Digicel

Digicel's response to the consultation on

The Recommendation of the Eastern Caribbean Telecommunications Authority ("ECTEL") To the National Telecommunications Regulatory Commission to consult on Draft Cost Models for Fixed and Mobile Interconnection Rates

18 July 2017

Digicel welcomes the opportunity to comment on The Recommendation of the Eastern Caribbean Telecommunications Authority ("ECTEL") To the National Telecommunications Regulatory Commission to consult on Draft Cost Models for Fixed and Mobile Interconnection Rates. Digicel is of course available, and would be happy, to discuss our submission further.

The comments as provided herein are not exhaustive and Digicel's decision not to respond to any particular issue(s) raised in the application document or any particular issue(s) raised by any party relating to the subject matter generally does not necessarily represent agreement, in whole or in part nor does any position taken by Digicel in this document represent a waiver or concession of any sort of Digicel's rights in any way. Digicel expressly reserves all its rights in this matter generally.

Please do not hesitate to refer any questions or remarks that may arise as a result of these comments by Digicel to: -

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Introduction

Digicel questions the appropriateness of cost modelling in small island developing states generally as we believe that they ae an inappropriate regulatory tool for such economies. In the event that cost modelling is used, it is critical that any model has regard to the particular economic characteristics of these states – including the particular problems of minimum economic scale. This means that cost oriented prices in microstates (at wholesale and retail) are likely to be significantly above those observed in macrostates and could easily even be more than double. It's therefore wrong to rely on model inputs and assumptions aligned with those in macrostates because this would lead to model outputs and regulated prices that are too low. Such under assessment of the level of cost oriented prices will lead to under recovery of investment. In addition it will lead to inefficient market entry in sectors such as international voice services as the regulated prices would not correctly reflect costs. As a validity check on the correct model operation outputs which are not significantly above those modelled in other larger states such as Jamaica are indicative that the model does not properly take account of the characteristics of network deployments in microstates like those in the ECTEL region.

Digicel has commissioned the respected economic consultancy firm Analysis Mason to support its review of the draft ECTEL model. Analysys Mason is the world leader in the design, construction and implementation of mobile network service costing models, and has been a pioneer in all aspects of regulatory costing and pricing since the early 1990s.

The Analysys Mason review of the ECTEL has highlighted a number of material deficiencies in the construction of model, the chosen inputs to the model and factual inaccuracies in the information which ECTEL has relied on to justify various decisions. The report produced by Analysys Mason is attached to the submission and forms part of it.

Detailed Comments on Model

Benchmarks

The ECTEL decision making is informed by benchmarks produced by Axon. Analysys Mason was directly involved in the modelling process in a number of benchmarked countries and therefore is uniquely qualified to review the accuracy and adequacy of these benchmarks. The Analysys Mason report sets out where the Axon benchmarks are simply wrong. The details of these are set out in the Analysis Mason Report. These factual inaccuracies undermine both the validity of decisions that rely on such benchmarks and the credibility of Axon when it makes other assertions which are not so easily verified.

Overcapacity

Analysis Mason has identified that the overcapacity factor used by Axon is both unrealistic and out of line with similar figures used in other jurisdictions and in particular is significantly out of line with equivalent figures used by Axon itself elsewhere. Please refer to the Analysys Mason report for the detail of this.

Geotype modelling

Analysys Mason has identified a number of material deficiencies in the Axon approach including results which are totally at odds with the actual geography and demographics of the modelled countries and which are easily verifiable (where for instance Portsmouth in Dominica has been missed almost entirely, as the location data is in the sea). These inaccuracies in the geotype modelling demonstrate that the model as proposed does not in fact model the countries that make up ECTEL. The details of these are set out in the Analysys Mason report.

The lack of verification by Axon or by ECTEL of the accuracy of outputs of the geotype modelling demonstrates the lack of quality control on the suitability of the model for use in accurately determining the costs of operators in the ECTEL Contracting States.

Digicel notes that information relating to operators site locations is currently held by NTRCs and would be therefore be available to ECTEL and its consultant. The fact that this information was not used to validate the operation of the model is a material procedural deficiency.

Analysys Mason has set out a compelling case that the modelling needs to be repeated using a different and more accurate geotype source as it does not currently reflect the actual countries of ECTEL. Digicel strongly endorses this finding.

Internal Inconsistencies in Axon Modelling

Analysys Mason has identified internal inconsistencies in Axon approach between fixed and mobile model inputs. In particular Analysys Mason has identified that Axon is proposing to use different asset lives for the same class of asset in both the fixed and mobile models. The different approaches proposed in fact are skewed to advantage the fixed operators as they result in higher termination rates. In the context of the lack of competitive pressures in the fixed market this is both surprising and disappointing. In addition it indicates a lack of basic quality control by Axon on the modelling inputs. This coupled with the verifiable errors in benchmarking and other issues further undermines confidence that the Axon model is fit for purpose for the ECTEL Contracting States.

Service Mix

Analysys Mason has identified that the model assumes that all handsets are 3G compatible. This is factually incorrect as Digicel continues to sell 2G handsets in the market. This demonstrates yet another easily verifiable assumption that neither ECTEL nor its consultant has performed any validity check on.

Suitability of model for use in ECTEL Contracting States

Analysys Mason has identified that very large portions of the model are not actually operative in terms of either inputs or generating outputs. In addition Analysys Mason has identified the use of terms such as "Sultanate" which indicates that this model is likely to be a re-use of a previous model constructed by Axon. While such re-use allows some efficiencies the very large portions of the model which care not used, the disconnect between the geo data used by Axon and local geography and demographics demonstrate that the model has not been sufficiently tailored to produce accurate results which reflect the actual costs of operators in the ECTEL Contracting States.

Digicel particularly notes that as an expert body Analysys Mason has identified the difficulties that respondents would have in properly analysing and commenting on the model due to the complexity and lack of notation and explanation of the operation of its various element. Digicel had requested an extension to the response time to this consultation which reflected the complexity of the model and the difficulties in reviewing it. While ECTEL granted an extension it is Digicel's view that this was entirely inadequate and in practice undermined the validity of the consultation process.

Procedural issues

Digicel believes that the failure of ECTEL and its consultant to properly validate the model outputs and operation, the reliance on factually inaccurate information provided by the consultant and the denial of an adequate period to respondents to properly analyse and assess such a complex and poorly annotated model combine to mean that the consultation process falls short of the minimum procedure required by well established administrative law. Unless these deficiencies are addressed Digicel is of the view that the process to date is amenable to successful to review and reserves its rights in this regard.

Glide paths

Digicel wishes to comment on the method of transition from the current mandated prices to any prices resulting from the modelling exercise. In the event that the modelled price is significantly below the current price then an issue arises as to how to manage the transition between the two.

Where the change is large then it is a well recognised and widely adopted regulatory approach to use a so called "glide path" to move between the initial price and the final price with a number of interim step down prices spread out over time.

There are multiple reasons for this approach. It is worth noting the fact that reductions in wholesale Fixed and Mobile Termination rates do not immediately flow through to the retail market. They do so by the operation of competitive market pressure over time. Therefore any negative impact on consumer welfare benefit from the phased reduction of termination rate reductions are significantly ameliorated.

In addition other considerations relating to negative impacts of a step change pricing transitions must also be taken into account.

The first is the need to minimise the business disruption to the cash flow of the regulated companies which could have short term impacts on investment phasing. Positive working capital is required to ensure that a firm is able to continue its operations and that it has sufficient funds to satisfy both maturing short-term debt and upcoming operational expenses. Therefore step changes in wholesale pricing will also act to delay reductions in retail pricing as operators must protect their ability to meet their short term liabilities.

Negative impacts on cash flow from large step changes in termination rate revenues would also have downstream impacts on operator investment phasing, delaying the availability of new services to end users.

In general competitive pressure will result in retail price reduction over time to reflect the reduction in the wholesale Mobile and Fixed Termination rate reductions. However in the specific circumstances of the ECTEL contracting states there is little or no competitive pressure to be exerted on the retail pricing for fixed voice services

Digicel is of the view that regulation of MTRs is not an end in itself but is based on some calculus that sees the benefit of regulated (and in this case) lower wholesale prices passed on to end users. For fixed consumers with multiple fixed operators this occurs as cost savings on the wholesale side are traded away by competing fixed providers on the retail side. Absent functioning and effective retail competition on the fixed retail side the margin excess resulting from any reduction in MTRs will not be passed through to Consumers but will be retained by the fixed retail providers as excess or windfall profits.

In the case of ECTEL there is currently no effective retail competition in the fixed market and a steep glidepath would allow the combine Cable and Wireless/Colombus Communications entity (Flow) leverage its market power by simply retaining the benefit of MTR reductions and not passing them onto consumers. The fact that Flow is also active in the mobile market means that these excess profits can be leveraged into the mobile market damaging competition.

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The lack of competitive pressure in the retail fixed market reductions in MTR are unlikely to be promptly passed through to consumers and be retained as windfall profits by the fixed incumbent. Based on this Digicel believes that it would also be appropriate for ECTEL to adopt a multiyear glide path for MTRs spanning 3 years with equal step down increments between the current pricing and any modelled price.

By contrast because of more intense competitive pressure in the retail mobile market reductions in FTR are more likely to be passed through to consumers and a shorter steeper glide path of no longer than 1 year for Fixed Termination Rates would be justified. This is all the more appropriate as the structure of retail fixed pricing means that the high cost access element of the network is covered by separate retail access fees reducing the negative impacts of step changes in FTRs on fixed operators.

https://www.hakom.hr/userDocsImages/javnarasprava/Igor/903/Prilog%203_MTR_Glide_paths_CEE_October2011.pdf

https://www.google.com.do/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwjKiOncm4zVAhWJCD4KHTRZAO4QFggsMAA&url=https%3A%2F%2Fwww.comcom.govt.nz%2Fdmsdocument%2F7948&usg=AFQjCNHaPPqhi53cuFl8lXRyub9F3vPRWw

Conclusion

The Analysys Mason review of the ECTEL has highlighted a number of material deficiencies in the construction of model, the chosen inputs to the model and factual inaccuracies in the information which ECTEL has relied on to justify various decisions.

It has also identified that the model as currently constructed could not adequately or accurately reflect the costs of an operator in the ECTEL,

The deficiencies are so significant that in addressing them ECTEL would alter the nature of the model to such a material extent that it would require a new round of consultation on the modified model in order to meet the requirements of administrative law.

We look forward to engaging in the necessary consultation on the revised model.

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