controls.

Further C&WJ believes that there are other regulatory mechanisms in place that are designed to achieve similar objectives to the price cap regime and therefore the maintenance of the price cap regime would only amount to double regulation that would add increased administrative burden without commensurate benefits. These mechanisms include the ,reference interconnect offer and fair-trading regulations and most importantly the market. C&WJ will demonstrate that the market is a significant constraining force where retail prices are concerned and that further retail price controls are redundant.

OBJECTIVES OF EXISTING PRICE CAP REGIME

Price cap regulation operates on a very simple principle: price or the cost to the customer is regulated rather than the utility's profit. Once the price caps are set, the regulated utility is free to set the prices of its services provided that the weighted average price change meets the agreed predetermined cap. The firm retains all profit earned and is able to increase its profit by reducing its various costs for service provision. The regime creates an incentive for the firm to introduce as many efficiencies and cost-saving measures as possible. Price caps also reduce regulatory lag and facilitate timely adjustments to accommodate the dynamic nature of the telecommunication market.

The OUR on page 8 of the General Price Cap Rules, published January 2001, has stated its objectives for the Price Cap Regime to be consistent with sections 3(a)(b)(c) and 4 (c) (f) of the Act, that is to:

- Promote universal service of high quality and affordable prices,
- Foster competition in the Jamaican market for telecommunication services; and
- Provide incentives for the incumbent telecommunications carrier and service provider to improve efficiency and innovativeness while allowing the opportunity to earn a reasonable return on investment.

Objective 1

Promote Universal Service of High Quality and Affordable Prices

Consumers have been able to benefit from low prices for services under the regime over the span of the Price Control Regime (PCR). Consumers have benefited from rate reductions in many services as will be discussed further in the document. Rates have also been significantly rebalanced bringing prices closer to economic cost. This will benefit customers, as it will encourage efficient consumption.

The OUR, based on its findings in the universal service obligations consultation, has concluded that the mobile market has successfully met the objective of securing basic telecom services for consumers. Therefore the inclusion of basic voice services under the PCR must be reviewed.

Objective 2

To Foster Competition in the Jamaican Market for Telecommunication Services

The market has provided significant constraint on C&WJ where price increases are concerned. We have seen significant substitution in the market for some services as well as an influx of new providers for other services. We now have competition in the market for international outgoing and incoming calls, leased lines and data services. The level of constraint provided by the market is evidenced by the fact that currently C&WJ is unable to utilize the over 30% headroom that is available, that is C&WJ can increase prices by over 30% but is prevented from doing so by the market.

The existing regulatory structure in no way promotes competition in the fixed line market as is abundantly clear from the lack of new entrants. New entrants into the telecom market have avoided fixed line and other capped services to a large extent because, coupled with the constraints of the market as above, the existing PCR has meant these services cannot generate a reasonable return. The unattractive potential return from capped services has directed new entrants to uncapped services, such as mobile. While the factors above, particularly market constraint, have provided consumers with very low prices for fixed line services the PCR has limited C&WJ's ability to innovate in the pricing of these products. This places significant pressure on C&WJ as increased competition for uncapped services adversely affects revenues while pricing flexibility is limited under price caps.

The migration of a number of fixed line customers to mobile technology is a clear indication that mobile technology provides an effective substitute for some services provided by the fixed network. If the OUR continues to subject fixed line rates to regulation then C&WJ's ability to compete effectively in the market will be severely constrained.

Objective 3 - To provide incentives for the incumbent telecommunications carrier and service provider to improve efficiency and innovativeness while allowing the opportunity to earn a reasonable return on investment.

C&WJ was not able to achieve a reasonable rate of return on capped services due to a number of flaws in the regime. These flaws were made known to the OUR before the start of the regime but unfortunately they were not addressed. These included errors in the elasticity estimates used, demand growth assumptions, assumption of market share losses and Z-factor modeling. The late finalization of regime in January 2004 also contributed to C&WJ's inability to make a market rate of return on investment.

C&WJ's opportunity to earn a reasonable rate of return was also significantly compromised by the ill-timed "partial compensation" provided by the Z-factor. Although the Z-factor is designed to compensate for reduction in international incoming settlement rates there is a two-year lag in the adjustment. With the free fall of international incoming settlement rates this lag did not allow for timely adjustment and needs to be significantly reduced.

Based on the foregoing arguments C&WJ believes that the telecommunications market is at a stage where continuing retail price regulation will bring very limited benefit to the consumer. However, should the OUR have sufficient concerns with a full removal of the regime and decide to continue with a revised price cap mechanism then C&WJ recommends specific adjustments to the current structure.

MODIFICATION TO EXISTING PRICE CAP REGIME

In paragraph 1.6 of "*Specific Price cap Rules – Notice of Proposed Rule Making*" the Office states "... as competition emerges in different market sectors there will be a need to reclassify products in order to remove them from price cap regulation..."

The Office states that effective competition has been achieved if the following criteria have been met:

- At least one competitor is actually operating in the relevant market using its own switching and transmission facilities.
- Other competitors, in aggregate, have capacity in place to meet a large portion of total demand in the relevant market.
- The market is not characterized by anti-competitive practices or pricing, including collusion among competitors.

Removal of services from the CPI-X basket

Over the period of the price cap regime some services in the price cap basket have been subjected to increasing levels of competition. C&WJ believes the markets for some of these services are sufficiently competitive to warrant their removal from the CPI-X basket. Almost

exclusively those segments of the market that are subjected to competition have enjoyed rate reductions under price caps.

In accordance with the criteria established by the Office, C&WJ request the removal of the following services from the CPI-X basket:

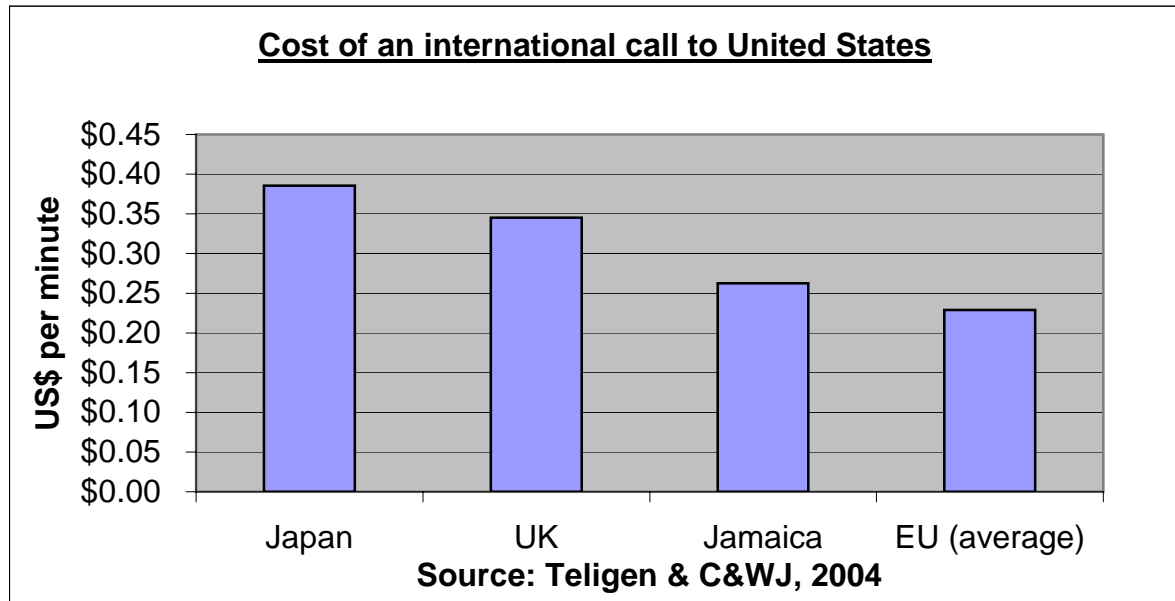
- International outgoing calls
- Worldtalk
- International data services
- Leased lines

International outgoing calls

C&WJ request the removal of international outgoing calls on the basis that this service is subject to effective competition. Currently there are in excess of seven (7) carriers providing international outgoing calls. C&WJ fixed line has less than 30% of the international outgoing call market. Evidence of this intense competition is reflected in the price changes in this service over the duration of the price cap. Over the four years of the price cap the price of international outgoing calls (except calls to Cuba) have never increased and in fact over the four-year period of the price cap, the price for international outgoing calls have fallen by approximately 60%. Aggressive competition in the mobile arena has also pushed the price of international calls to historic lows on both the fixed and mobile network. An increase in the number of licensees using VOIP solutions, to approximately five (5), has also resulted in significant price reductions in international outgoing calls.

Table 1 below indicates that the price of outgoing calls from Jamaica compares favourably with charges in highly competitive, liberalized markets.

Table 1



WorldTalk services

The WorldTalk product is a calling card service that provides national and international calling capabilities from a fixed line phone. The pervasiveness of prepaid mobile has marginalized the WorldTalk product. Further WorldTalk is subject to effective competition both from prepaid mobile and other card service providers. There are in excess of six (6) card service providers offering international services.

Leased lines and International Data Services

Competition exists in the market for leased lines and international data services. There is at least one service provider, Merit, supplying these services in the market using satellite technology. There are also other companies which are using a combination of fibre and wireless to provide data services. Further competition in the provision of these services over submarine cable facilities is imminent - Two entities, Fibralink Jamaica Limited and Trans-Caribbean Cable Company Limited, have been granted licenses to operate submarine cable facilities and have already started establishing operations. It is expected that before the end of the year these companies will be fully operational. C&WJ expect that there will be intense competition in the market for these services and accordingly expect that these services will be removed from PCR.

Removal of Regulation on Services Provided to Business Customers

The market for the provision of telecom services to business customers is much more competitive than that for residential customers. New entrants normally target the corporate telecommunications market since business customers are inherently more profitable than residential customers. That many firms are now utilizing the alternatives available for basic

communication is indicative that C&WJ no longer maintains any significant market power in the provision of business services

Business customers, in particular, have benefited from drastically reduced rates for leased lines, data services and particularly for international outgoing calls, as the competition in this segment of the market has been very intense.

At the current stage of development of Jamaica's telecommunications industry, regulation should be focused on residential customers. C&WJ believes that this targeted approach to retail price regulation will assist in minimizing the level of market distortion while protecting any consumers that the OUR may feel are not benefiting as greatly from competition.

Such an approach is a typical progression of retail price control mechanisms in other jurisdictions as competitive markets develop at different rates for particular products or consumer segments. For example, in the United Kingdom as competitive pressures, for business services in particular, increased during the initial years of liberalization, the Office of Telecommunications (OFTEL) amended the structure of the price cap to focus on the lowest-spending 80% of residential customers. The relative weighting of each service within the basket was assessed through examining the expenditure patterns of these residential customers. This meant that the control focused on price changes for services used largely by customers who were not benefiting as greatly from competition¹. This structure was considered to be the best way of ensuring that price-cap protection was provided to those who needed it most, whilst giving British Telecom (BT), the U.K. incumbent, greater freedom in areas where competition was more effective or where competition was imminent.

On the basis of the foregoing C&WJ considers that services to business customers should be removed from PCR.

Inclusion of Discounts and Promotions in Defining Price Cap Compliance

C&WJ believes that promotions and discounts should be included in price control compliance because these offers result in "tangible" savings to consumers. We believe this is consistent with the approach taken by many regulators, for example in the United Kingdom and Barbados. C&WJ is of the view that the consumer benefits from price decreases equally for a particular period of time regardless of whether the price decline is permanent or temporary and therefore it should count towards compliance. Such treatment would encourage C&WJ to offer appropriate discounts, which it notes are a common feature of competitive markets.

¹ Paragraph 1.5, Chapter 1. OfTel, Price Control Review. A consultative document issued by the Director General of Telecommunications setting out proposals for future retail price and network charge controls, October 2000.

If C&WJ were to be further disallowed from including discounts in defining price cap compliance this would continue to limit the company's ability to respond to competitive offers in the market place with no parallel restriction on the activities of other operators. This amounts to a prejudicial and discriminatory restraint on the Company. Such a restriction would also continue to artificially limit competition in the sector and would be of detriment to consumers who would be denied the benefits of robust competition. In addition the inclusion of discounts and promotions simplifies price cap compliance reporting.

Within the price cap framework C&WJ should not be subject to limitations in its ability offer discounts or other promotional offers.

Notice of Price Change

Given that the price cap plan is operating in a competitive environment, C&WJ needs sufficient flexibility in implementing rate decreases to permit the Company to compete effectively. Therefore C&WJ submits that one (1) working day's notice of price decreases be given to its customers. Such a notice period would create no hardship for consumers given that any such price decreases will be beneficial. Further, the OURs ability to review such price changes will in no way be impaired.

Z-factor

The Z-factor in the Price Cap Model needs significant adjustment to ensure that C&WJ is given the opportunity to recover its costs including the cost of capital. The parameter V needs to be increased to reflect the rapid rate of decline of international settlement rates. The significant reduction in settlement rates over the span of the price cap regime proved to be quite detrimental to C&WJ. The Z-factor was designed to compensate C&WJ for uncontrollable external shocks, however the rate of adjustment for revenue loss was too slow. In its current form, the Z-factor does not compensate for reduction in settlement rates until two years after the reduction. At the current rate of adjustment the company is not given the opportunity to recover lost revenues in a timely manner.

C&WJ believes that the level of partial compensation of the Z-factor is insufficient. C&WJ proposes that the V parameter be increased to at least 0.8 to facilitate compensation that will be more reflective of the effect of the rapid decline in International Settlement Rates (ISR) as well as the imminent declines arising from increased competition from other international data/voice service providers. This increase will maintain the partial recovery desired by the OUR.

Transparency in Setting Factors

There are a number of contentious issues from the last price cap regime that C&WJ would like to have a greater level of transparency and involvement in resolving. Some of the issues include elasticity, growth rate and market share assumptions. These parameters are critical to

the success of the price cap regime and the ability to the company to achieve a reasonable rate of return. Incorrect specification of these parameters is likely to result in a sub optimal X-factor. Visibility of how the actual X-factor is calculated is also necessary. C&WJ therefore looks forward to working more closely with the Office in the establishment of the foregoing parameters.

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