FLOW'S COMMENTS
ON RESPONSES
TO

FLOW'S APPLICATION FOR RECONSIDERATION OF THE OFFICE OF UTILITIES REGULATION'S

COST MODEL FOR FIXED TERMINATION RATES – THE DECISION ON RATES

DETERMINATION NOTICE

20 July 2017

1. Introduction

1.1 Cable & Wireless Jamaica Limited and Columbus Communications Limited (both trading as 'Flow') are pleased to comment on the industry's response to Flow's Application for Reconsideration of Office of Utilities Regulations' ('OUR's') Cost Model for Fixed Termination Rates – The Decision on Rates ('the Determination on Rates'). Submissions were received from Digicel (Jamaica) Limited ('Digicel'), Verge Communications Limited ('Verge') and the Consumer Advisory Committee on Utilities ('CACU').

1.2 Flow expressly states that failure to address any issue raised in any submission does not necessarily signify its agreement in whole or in part with the submission. Flow reserves the right to comment on any issue raised in the consultation process at a later date.

1.3 All responses to this document should be sent to Sola Hines, Legal & Regulatory Counsel, at sola.hines@cwc.com.

2. CACU's Submission

2.1 Flow appreciates that the CACU is of the opinion that the OUR should reconsider the Determination on Rates. The CACU has pointed specifically to the following arguments by Flow which warrant consideration: (i) Flow's reasonable expectation that the OUR would have implemented the new rates over a period which was longer than six months; (ii) the OUR does not appear to have given sufficient consideration to the effect of the magnitude of the reductions on Flow's business; and (iii) the effect of the reduction in the rates for the Incoming Call Termination Service on PSTN on Flow's Wholesale Carrier Business.

3. Digicel's and Verge's Submissions

3.1 Digicel and Verge both responded to Flow's argument that the six-month glide path, with the twenty-three-day notice of the first reduction, was counter to a legitimate expectation by Flow of a longer glide path. Digicel also examined whether the OUR's decision was reasonable.

3.2 Digicel argues that there has not been a frustration of Flow's legitimate expectation. It claims that the OUR had stated that it was initially minded to implement a "maximum" transition period of two years, but that it would consider the actual glide path once the output of the modeling exercise was available. Having considered the issue, it determined a six month glide path.

3.3 Verge makes a related argument that the OUR never promised a glide path of two years to introduce the new rates, but a maximum period of two years. Further, the OUR then outlined in the Determination Notice the reason which propelled it to implement a glide path which is below the maximum period.

3.4 In response to Digicel and Verge, Flow reiterates that as it is a question of law whether it had a legitimate expectation of a glide path longer than six months, it is necessary to examine the law on legitimate expectation. There are three questions to be determined:

(i) Does Flow have a legitimate expectation and if so what is it?

(ii) Has the OUR frustrated the legitimate expectation and if so was the OUR's decision so unreasonable as to amount to a wrongful exercise of the OUR's discretion?

(iii) What remedy should Flow be awarded?

3.5 The facts in this matter are repeated below:

During the course of its consultation to determine the Fixed Termination Rates ('FTRs'), the OUR stated that it may implement a glide path of a maximum period of two years, but would make the final determination after the rates from the modelling were available. In Determination 17 of its Determination Notice 'Cost Models for Fixed Termination Rates – Principles and Methodology' dated 1 July 2015 ('the Methodology Determination'), the OUR stated the basis on which it would determine the glide path:

> *6.4. The Office however disagrees with LIME that termination rates higher than the TLRIC rate do not generate unusual profits. The model will estimate an efficient operator's cost of providing termination service. Consistent with the position in the mobile LRIC process, the Office will only consider a glide path from the TLRIC rate to the Pure LRIC rate. According to the Act, rates should be cost oriented. If the current termination rate is above the TLRIC rate estimated by the model then that means operators would have already reaped significant benefit from having a termination rate which is above cost. The Office is cognisant of the need for rates to be quickly aligned with costs to be compliant with the stipulations of the Act and to curtail the negative effects of having a fixed termination rate which is above cost.*
> *6.5. The Office therefore acknowledges both operators' concerns regarding the definition of glide paths and is in general in agreement with Flow's proposal to only decide on the final glide paths after the results for the modelled rates have been reviewed. However, as stated in the Consultation Document, the Office will only consider a glide path up to a maximum of two years.*
> *Determination 17: The Office may resort to glide paths for adjusting termination rates, the exact length of which will only be defined after reviewing the rates from the modelling.*

If we rely on the OUR's statement to answer the question, how will the OUR determine the glide path, the answer in the OUR's own words is "*If the current termination rate is above the TLRIC rate estimated by the model then that means operators would have already reaped significant benefit from having a termination rate which is above cost. The Office is cognisant of the need for rates to be quickly aligned with costs to be compliant with the stipulations of the Act and to curtail the negative effects of having a fixed termination rate which is above cost.*"

Following the Methodology Determination, the OUR issued its consultation on the draft model 'Cost Models for Fixed Termination Rates – Draft Model Consultation Document' dated 22 June 2016 ('Draft Model Consultation'). The OUR subsequently issued the Determination on Rates and made its determination on the glide path as set out below.

> *15.3. In the Methodology published on 2015 July 1, the OUR stated that if an existing termination rate is above the TLRIC rate estimated by the model, this would mean that operators would have reaped significant benefits from having a termination which is above cost. The OUR indicated that should such a scenario occur, the termination rate will be immediately adjusted to its TLRIC level. The OUR also established that glide paths will be allowed from TLRIC rate to the Pure LRIC rate only where there is a significant difference in the rates in dollar terms. While the*

OUR established that the maximum time period for a glide path should be two (2) years, it indicated that it will only decide on the final glide paths, detailing exact lengths and the adjustment steps, after the model is developed and the fixed termination rate is calculated. The OUR did not however, indicate the approach to be taken in the scenario where the current termination rates are lower than the TLRIC level.

15.4. After comparing the model's results with the tariffs in the existing reference interconnection offer, the OUR observes that current termination rates are much lower than the TLRIC model results. This means that the current rates already accord with the principle of cost-orientation and as such C&WJ would not have been benefitting from supernormal profits. It was also observed that there were significant differences between current termination rates and the rates resulting from the new methodology (Pure LRIC). Table 21 shows the comparison of current termination rates against the average of the LRIC model results for 2017-2020.

Services	*Units*	*Average RIO*	*Average 2017-2020*	*Difference*
PSTN - Local	*JMDcent/min*	*41.33*	*9.39*	*-77%*
PSTN – National	*JMDcent/min*	*115.16*	*9.58*	*-92%*
PSTN – International	*JMDcent/min*	*144.70*	*10.04*	*-93%*

Services

15.5 In its deliberations regarding the implementation of a glide path, the OUR took note of the significant differences found between the current rates and the Pure LRIC rates and the impact that the immediate reduction of the rates to the Pure LRIC level would have on C&WJ revenues. The fact that the current rates were also not above TLRIC was also taken into account. Based on these considerations, the OUR decided, in keeping with its statutory mandate to balance short term welfare gains of immediate price reductions with the long term interests of protection of efficient investment incentives, to implement a two-step glide-path. The first step of the glide-path for fixed termination rates becomes effective on 2017 July 1 and remains in effect until 2017 December 31. The second step will become effective on 2018 January 1.

3.6 Based on the facts above, **does Flow have a legitimate expectation of a glide path, and if so what is it?** Verge in paragraph 9 of its response, seeks to define the doctrine of legitimate expectation thus:

> *The doctrine of legitimate expectation rests on the principle that when a public authority has promised to follow a certain procedure, it is in the interest of good administration and transparency that it should act fairly and should implement its promise, so long as implementation does not interfere with its statutory duty. It is trite law that a legitimate expectation must be reasonably held by the person or entity that seeks to rely in it. This means that the public body, which is the OUR in this case must have made a representation, either by way of an express promise or implicitly through its past conduct, that it would act in a particular way, therefore giving all interested stakeholders a reasonable and legitimate expectation that it would proceed in accordance with its representation.*

Amazingly, after this cogent statement of the law, Verge proceeds to find that "the OUR, never promised to implement a glide path of two years to introduce the new rates. On the contrary, the OUR merely stated at Section 7.4 of its Consultation Document, 'Cost Models

For Fixed Termination Rates – Principles and Methodology Consultation' … that the **maximum** time period that it would consider for rates to adjust costs is two years." (Emphasis Verge's)

Flow wishes to buttress Verge's definition with the summary of the principles of legitimate expectation from the judgment of Peter Gibson LJ in Rowland v. Environment Agency[1]:

> *(1) A legitimate expectation may arise from "the existence of a regular practice which the claimant can reasonably expect to continue": see Council for Civil Service Unions v Minister for the Civil Service [1985] AC 374 at p. 401 per Lord Fraser, quoted by me in Begbie [2000] 1 WLR 1118 at p. 1125.*
>
> *(2) It is not always a condition for a legitimate expectation to arise that there should be a clear, unambiguous and unqualified representation by the public authority (R v IRC, ex p. Unilever plc [1996] STC 681 at pp. 693-5 per Simon Brown L.J.): the test is whether the public authority has acted so unfairly that its conduct amounts to an abuse of power.*
>
> *(3) Similarly, without in any way wishing to belittle the "cards on the table" requirement laid down in the MFK case (a tax case), the answer to the question whether there has been such a failure of disclosure by a party as to disentitle him from having a legitimate expectation must depend on the particular circumstances of the case.*

3.7 Relying on paragraph 2 above, Flow's argument is that the OUR has advised that it will implement a glide path of maximum two years after reviewing the rates from the modelling. After its lengthy consultations and statements on various matters, the determination includes a single paragraph explanation as to why it implemented a six-month glide path, with the first cut of the rates to be implemented twenty-three days after the determination is issued. Given the magnitude of the ordered rate reductions and their direct impact on the welfare of the company, Flow stands firm in its conviction that the OUR's explanation for ordering a six-month glide path is insufficient:

> *15.5 In its deliberations regarding the implementation of a glide path, the OUR took note of the significant differences found between the current rates and the Pure LRIC rates and the impact that the immediate reduction of the rates to the Pure LRIC level would have on C&WJ revenues. The fact that the current rates were also not above TLRIC was also taken into account. Based on these considerations, the OUR decided, in keeping with its statutory mandate to balance short term welfare gains of immediate price reductions with the long term interests of protection of efficient investment incentives, to implement a two-step glide-path. The first step of the glide-path for fixed termination rates becomes effective on 2017 July 1 and remains in effect until 2017 December 31. The second step will become effective on 2018 January 1.*

3.8 Flow also takes issue with Digicel's response to its criticism of the OUR's statement on the determination of the glide path that "The fact that the OUR balancing exercise did not produce a result to the liking of C&WJ does not invalidate the procedure." This argument by Digicel is a red herring. Flow does not contend the balancing procedure undertaken by the

[1] [2005] Ch1 (CA) para 68

OUR is invalid or lacks legal force. Flow acknowledges that it is an appropriate and legally binding procedure, but instead asks for reconsideration of how the procedure has been applied. Flow is concerned the OUR did not accurately quantify the costs and benefits, and questions whether all relevant information was given proper consideration.

Furthermore, in the Determination on Rates, the OUR admits that while it had contemplated certain scenarios for setting the glide path in the consultations, it did not contemplate how it would set the glide path in the current scenario:

> *15.3. In the Methodology published on 2015 July 1, the OUR stated that if an existing termination rate is above the TLRIC rate estimated by the model, this would mean that operators would have reaped significant benefits from having a termination which is above cost. The OUR indicated that should such a scenario occur, the termination rate will be immediately adjusted to its TLRIC level. The OUR also established that glide paths will be allowed from TLRIC rate to the Pure LRIC rate only where there is a significant difference in the rates in dollar terms. While the OUR established that the maximum time period for a glide path should be two (2) years, it indicated that it will only decide on the final glide paths, detailing exact lengths and the adjustment steps, after the model is developed and the fixed termination rate is calculated. The OUR did not however, indicate the approach to be taken in the scenario where the current termination rates are lower than the TLRIC level.*

As the largest investor in fixed networks in Jamaica, Flow makes no apologies for seeking to protect these investments, or insisting that the OUR provide a clear and complete explanation for its decision to implement a six-month glide path. Flow reiterates that in the context of the massive reductions in the rates, were the OUR acting within its statutory mandate to balance short term welfare gains of immediate price reductions with the long-term interests of protection of efficient investment incentives, it could not implement a six-month glide path.

3.9 The second question is **whether the OUR has frustrated a legitimate expectation, and if so was it so unreasonable as to amount to a wrongful exercise of the OUR's discretion?** The cases are reluctant to offer an explanation or example of this principle:

> *Legitimate expectation of either kind may (not must) arise in circumstances where a public decision-maker changes, or proposes to change, an existing policy or practice. The doctrine will apply in circumstances where the change or proposed change of policy or practice is held to be unfair or an abuse of power: see for example Ex p Coughlan paragraphs 67 ff, Ex p Begbie [2000] 1 WLR 1115, 1129F – H. The court is generally the first, not the last, judge of what is unfair or abusive; its role is not confined to a back-stop review of the primary decision-maker's stance or perception: see in particular Ex p Guinness Plc [1990] 1 QB 146. Unfairness and abuse of power march together: see (in addition to Coughlan and Begbie) Preston [1985] AC 835, Ex p Unilever [1996] STC 681, 695 and Rashid [2005] INRL 550 paragraph 34. But these are ills expressed in very general terms; and it is notorious (and obvious) that the ascertainment of what is or is not fair depends on the circumstances of the case. The excoriation of these vices no doubt shows that the law's heart is in the right place, but it provides little guidance for the resolution of specific instances.*[2]

[2] R (Bhatt Murphy and others) v Independent Assessor [2008] EWCA Civ 755, para 28

In the circumstances, Flow argues that the fundamental unfairness of the OUR's six-month glide path lies in the fact that, even by the OUR's own admission, it has not dealt with the current scenario found in rates from the modelling in its consultation. What it promised Flow was that it would implement a two-step glide path of up to two-years, based upon the modelled rates and "*in keeping with its statutory mandate to balance short term welfare gains of immediate price reductions with the long term interests of protection of efficient investment incentives.*" Flow is concerned the OUR has not fulfilled its promise and has not accurately quantified these welfare gains and long-term costs to investment.

3.10 As Flow highlighted in its Application for Reconsideration, the magnitude of the FTRs reductions is much larger than expected. To put the size of these reductions in context, they are unprecedented. To our knowledge, the Jamaican FTRs are the lowest anywhere, ever in the Caribbean.

The percentage reduction in FTRs even exceed the then-unprecedented percentage reduction to Mobile Termination Rates (MTRs), previously ordered by the OUR in 2012-2013. Starting in July 2012, the OUR reduced the MTRs from \$9 per minute (p.m.) to \$5 p.m. (in an Interim MTR) and then again in July 2013, from \$5 p.m. to \$1.10 p.m. This percentage reduction (from \$9 to \$1.10), accomplished over a *12-month* period, is 88%. In contrast, starting from 1 July 2017, the OUR has ordered termination rates for national calls be reduced from an average rate of \$1.15 p.m. to \$0.624 and then again on 1 January 2018, from \$0.624 to \$0.0958 p.m. This percentage reduction (from \$1.15 to \$0.0958), accomplished over a *six-month* period, is 92%.

We contend the magnitude of these FTRs reductions, and their lack of precedent, produce a significant, unexpected cost on operators, such as Flow, who have committed large investments in fixed networks in Jamaica. Therefore, given the extremity of these results, Flow believes that the maximum allowable glide path of two years is at minimum necessary; and in no case do we find it reasonable or appropriate to apply an implementation period less than the 12-months that was applied to the proportionally smaller MTRs reductions.

3.11 In Section 2 of Digicel's comments, it further contends that the glide path proposed by Flow has already been fulfilled, in large part, "of [Flow's] own volition" and, hence, Flow's "seeking a longer glidepath [than the 6 months, proposed by the OUR] is unreasonable." Digicel's argument is logically incoherent, in that it fails to properly consider the assumptions on which our proposal was based. Flow assumed the modelled pure LRIC rates would be trending down over the 4-year modelling period and would not be at unprecedented low levels. Flow also assumed our existing rates would exceed the modelled TLRIC rates. None of these assumptions, it now turns out, were accurate. The modelled rates are not trending down, but are volatile and even trending up in many cases. Given these unexpected model results, Flow disagrees that there is any inconsistency between our initial proposal and our application for reconsideration, and in no event do we agree with Digicel's assertion that a glide path greater than six-months is unreasonable.

3.12 Digicel has also compared the thirty day notice period for the implementation of the 88% reduction in MTRs in 2013, with the notice period and level of reduction for the FTRs and Flow's insistence that the glide path should be longer than six months. Section 2 of its response states *inter alia*:

Digicel notes that in implementing Mobile Termination Rate (MTR) price controls in 2013 the OUR mandated a 78% reduction in MTRs with 30 days' notice. This is almost double the interim reduction mandated for FTRs with equivalent notice. Therefore, by comparison to the level and speed of reduction in MTRs in Jamaica, the determined FTR glidepath is not unreasonably short and is proportionate. In these circumstances Digicel believes that a longer glidepath would be unreasonable.

In the context of the history of the OUR's setting of the MTRs in Jamaica, and the effect of high MTRs on the mobile market in Jamaica, Digicel's statement is erroneous and disingenuous. It is necessary to give the reader in general and Digicel in particular a brief overview of the history of mobile regulation in Jamaica. Historically, the MTRs were not regulated on a cost based premise. In fact this period of unregulated MTRs lasted for over ten years. These high and unregulated MTRs facilitated Digicel's uncompetitive pricing practice of maintaining higher off net rates compared to its on net rates. Digicel set a high off net rate of $14.00 p.m., while making its effective on net rate (estimated at $3.50-$4.00p.m.) lower than the MTRs ($7.75 weekend, $8.25 off peak and $9.00 peak). This situation created a market failure as Digicel would ring fence its customers and therefore not allow the market to respond to pricing signals. Flow's mobile business then trading as LIME, faced great difficulty to attract subscribers to its network, since they would face a high retail rate (due to the high MTRs) to call Digicel, the network of their family, friends and co-workers. Therefore, this "Club Effect" needed to be urgently addressed by the OUR as the high MTRs had a serious impact on the retail market place for the mobile operators.

The OUR began its consultation on the LRIC model in 2008. It should also be noted that at that time, Digicel had an ongoing challenge the OUR's 2003 determination that each mobile operator is dominant is on its own network for call termination services, which was the necessary precursor for the regulator to set the rates. The OUR's first urgent step was to reduce the MTRs to a cost based rate. Otherwise, competitors' mobile business would eventually be foreclosed. In response to the OUR's request for the cost based MTR information, LIME was the only mobile operator to respond and presented costs based on the Modern Equivalent Asset valuation method approximating a MTR of $5.00p.m.. This led to the OUR setting an interim MTR of $5.00 in July 2012. This interim rate ended the decade long period of unregulated MTRs. And the reader should note, that the interim MTR was still higher than Digicel's effective on net rate.

In addition, Digicel exploited the OUR's regulation which allowed mobile operators the authority to set the Fixed to Mobile (FTM) rate, by setting a high FTM rate for LIME's fixed customers to call its mobile network. LIME was allowed to retain only the regulated call origination charge while Digicel retained the balance of the FTM retail rate imposed, propped up of course by its high MTR. This bizarre circumstance caused many of LIME's fixed subscribers to run up high bad debts which had to be written off and many churned from the network. Therefore, once the OUR completed its consultation on the mobile LRIC model, in the context of the significant market distortions, it was impelled to implement the MTR immediately.

This process of setting the MTRs is in direct contrast with the process of setting the FTRs. Unlike the MTRs, since the liberalization of the telecommunications sector, C&WJ's FTRs have been regulated. C&WJ has had to publish a Reference Interconnect Offer (RIO) based on costs approved by the OUR since 2001. In fact, the current rates are cost based rates approved by the OUR using the Modern Equivalent Asset valuation method. With the recent LRIC consultation, the OUR sought to change the costing method from the Modern Equivalent Asset valuation method to the LRIC method.

Flow reiterates that it is not objecting to this process, but objects instead to the timing being required to effect the reductions for the numerous reasons which have been stated in this document. Any attempt to simplistically compare the regulation of the FTRs with the regulation of the MTRs displays a complete lack of understanding or appreciation for what has transpired in the Jamaica market. On this basis, Flow submits that the treatment of the implementation of MTRs based on a LRIC calculation does not serve as an appropriate barometer for the treatment of the implementation of FTRs based on LRIC calculation.

3.13 The final question is **what remedy should Flow be awarded**? Flow repeats the remedies sought in its application for reconsideration of the Determination on Rates:

> *In the circumstances, Flow seeks:*
>
> *(i) a glide path of a minimum of two years or a maximum of three years for the implementation of the reductions in Fixed Termination Rates as set out in the Determination on Rates; and*
>
> *(ii) a stay in the effective date of the first reduction from 1 July 2017 to a date when the new glide path is determined by the OUR or pending an appeal to the Appeal Tribunal.*

4. Wholesale Carrier Services Impact

4.1 In Digicel's comments on the impact to Flow's wholesale carrier services business (Section 3 of its comments), Digicel contends that applying a glide path to fixed international termination is improper because it would provide "a regulatory support for Flow's fixed carrier services business while failing to provide an equivalent support to the mobile carrier services business of Digicel." Digicel concludes:

> *"[This] would amount to a discriminatory and competitively distortive regulatory intervention in the market. Digicel believes that extension of the fixed glidepath based on such considerations would be unlawful in the circumstances where the OUR has not also allowed the mobile operators to maintain their prices above the Pure LRIC level for the purposes of shielding their wholesale carrier services businesses."*

This argument is specious for at least two reasons. Firstly, a decision to extend the glide path for implementing fixed termination price reductions would apply to *all* fixed network operators. Thus, it would not be limited to traffic terminating to Flow's fixed network, but would apply to all fixed networks in Jamaica, including Digicel's. The fact that such a glide path would not apply to Digicel's mobile terminated traffic is not discriminatory as it would also not apply to *all* mobile networks, including Flow's. It should also be obvious that MTRs are outside of the scope of this proceeding, and were addressed previously in the 2013 Mobile Termination Rate determination, which it should be added likewise reduced the termination rates for *all* mobile operators equally.

4.2 Second, Flow is not seeking to indefinitely maintain existing prices for the purpose of "shielding" its wholesale business from competition. Flow's application is specific to the OUR's ordered six-month glide path and seeks specific, temporary relief by extending the duration of this path from six- to twenty four or thirty six months. This is not a "shield", but a reasonable approach to implementing interconnection price reform, considering the changed methodology of calculation and the severity of the fixed interconnection price reductions at issue.

5. The Impact on Other Carriers

5.1 Flow is also compelled to comment on Verge's submission on the "financial harm" that it claims it would suffer from a longer glide path in the implementation of the new FTRs. Verge argues at paragraph 5 of its response:

> *Verge further submits that any further delay in the implementation of this long overdue Determination wrongfully, and we would submit illegally, exacerbates the financial harm suffered by interconnected operators. Should the OUR accept C&WJ's proposal of a glide path of a minimum of two years or a maximum of three years for the implementation of the reductions in Fixed Termination Rates, this would extend the financial and commercial harm other interconnected operators are suffering. If the old rate regime is allowed to continue for two or three years, Verge will lose an estimated monthly sum of [redacted figure].*

Flow has tried without success to appreciate the arguments being made by Verge. Again, it is necessary to understand the historical context in which any argument is made. Public documents indicate that Verge was incorporated in July 2014, granted licences by the OUR in December 2014 and subsequently entered into an interconnection agreement with C&WJ based on C&WJ's published Reference Interconnection Offer (RIO). The current RIO was issued by the OUR in 2012, with the approved rates including the FTRs. It can therefore be correctly concluded that Verge's business case or financial projections would have been based on these rates. While Verge would enjoy a financial windfall from the faster implementation of lower FTRs, that windfall is patently distinguishable from any "financial harm" it can claim it would suffer from a two year glide path from the implementation of the new FTRs.

5.2 Further, Flow is constrained to counter the merits of Verge's argument as it is privy to the destination of termination of incoming international traffic which Verge carries into the market. Our figures indicate that Verge terminates [

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]. Our records of the minutes terminated between [**CONFIDENTIAL**] are set out below:

[**CONFIDENTIAL]**

6. Conclusion

6.1 Flow maintains its position that in all the circumstances surrounding the Determination on Rates, it had a legitimate expectation of a longer glide path than the six month period set out in the Determination. It continues to seek the following remedies:

(i) a glide path of a minimum of two years or a maximum of three years for the implementation of the reductions in Fixed Termination Rates as set out in the Determination on Rates; and

(ii) a stay in the effective date of the first reduction from 1 July 2017 to a date when the new glide path is determined by the OUR or pending an appeal to the Appeal Tribunal.

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