



CABLE & WIRELESS
CAYMAN ISLANDS

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Mr. David Archbold,
Managing Director,
Information and Communication Technology Authority,
P.O. Box 2502,
3rd Floor Alissta Towers,
Grand Cayman, KY1-1104

Dear Mr. Archbold,

Re: Determination of Cost-Oriented Mobile Termination Rate

Cable and Wireless (Cayman Islands) Limited (“**C&W**”) is submitting this application pursuant to sections 68(3) of the *Information and Communications Technology Authority Law* (2006 Revision) (the “**Law**”) and 6(h) of the *Information and Communications Technology Authority (Interconnection and Infrastructure Sharing) Regulations 2003* (the “**Regulations**”), both of which require that rates for interconnection services in the Cayman Islands be “cost-oriented”. C&W submits that there is no evidence that either the “interim” mobile termination rate (“**MTR**”) between C&W and Digicel Cayman Limited (“**Digicel**”) of C\$ 0.1555 per minute or the mobile termination rate set by the July 2004 agreement among C&W, Digicel and Wireless Ventures (Cayman Islands) Limited (the “**Settlement Agreement**”) of C\$ 0.1845 per minute, are in fact cost-oriented as required by the Law and the Regulations.

By virtue of the abovementioned section 68(3) of the Law and regulation 6(h) of the Regulations and also by virtue of section 9(3)(c) and (g) of the Law, the Authority not only has the power but an obligation to ensure that the rates for interconnection services are cost-oriented and therefore in compliance with the Law. This obligation is a continuing one and is exercisable independently of any agreement which may previously have been made between licensees. Allowing non-cost-oriented rates for interconnection services, and the attendant distortion of retail markets, is also inconsistent with the Authority’s obligation under section 9(3)(a) of the Law to promote competition.

The issue of the cost-orientation of the MTR must be re-examined at this time by the Authority in particular because of the failure by the Authority to approve the MTR set out in the Settlement Agreement or otherwise resolve the issue of the MTR, and also because of two

fundamental changes in circumstances since the last time the Authority ostensibly addressed the issue, i.e. in ICT Decision 2005-6, “Decision on TeleCayman Application for Determination of Mobile Termination Rates” of 24 November 2005 (the “**Decision**”).

As the Authority knows, the history of MTRs has been contentious in the Cayman Islands. While the period leading to the Settlement Agreement was a difficult one, the years since then have been no more peaceful. Shortly after the parties to the Settlement Agreement jointly¹ filed it with the Authority, TeleCayman Limited (“**TeleCayman**”) began disputing on 6 August 2004 with C&W that it should apply to them at all. After extensive correspondence between C&W and TeleCayman over the next 13 months, TeleCayman brought the issue to the Authority on 23 September 2005 as a formal dispute under the *Information and Communications Technology Authority (Dispute Resolution) Regulations*. It was this dispute that led to the Decision. However, even before TeleCayman filed its 23 September 2005 Determination Request, TeleCayman had also been arguing that it should not have to pay the relevant third-party charges (including the third-party MTR) when C&W transited calls on TeleCayman’s behalf to that third party. C&W finally brought this issue before the Authority as a Determination Request on 2 March 2006. The Authority resolved that Determination request by its ICT Decision 2006-1 (13 July 2006), which it ultimately upheld in ICT Decision 2006-2 (27 July 2006) following a request by TeleCayman that the Authority review ICT Decision 2006-1. This did not settle the issue of MTRs, as TeleCayman then applied to the Authority for a determination that the Settlement Agreement was an anti-competitive price-fixing agreement, contrary to Part 4 of the Law. It was following these proceedings involving C&W and TeleCayman, that #

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It should be clear from the preceding that the Decision in fact determined few if any of the issues relating to MTRs in the Cayman Islands.

Cost-Orientation

The Decision arose out of a Determination Request filed by TeleCayman on 23 September 2005 asking for a new, lower MTR. TeleCayman argued among other things that the MTR set by the Settlement Agreement was not cost-oriented, as required by the Regulations. In the Decision, the Authority denied TeleCayman’s application on two grounds:

1. TeleCayman’s proposed remedy “would not substantially increase the probability that the rate would accurately reflect costs in Cayman” (paragraphs 11 to 13); and
2. A new mobile termination rate would be generated by the FLLRIC model, following completion of the FLLRIC costing methodology proceeding, anticipated at the time to be finalized during the third quarter 2006 (paragraph 14).

It should be obvious from the above that the Authority did not state that the MTR of C\$ 0.1845 per minute was cost-oriented. Rather, the Authority denied the application because of the proposed remedy, not because of the merits of the case. The very statement

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used to reject TeleCayman's proposed remedy, that it "would not substantially increase the probability that the rate would accurately reflect costs in Cayman", suggests that the Authority understands that the MTR of CIS 0.1845 per minute was (and is) not cost-oriented. C&W submits in this regard that at all times the Authority retains its statutory obligation implied in section 22(2) of the Regulations to ensure that interconnection agreements "comply with the Law, conditions of licence, relevant regulations, regulations, decisions, directives or standards and other guidelines that the Authority may prescribe."

More to the point, C&W submits that an MTR of CIS 0.1845 or indeed CIS 0.1555 is not "cost-oriented" as defined in the Regulations. While the true forward-looking termination costs of an efficient operator in the Cayman Islands will not be known until the FLLRIC process is completed, a cursory examination of costs or reference to benchmark data from other markets clearly demonstrate that any claim that a rate of CIS 0.1845 per minute is cost oriented is plainly ridiculous. This is a common problem in the Caribbean region, where MTRs have been set so high as to distort the market in favour of mobile entrants and to harm fixed operators (whether incumbent or new entrant). The most reliable recent source of comparable information comes from Trinidad and Tobago, where an independent expert arbitration panel found that MTRs should be set in the range US\$ 0.06 – 0.09 per minute (significantly less than half of the current rate in the Cayman Islands). Elsewhere, even allowing for some externality costs which would not be relevant in the Cayman Islands, European regulators are capping *rates* paid for mobile termination around the US\$ 0.10 per minute level and acknowledging that that the *costs* of mobile termination are lower still.

Capping the MTR in the Cayman Islands at CIS 0.11 per minute, with reference to C&W's adjusted FAC model (as required by the Regulations), would bring MTRs more in line with the costs of mobile termination. This would serve as an important interim step until the FLLRIC process can establish the efficient level of costs of call termination and set rates at a level which will remove current distortions.

At this point, a review of the Regulations would be useful.

The Regulations require charges for interconnection (including the MTR) to be based on a "forward-looking long-run incremental cost methodology once it is established by the Authority following a public consultative process" (section 10(1)(f)). This is clearly not practicable at the present time, as the Authority has not yet concluded the public consultative process that is supposed to lead to the FLLRIC methodology. The Regulations also provide for a mechanism for resolving disputes among licensees as to whose "sets of costs" should be used for setting interconnection charges – the Authority would determine which licensee had produced a detailed cost model that conforms to the FLLRIC methodology (section 10(11)). Again, this is not practicable at the present time, because the FLLRIC methodology, the standard to be used in such a determination, has not yet been developed.

Until the development of an approved FLLRIC methodology, the Regulations require the use of C&W's "adjusted FAC model" (section 10(2)). This model is, therefore, the only cost model recognized by the Regulations as an appropriate basis for determining interconnection rates in the Cayman Islands, until such time as the Authority concludes its FLLRIC proceeding and approves a FLLRIC methodology. C&W notes that, consistent with this

provision of the Regulations, every interconnection rate (other than the MTR) is based on that “adjusted FAC model”.²

If the MTR were to be set based on the results of the adjusted FAC model, it would be around C\$ 0.11 cents per minute.³ As a result, C&W does not believe that an MTR set at a level higher than this is “cost-oriented” as required by the Regulations.

Failure by the Authority to approve the MTR in the Settlement Agreement

The Settlement Agreement contains the following express condition:

“The Parties agree to submit this Agreement to the Authority for such approval as is required by law. In the event that such approval, for all or any part of the Agreement, is not obtained, then the entire Agreement shall be null and void.”

Upon submission of the Settlement Agreement to the Authority for approval on 27 July 2004, in accordance with this provision, the Authority in its letter dated 29 July 2004, failed to give its approval, stating that the Authority “cannot be contractually bound” by the Settlement Agreement, and “nor can it prejudice or fetter its statutory rights and obligations.” While this clearly states the position of the Authority with respect to the Settlement Agreement, it has also led to a number of the issues which have arisen since 2004, (such as the opportunities for arbitrage referred to below) which, by this application, C&W seeks resolution by requesting that the Authority determine an MTR which is cost-based and in all other respects compliant with the Law and the Regulations.

It is also clear from the express terms of the Settlement Agreement that the contemplation of the parties to the Settlement Agreement at the time was that the FLLRIC model would have been completed by 30 June 2006. This formed no small part of the basis on which the MTR was set in the Settlement Agreement. The Authority itself stated in its letter of 29 July 2004 that this was not “an unreasonable assumption”. The Authority should therefore be prepared to revisit the issue of the MTR, now that it has become clear that the not unreasonable assumptions made in July 2004 regarding the completion of the FLLRIC model have not been realized.

Fundamental Changes in Circumstances since the Decision

In the interval since the publication of the Decision, there have been two fundamental changes in circumstances which require the Authority to (re-)examine the issue of cost-orientation of the MTR.

² As stated elsewhere herein, the domestic MTR was set well above the level suggested by the adjusted FAC model. The Incoming International MTR was set below the relevant adjusted FAC model rate by operation of section 11(2) of the Regulations, because the settlement payments received from foreign carriers are not sufficient to cover the MTR and the costs of transiting and delivering the calls to mobile carriers in the Cayman Islands.

³ C&W advised the Authority as early as 10 July 2003 of the interconnection rates, including the MTR, which resulted from the “adjusted FAC model”.

- First, the completion of the FLLRIC proceeding has been unacceptably delayed beyond the dates that could or would have been reasonably expected at the time of the Decision.
- Second, arbitrage by other parties based on the MTR has emerged in the market.

Delay in FLLRIC

As noted above, the Authority depended heavily upon the completion and the results of the second FLLRIC proceeding (commenced by Consultation Document 2005-1 of 27 October 2005, “**CD 2005-1**”) in arriving at the Decision. At the time of the Decision, the record was to have closed on 26 April 2006 with the filing of reply comments. Based on the Authority’s statements in the Decision, therefore, the Authority anticipated some two to five months of analysis and deliberations prior to finalizing the costing methodology.

However, on 08 February 2006, at Digicel’s request, the Authority decided to require more of C&W than originally specified in CD 2005-1, and pushed the close of record date to 21 July 2006. This means the finalization of the FLLRIC costing methodology, and therefore of the new MTR, would be pushed back to the third quarter or end of 2006. Furthermore, even that time-line is optimistic, as the Authority’s resources with economic expertise appear to be fully engaged by the onerous economic regulatory regime imposed on C&W by Annex 5 of C&W’s Licence, and to have little additional time or resources to devote to the FLLRIC proceeding. In other words, parties will have to wait a year or more after the Decision for the basis for that Decision to materialize.

Digicel has also made comments that clearly suggest that it may undermine the purpose and process of the FLLRIC proceeding, leading to further delays. For example, in its response on 2 June 2006 to C&W Interrogatories on the FLLRIC modeling, Digicel stated “the FLLRIC model should help to inform and develop the future direction of rates but given the arbitrariness of any cost model it should not be the sole determinant.” More recently, #

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Finally, C&W notes that the 10 July 2003 Agreement among C&W, the Governor in Cabinet of the Cayman Islands and the Authority, had anticipated that the FLLRIC methodology could be fully implemented in two years, in other words, by July 2005. At the time, C&W believed this time frame was aggressive yet achievable. Unfortunately, despite C&W’s efforts, the combined effects of Hurricane Ivan, Authority delay and Digicel requests and objections, have already resulted in an 18-month (if not longer) delay in implementing a FLLRIC methodology.

Given that the two bases⁴ for the Decision, which supposedly addressed the question of cost-orientation of MTRs in Cayman, are either suspect or not forthcoming in a timely manner, C&W submits that the Authority must turn its mind again to this issue. To be clear, the

⁴ Ref. the “Cost Orientation” section of this application.

effects of this continuing delay are substantial, and have and continue to result in significant losses and expenses for C&W and for the general public. It is increasingly clear that, based on a cost-oriented model, the MTR should not exceed a figure of C\$ 0.11 per minute. We strongly believe that the final FLLRIC-based figure will be lower than that.

Arbitrage

Second, other licensees in the Cayman Islands have taken advantage of the interconnect policy vacuum created by the Authority to engage in arbitrage in the retail market. This arbitrage is hampering the development of fair and healthy competition in telecommunications in the Cayman Islands.

For example, C&W has learned that Digicel is offering two retail fixed-to-mobile (“FTM”) prices to local businesses, C\$ 0.15 per minute for calls from Digicel fixed lines to Digicel mobile phones, and C\$ 0.20 per minute for calls from Digicel fixed lines to other mobiles. It should be immediately obvious that the retail FTM price of C\$ 0.15 is well below the Settlement Agreement MTR of C\$ 0.1845 per minute, and even below the “interim” MTR of C\$ 0.1555 per minute set in January 2004, even though the MTR should be a component of the FTM price. It is also important to note that the “off-net” FTM price for calls to third-party mobiles (where Digicel must make an MTR out-payment) is set slightly above the highest of the possible MTRs in the market (C\$ 0.1845 per minute). If Digicel’s costs of terminating mobile calls were in fact C\$ 0.1845 per minute, then it would be offering its “on-net” FTM calls well below cost and its “off-net” calls just above cost, if at all, and certainly not high enough to cover the “losses” from on-net calling.⁵ It is irrational to believe that a commercial entity like Digicel, with shareholders and bondholders expecting a return on their investments, would price its services in this manner. This creates a strong presumption that Digicel’s own costs of terminating calls on its mobile network are far below the C\$ 0.1845 MTR, and likely even below the “interim” MTR of C\$ 0.1555.

In other words, Digicel is using the difference between its actual costs of terminating mobile calls and the artificially high MTR that the Authority has allowed to remain in place, to gain an artificial advantage in the retail marketplace. This, in turn, is seriously distorting competition in the market for fixed services in the Cayman Islands

Similarly, C&W understands that TeleCayman is offering to business customers a retail FTM price of C\$ 0.16 per minute. This is possible because TeleCayman only pays # # per minute for calls to C&W’s mobile network, and as a result its average cost of mobile termination is probably low enough for this price to be above cost. However, TeleCayman pays this lower MTR to C&W only because the Authority did not address the question of cost-orientation in the Decision and deferred matters until the development of a FLLRIC-based MTR. As noted above, the development of a FLLRIC-based MTR has been delayed and its actual date is unknown. In the mean time, TeleCayman is free to leverage the unfair commercial advantage afforded to it by the Authority’s inaction in the Decision. This is also seriously distorting competition in the market for fixed services.

⁵ If Digicel’s true costs of mobile termination were C\$ 0.1845 per minute, then Digicel would be losing more than C\$ 0.0345 per minute on every “on-net” FTM call.

C&W reminds the Authority that, unlike Digicel and TeleCayman, it cannot respond to these competitive pressures and lower its own retail FTM prices to reflect its own costs of mobile termination. As the Authority is aware, Part 3 of Annex 5 of C&W's Licence requires that C&W set its retail FTM price above a cost floor based on "interconnect" rates.

If those "interconnect" rates were cost-oriented, then C&W would be able to respond to competitive pressures (albeit with greater or lesser delays created by the Authority's regulatory procedures). However, where those "interconnect" rates are set well above actual costs of mobile call termination, as is the case here, Annex 5 forces C&W to price its retail FTM services at artificially high levels. C&W is, therefore, in the unsustainable position of being forced to compete against the cost-oriented FTM prices of its competitors while its own FTM services are priced at artificially high levels based on artificially high MTRs advocated by some of those very competitors.

The Authority Must Intervene

C&W submits that this issue is not one that can be the subject of bilateral inter-carrier negotiations. Rather, it needs to be squarely and directly addressed by the Authority.

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suggests that C&W and Digicel are so far apart in their respective positions that further bilateral discussions on this subject with Digicel are unlikely to produce a resolution. Second, the past two years of continual disputes between C&W and TeleCayman over various MTR-related issues is clear evidence that an MTR agreed between C&W and Digicel will have repercussions beyond that bilateral relationship, and will not necessarily be accepted by all other telecommunications licensees in the Cayman Islands.

We have a situation where a very public and damaging dispute between C&W and Digicel looks inevitable. To avoid that situation, C&W proposes that the Authority immediately institute a proceeding to determine whether an MTR set at C\$ 0.1845 per minute, C\$ 0.1555 per minute, C\$ 0.11 per minute or indeed some other rate (such as C\$ 0.864 per minute) is "cost-oriented" as required by the Law and the Regulations. C&W suggests that this cost-based MTR be effective as of 1 September 2006, as that is the start date of the most recently completed inter-carrier billing period. C&W is copying this letter to all other telecommunications licensees with telephony services licences, in order to ensure all relevant parties are advised of the issues and to avoid any unnecessary delay. If the Authority acts expeditiously, it should be possible for the record of the proceeding to close by mid-December 2006, with a determination to be issued shortly thereafter.

Yours sincerely,
Cable & Wireless (Cayman Islands) Ltd.

"Signed"

Rudy B. Ebanks
Chief Regulatory & Carrier Relations Officer

c.c. [Redacted letter only]
Minister for Communications, Works and Infrastructure
Blue Sky Communications Ltd.
Blue Sky Wireless Ltd.
E-Technologies Ltd., trading as CaymanOne
Digicel Cayman Limited
Infinity Broadband Ltd.
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