

ICTA FLLRIC Public Consultation
Response to Interrogatories
REDACTED

REQUEST: ICTA, 25 June 2004

DATED: 30 July 2004

ITEM: ICTA-CW 1-1

QUESTION: Has C&W implemented an incremental cost-based model – such as a FLLRIC, LRIC, or TSLRIC model – in any other jurisdiction where it operates? If so, please provide all such models, including the models’ user manuals and user documentation.

REPLY: C&W only operates in the Cayman Islands. Further, generally, a FLLRIC, LRIC, or TSLRIC model from another jurisdiction would contain private and confidential information. However, in an effort to provide the ICTA with additional examples of LRIC models that have been adopted in other jurisdictions, we provide the documentation that a C&W group company has agreed to share with us in confidence. This documentation is currently before its regulator for approval. At such time that the regulator approves documentation--or a version of it--we expect it to be made public. We ask the Authority to hold the documentation in its entirety in confidence until such time as we may replace it with the public version. A redacted version of the documentation is not being provided for the public record at this time, as we expect to provide the public version in due course.

[Confidential Document Redacted]

REDACTED VERSION

ICTA FLLRIC Public Consultation
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REQUEST: ICTA, 25 June 2004

DATED: 30 July 2004

ITEM: ICTA-CW 1-2

QUESTION: Confirm or deny the following statement:

C&W believes that the burden of proof resides with C&W to demonstrate that its cost studies comport with FLLRIC principles and guidelines.

REPLY: Phase 1 of this public consultation is intended to, "identify generally accepted economic and 'best practice' regulatory costing principles to be adopted by Cable & Wireless in a FLLRIC model." It is our understanding that C&W will have to demonstrate compliance with these principles and guidelines in the cost studies prepared by C&W in Phase 2 of this proceeding.

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ITEM: ICTA-CW 1-3

QUESTION: Provide documentation for all engineering rules C&W plans to use for the FLLRIC analysis.

REPLY: C&W does not maintain documentation for any engineering rules beyond those submitted to the ICTA confidentially in the biannual “Development Plans.” The biannual development plans include network performance indicators and Key Performance Indicators (KPI) maintained by C&W. These KPIs (grade of service, coverage, etc.) provide one set of parameters that can be used as a starting point for dimensioning the network.

Examples of the kinds of rules that will be used for bottom-up dimensioning rules can be found in literature cited in response to WVCIL-CW 1-6, for example, #11 and #27 (sections 4.3, 5.4). The dimensioning of the mobile network will require specification of such technical assumptions as spectrum, carrier bandwidth, carriers per sector, geographic traffic distribution, cell capacity, coverage, cell sectorization, grade of service as well as the subscriber and traffic volumes.

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-4

QUESTION: What adjustments does C&W propose to make in order to account for inflationary and deflationary pricing trends for capital equipment and labor?

REPLY: Please see response to WVCIL-CW 1-19.

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-5

QUESTION: Paragraph 1.3 states that the “cost modeling should therefore be structured in such a way that the cost of a sufficient set of network elements can be estimated.” Provide a complete list of every network element and every network component for which the company proposes a cost element be estimated.

REPLY: There are two distinct concepts that must be differentiated in answering this question: (1) there is data that will be obtainable from the model, such as cost levels for different network elements, and (2) there are services for which rates will be determined based on outputs from the model (i.e., services that are made up of network elements).

We anticipate the list of network elements for which data will be available as a result of completing the network models will include:

Model	Major Category	Individual Element
Fixed	Access	Local Loop
		RLU – Lines
	Switching	Remote Line Unit (RLU) – Traffic
		Local Exchange (LX)
		International Switch Centre (ISC)
		Value added Services (VAS) Equipment
		RLU-LX
Transmission		LX-LX
		LX-ISC
		LX-VAS
Retail Costs for Network Services		Billing
		Marketing & Sales
		Bad Debt
		Customer Services
Other		Eg. Interconnect Specific

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Mobile	Subscriber	
		Mobile Switching Centre (MSC) – Subscriber
		Home/Visitor Location Register (HLR / VLR) – Subscriber
	Switching	Base Transceiver Station (BTS)
		Base Station Controller (BSC)
		Mobile Switching Centre (MSC)-traffic
		VAS (Voicemail)
		HLR/VLR (traffic)
	Transmission	BTS
		BTS to BSC
		BSC to MSC
		MSC to MSC
		MSC-HLR/VLR
	Retail Costs for Network Services	Billing
		Marketing & Sales
		Bad Debt
		Customer Services
	Other	Eg. Interconnect Specific

On the basis of these network elements, and the immediate requirements for interconnection pricing, the completion of the FLLRIC model will result in service prices for the following services:

Fixed Network Services:

- PSTN termination
- National transit
- Operator Services access
- Emergency Services access

Mobile Network Services:

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- Mobile termination
- National transit
- Operator Services access
- Emergency Services access

The fixed model will also provide the cost of access (See DIG-CW 1-15). That is, it will provide the cost basis for determining the existence of an access deficit. Finally, the network element and other costs generated in the model will provide cost inputs for future imputation tests.

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ITEM: ICTA-CW 1-6

QUESTION: Define and provide examples of both directly attributable operational expenditures and indirectly attributable operational expenditures.” Does C&W believe both types of expenditures are relevant for determining price floors? If so, please explain why. If not, please explain why not?

REPLY: Directly assignable costs vary with the level of a specific activity, and it is therefore always possible to identify the “cause” of that cost (i.e., the activity) and to attribute all of the cost to that activity. An example is the right-to-use fee for software that is only used to provide a single type of telephone service.

Indirectly attributable costs are shared by two or more activities of a firm. Stopping an indirectly attributable activity of a particular service will not avoid these costs altogether, only the complete cessation of all activities associated with the costs will avoid the shared costs. An example is the enhanced services network that, when installed, can be used to provide a variety of enhanced services; however, not providing any one service in that group will not avoid any portion of the cost of that network.

C&W’s position is that price floors should be set based on the marginal costs of the firm, since pricing at any level at or above marginal costs ensures a positive contribution to the firm’s profits (or reduces its losses). A marginal cost based test considers the marginal revenues and costs the firm faces as a result of its activities in the relevant market, and therefore excludes any indirectly attributable costs. There are a number of ways to measure marginal costs, and important concepts include (1) defining the relevant increment, (2) whether “avoidable” or “incremental” costs are relevant, and (3) the relevant timeframe (that is, short-run or long-run). C&W’s position is that the increment should be the total demand, “marginal” should be defined as incremental, and the relevant timeframe is the long-run. In this manner, C&W’s position is that price floors should be set based on Long Run Incremental Costs (LRIC), which excludes indirectly attributable (i.e., shared and common) costs.

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ITEM: ICTA-CW 1-7

QUESTION: What specific processes and practices does C&W envision establishing to ensure that the transparency principles are satisfied?

REPLY: C&W considers that transparency will be achieved with the creation of user manuals, user documentation, documented assumptions, and use of a transparent software product. Transparency means that the logic and algorithms of the cost study are revealed to and understandable by the parties and the regulator. C&W intends to develop the cost model in Excel or Access, which does not require the same level of programming skills as other models that are developed in code-based languages such as Mathematica or Pascal.

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ITEM: ICTA-CW 1-8

QUESTION: Will C&W provide the model, user manuals, and user documentation to other parties, subject to an agreed upon non-disclosure agreement?

REPLY: C&W expects to provide the user manuals, user documentation, and a model with dummy data to other parties, subject to an agreed upon non-disclosure agreement. Company-specific data that is considered confidential and proprietary will be replaced in the model with dummy data.

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ITEM: ICTA-CW 1-9

QUESTION: Does C&W accept that an actual quotation from a major international supplier is verifiable?

REPLY: See response to DIG-CW 1-4

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-10

QUESTION: Would C&W agree that current and future prices are more relevant to a new entrant than “historic” prices?

REPLY: Please see response to DIG-CW 1-4

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-11

QUESTION: Under the scorched node assumption how does C&W deal with the issue of having switch sites outside the Cayman Islands?

REPLY: Under the scorched node assumption, and modeling C&W's long run incremental costs of its mobile network, the modeler would include all costs arising from use of the switch located outside the Cayman Islands. Generally, if the modeler is attempting to develop long run incremental costs of a hypothetical efficient entrant, the modeler is free to locate a switch in the most efficient manner possible. However, given the current regulatory policy regarding new entrants, we are proposing that the mobile model assume that the switch is located in Cayman.

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-12

QUESTION: If the model is supposed to represent efficient market entry in Cayman, would using the scorched node approach, in the case of C&W, require an assumption that a new entrant purchase a license to operate in another jurisdiction?

REPLY: A model intended to measure the long run incremental costs of an efficient entrant in Cayman would not require the purchase of a license to operate in another jurisdiction.

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-13

QUESTION: Consistent with C&W's proposal that the FLLRIC model incorporate a forward-looking view of costs, what planning horizon(s) does C&W propose be adopted (1 year, 3 years, other)? Please explain the rationale for the planning horizon(s) selected.

REPLY: C&W proposes that an economically reasonable planning horizon be adopted for purposes of the FLLRIC model. The planning period should reflect the actual planning horizon adopted by engineers who maintain the network today. C&W proposes that the FLRRIC model incorporate a planning horizon of three to five years for the fixed network, as this coincides with the planning horizon recently adopted for deployment of the Company's new switch technology. This planning horizon will produce a realistic picture of C&W's expected costs, and is long enough to capture a sufficiently representative range of investments decisions.

For the mobile network, C&W proposes that the recently adopted dual band GSM technology establish the planning horizon. In this the horizon is much shorter-- two years.

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ITEM: ICTA-CW 1-14

QUESTION: Does C&W have any formal or informal guidelines, practices, or methodologies for “bringing forward historic costs”? If yes, please provide all documentation related to those guidelines, practices, or methodologies.

REPLY: Please see response to WVCIL-CW 1-10

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-15

QUESTION: Explain in detail the “indexation” method referred to in this paragraph.

REPLY: Please see response to WVCIL-CW 1-11

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Response to Interrogatories
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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-16

QUESTION: Explain in detail the “MEA” methodology referred to in this paragraph.

REPLY: The absolute method is one of two methods for bringing historical costs forward. When determining the value of an historical asset today, an analyst using the absolute method would observe the price of a modern equivalent asset (MEA) and use that price as the current value of the historical asset. An MEA would have a structure similar to the historical asset and have the equivalent productive capacity, which could be built using modern materials, techniques, and design.

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ITEM: ICTA-CW 1-17

QUESTION: Provide any “engineering or statistical studies” undertaken, past or present, to estimate the cost volume relationship.

REPLY: Please response to WVCIL-CW 1-12

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REQUEST: ICTA, 25 June 2004

DATED: 30 July 2004

ITEM: ICTA-CW 1-18

QUESTION: What specific statistical techniques does C&W plan to use in performing the “engineering or statistical studies” required to compute the cost-volume relationship?

REPLY: Please response to WVCIL-CW 1-16

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-19

QUESTION: Define and explain what is meant by “dimensioning.”

REPLY: Please see response to DIG-CW 1-7.

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Response to Interrogatories
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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-20

QUESTION: How does C&W propose “routing factors” be calculated?

REPLY: Please see response to DIG-CW 1-7.

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REQUEST: ICTA, 25 June 2004

DATED: 30 July 2004

ITEM: ICTA-CW 1-21

QUESTION: Provide any support that C&W relied on for the statement “In most countries where bottoms-up models are implemented for interconnection services, top-down analysis is carried out in tandem or parallel for interconnection services.”

REPLY: A sample of countries in which this occurred is provided below.

We enclose a study that suggests three of five European markets that had implemented bottom-up cost modeling by early 2002 also implemented top-down as well. Although we are not familiar with the cases of Germany and Netherlands (which appear in text as the only “pure” bottom up), we would be surprised if no reference was made to top-down data for, at the very least, “sanity” checks. In addition to those listed in this document, we know of the following cases:



costaccountingmetho
dologies.pdf

- In the UK Competition Commission Calls to Mobile enquiry, several of the UK mobile operators chose to submit top-down models in addition to the bottom-up LRIC model developed by the Regulator. When LRIC was originally introduced by Oftel in the UK, British Telecom developed a TD LRIC model and Oftel developed a BU LRIC model. Oftel then reconciled these two models.¹
- In Romania, the fixed and mobile operators have been required to develop top-down models. The Regulator is developing a bottom-up LRIC model which it will then reconcile to the top-down models produced by the operators.
- In Belgium, the Regulator developed a BU LRIC model that applies to both fixed and mobile operators. The

¹ Reconciliation of the Top-Down and Bottom-Up Incremental Cost Models. Oftel. December 1996

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operator developed a TD LRIC model that is then combined with the BU model to produce a hybrid model.

- In Hong Kong a top-down approach is used for calculating retail costs with a bottom-up model being the primary approach to determine interconnection costs²
- In Canada a top-down approach is used estimate operational costs and overheads with a bottom-up approach principally used for network costs.
- In Australia, a bottom-up network model was used to calculate interconnect charges. However, in support of its undertaking, Telstra submitted its estimates of the costs of providing the costs of termination based on its regulatory accounts.³

² Ovum (1999), Implementing Cost Based Interconnection, page 65

³ Ovum (1999), Implementing Cost Based Interconnection, page 65

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ITEM: ICTA-CW 1-22

QUESTION: Define and explain the concept “‘organic’ nature of network growth.”

REPLY: The “organic” nature of network growth refers to the actual manner in which networks grow. One of the disadvantages of a bottom-up model is that in many cases it is interpreted as an opportunity to model a “hypothetical” network where facilities are instantaneously deployed with the most efficient technology in the most optimal network configuration. A rational telecommunications carrier, however, grows its network in a more “organic” manner. A rational carrier will gradually replace existing facilities with new technology over time, and will expand capacity and modify its network structure incrementally to serve growing and changing demand. A LRIC model, whether bottom-up or top-down, *should* account for the real-world, “organic” nature of network growth, but one of the disadvantages of a bottom-up model is that in many cases it does not. In the US, for example, the federal regulator is considering precisely this question in its review of TELRIC methodology and has tentatively concluded that, “TELRIC rules should more closely account for the real-world attributes of the routing and topography of an incumbent’s network in the development of forward-looking costs.”⁴

⁴ Federal Communications Commission, "Notice of Proposed Rulemaking," WC Docket No. 03-173, 15 September 2003, paragraph 52.

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ITEM: ICTA-CW 1-23

QUESTION: Explain the purpose of the proposed reconciliation of network capital costs with current asset values of existing plant. Explain why the proposed reconciliation is necessary in forward-looking cost analyses.

REPLY: The purpose of reconciliation is to provide some assurance that the bottom-up model accurately reflect actual costs that would be incurred by an efficient operator, and that the theoretic design of the network does not stray from the other relevant factors influencing cost in a specific market. Note we are not suggesting that a full top-down LRIC model be built to reconcile the results of the bottom-up model with a current costing of C&W accounts. In fact, we should qualify paras. 4.16 and 4.34 under the C&W proposal for network design. Full reconciliation of assets will not be possible to the extent that the assets of the modeled network differ from the type of assets found in the actual network. A straightforward comparison of many asset costs may not be feasible.

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-24

QUESTION: How does C&W propose to model efficiently incurred shared and common costs? What steps will be taken to ensure that these costs are forward-looking and representative of an efficient carrier?

REPLY: It is C&W's position that C&W's current shared and common costs are representative of the forward-looking costs of an efficient carrier. C&W has not been subject in practice to traditional rate of return regulation, and absence of such regulation has provided strong incentives for C&W to make efficient decisions about network investment – such as when to replace existing facilities with new technology – and about operating expenses. C&W's incentive to be efficient has only been reinforced as we have faced rapidly increasing competition from mobile operators who are taking both minutes and customers away.

However, demonstrable inefficiencies can be identified using appropriate benchmarking analysis (e.g., ratios of line per employee), statistical analysis (e.g. stochastic frontier analysis), mathematical techniques (e.g. data envelope analysis), direct measurement of costs, and time and motion studies. Costs can be adjusted downwards if such inefficiencies are identified.

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-25

QUESTION: Confirm or deny that the mark-up for fixed and common costs will be based on forward-looking, efficiently incurred, fixed and common costs. If confirmed, please explain in detail how forward-looking fixed and common costs are to be identified. If denied, please explain in detail the rationale for the denial.

REPLY: Please see response to ICTA-CW 1-24

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REQUEST: ICTA, 25 June 2004
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ITEM: ICTA-CW 1-26
QUESTION: Define “relevant planning horizon.”
REPLY: Please see response to ICTA-CW 1-13

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Response to Interrogatories
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REQUEST: ICTA, 25 June 2004

DATED: 30 July 2004

ITEM: ICTA-CW 1-27

QUESTION: What assumptions does C&W propose making in the FLLRIC model to account for spare capacity?

REPLY: C&W proposes to model the spare capacity that an efficient operator would maintain in its network to account for growth and maintenance within the construct of various real-world constraints of an operational network such as the so-called “lumpiness” of some network facilities. Account should also be taken for an efficient level of resilience.

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-28

QUESTION: Does the company propose there be instances where the FLLRIC model assumes spare capacity sufficient to handle growth over the relevant planning horizon?

REPLY: Yes. The model should assume spare capacity to handle growth over the relevant planning horizon.

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-29

QUESTION: Does the company propose there be instances where the FLLRIC model assumes spare capacity sufficient to accommodate all possible future demand for the life of the plant?

REPLY: Yes. The model should assume spare capacity sufficient to accommodate all possible future demand for the life of the plant in the instance where the life of the plant is equal to the planning horizon.

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-30

QUESTION: Provide all supporting documentation for the statement that
“current demand provides a reasonable estimate for volume over
the long term.”

REPLY: Please see DIG-CW 1-27.

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-31

QUESTION: Provide all supporting documentation for the statement that “Activity-Based-Costing is widely accepted as the best way to assign costs to products and services and minimize the share of common and fixed costs.”

REPLY: Activity-Based Costing (ABC) was developed as an approach to measuring costs that minimizes the effects of cross-subsidization. Robin Cooper and Robert Kaplan pioneered the method in the late 80s and early 90s in a number of articles appearing in Harvard Business Review, Management Accounting, and Journal of Cost Management. The following website contains numerous resources on the method including the benefits of ABC costing as they relate to minimizing the share of common and fixed costs.

<http://www.offtech.com.au/abc/Home.asp>

In addition, numerous accounting texts, such as, “Accounting: Text and Cases,” Robert N. Anthony, James S. Reece, and Julie H. Hertenstein, IRWIN, Ninth Edition (1995) explain why ABC minimizes common and fixed costs by directly attributing more costs to specific activities.

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-32

QUESTION: Provide all documentation compiled by the company that endorse the ABC approach, in the context of forward-looking costing.

REPLY: Please see response to ICTA-CW 1-31

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-33

QUESTION: Provide all relevant documentation and analysis relied upon in calculating the WACC of 13.5%.

REPLY: The WACC of 13.5% was a figure previously adopted by the Authority for the purposes of C&W's Licence (see paragraph 53(f) of Annex 5).

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-34

QUESTION: If not already provided in interrogatory #33, provide all relevant documentation and analysis relied upon in arriving at the assumed risk free rate, gearing ratios and equity risk premium, cost of debt, and the beta.

REPLY: There is no such documentation. Please see our response to ICTA-CW 1-33.

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Response to Interrogatories
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REQUEST: ICTA, 25 June 2004

DATED: 30 July 2004

ITEM: ICTA-CW 1-35

QUESTION: With respect to the WACC of 13.5%, please provide the following:

- i. Any comparative analysis performed by C&W regarding WACC for other telecommunications companies;
- ii. Any data gathered by C&W on the WACC for other telecommunications companies;
- iii. A listing of all telecommunications companies of which C&W is aware that have a WACC capital equal to or higher than 13.5%; and
- iv. Any further analysis performed by C&W since the 2003 determination referenced in Section 3.52, regarding its WACC.

REPLY: Please see response to WVCIL-CW 1-20

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REQUEST: ICTA, 25 June 2004

DATED: 30 July 2004

ITEM: ICTA-CW 1-36

QUESTION: Specifically identify the sources C&W will use to determine the unit investment costs of various network components.

REPLY: C&W will use vendor quotes, current cost accounting techniques, and other publicly available information to determine forward-looking investment costs of assets.

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REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-37

QUESTION: Provide comprehensive details of the “pre-existing allocation tool.”
Would C&W agree that merely applying equiproportional mark-up to the costs discussed in this section is liable to be more objective and less open to debate than the manner currently proposed by C&W?

REPLY: Please see response to DIG-CW 1-18

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REQUEST: ICTA, 25 June 2004

DATED: 30 July 2004

ITEM: ICTA-CW 1-38

QUESTION: Can C&W please provide a comprehensive list of the asset lives that it is proposing? What is the basis for setting these asset lives?

REPLY: Please see response to DIG-CW 1-19

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REQUEST: ICTA, 25 June 2004

DATED: 30 July 2004

ITEM: ICTA-CW 1-39

QUESTION: Provide the major categories of assets which it deems to be of low value or short life. How long is “short”?

REPLY: Please see response to DIG-CW 1-20

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Response to Interrogatories
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REQUEST: ICTA, 25 June 2004

DATED: 30 July 2004

ITEM: ICTA-CW 1-40

QUESTION: Provide a listing of “relatively short” lived assets for which C&W plans not to adjust capital prices.

REPLY: Please see response to WVCIL-CW 1-21

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Response to Interrogatories
REDACTED

REQUEST: ICTA, 25 June 2004

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ITEM: ICTA-CW 1-41

QUESTION: Describe in detail the “measures” that “may be necessary to adjust for demonstrable inefficiency.”

REPLY: Please see response to WVCIL-CW 1-22

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Response to Interrogatories
REDACTED

REQUEST: ICTA, 25 June 2004

DATED: 30 July 2004

ITEM: ICTA-CW 1-42

QUESTION: Define what constitutes a “demonstrable inefficiency.”

REPLY: Please see response to WVCIL-CW 1-23

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REDACTED

REQUEST: ICTA, 25 June 2004

DATED: 30 July 2004

ITEM: ICTA-CW 1-43

QUESTION: With what firms does C&W intend to compare its efficiency ratios in an effort to detect “demonstrable inefficiencies”?

REPLY: Please see response to WVCIL-CW 1-24