

**CABLE & WIRELESS (CAYMAN ISLANDS) LIMITED  
COMMENTS ON**

**PUBLIC CONSULTATION ON  
POLE ATTACHMENT RESERVATION FEES, PERMITS APPLICATION  
PROCESS AND CHARGING PRINCIPLES  
(Ref: ICT Consultation 2016-2)**

By E-mail to: [consultations@icta.ky](mailto:consultations@icta.ky)  
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## I. INTRODUCTION

Cable and Wireless (Cayman Islands) Limited, d/b/a Flow (“**Flow**”) is pleased to provide the following comments and responses to the consultation questions presented in the proceeding initiated by ICT Consultation 2016-2 – pole attachment reservation fees, permits application process and charging principles (the “**Consultation**”) published by the Information and Communications Technology Authority (the “**Authority**”) on 27 April 2016.

## II. CONSULTATION QUESTIONS RELATING TO THE APPROPRIATENESS OF THE RESERVATION FEES RELATING TO THE ATTACHMENT OF COMMUNICATION CABLES TO CUC’S ELECTRICITY POLES

**QUESTION A1:** Provide your view as to whether or not the reservation fees, being the Quarterly Reserved Space Payment, are appropriate as part of DataLink’s relevant charging principles relating to the attachment by Licensees of communication cables to CUC’s electricity poles.

**Flow response to QUESTION A1:** Flow understands that during the “Build-Out” period, in which reservation fees are applicable, the Attacher’s assigned space on a CUC electricity pole is guaranteed to the Attacher for its exclusive use, whether the Attacher is using that space or not (see, Consultation document, ¶160). Flow believe a reservation fee described as such is appropriate, in principle.

Economic theory state that whenever an asset is used or reserved for a specific purpose it can create an opportunity cost. An opportunity cost is defined as present-value dollar amount of the best alternative foregone.

Therefore, while Flow cannot comment on the appropriateness of the magnitude of the fee, it does conclude that, based on economic theory, charging a reservation fee is appropriate where a provider believes the reserved asset can generate a positive return in an alternative use.

**QUESTION A2:** If the reservation fees, being the Quarterly Reserved Space Payment, are appropriate as part of DataLink’s relevant charging principles relating to the attachment by

Licenseses of communication cables to CUC's electricity poles, provide your view as to whether such charges should apply to all the Attachers of communication cables.

**Flow response to QUESTION A2:** Flow believes that in the circumstances described in its response to Question A1 a reservation fee is appropriate, and can serve a legitimate economic purpose. That is, where an exclusivity arrangement imposes an opportunity cost on a provider, it is appropriate for that provider, in this case DataLink, to recover such costs from the cost causer, in this case the Attacher.

Note, also, the converse: if opportunity costs are zero, then there would not appear to be an appropriate basis for the provider to charge the Attacher a reservation fee. This circumstance would appear to explain why a charge for "Reserved Space" is not articulated in DataLink's contract with Flow (see, Consultation document, ¶163). In particular, the period during which Flow built out its network pre-dates market liberalization; Flow was the only legally sanctioned provider of communication services at that time and, therefore, there were no remunerative opportunities foregone (i.e., opportunity costs incurred) by DataLink or CUC from reserving pole space to Flow during Flow's "Build-Out" period.

Finally, the contemporary issue of whether today a provider *should* charge an Attacher or all Attachers a reservation fee is for the provider to decide, and should not be determined by regulatory edict.

**QUESTION A3:** If your view is that the reservation fees, being the Quarterly Reserved Space Payment, should not apply to all the Attachers, provide the reason and justification for not applying such charges to all the Attachers.

**Flow response to QUESTION A3:** Please see Flow's response to Question A2 above.

**QUESTION A4:** If your view is that the reservation fees, being the Quarterly Reserved Space Payment, are appropriate as part of relevant charging principles relating to the attachment of communication cables to CUC's electricity poles, provide your view as to what appropriate pricing formula should apply for such charges, including reasons as to why such proposed pricing formula is appropriate.

**Flow response to QUESTION A4:** The formula should generate a charge comparable to the expected foregone revenue or return the reserved pole space would generate in its most lucrative alternative use. In other words, were the space not reserved for the exclusive use of

the Attacher, what is the highest return the provider could generate from an alternative use of that space? This amount is the reservation fee a provider should be permitted to charge an Attacher.

**QUESTION A5:** Provide your view on any other issues relating to the operation of the “*Reserved Space*” and the “*Quarterly Reserved Space Payment*” in the pole sharing agreements, including, but not limited to, the reference to the “*Total Minimum Annual Payments*”.

**Flow response to Question A5:** Flow has repeatedly asked Datalink to explain the basis for setting the Reserved Space Fee at 35% of the Annual Attachment Fee. To date, the only explanation DataLink has offered is to state that “the reserved space fee is not relevant to Cable & Wireless.” Datalink’s response is somewhat less than satisfactory. First, it does not actually address the question, which sought an understanding of how the 35% figure was determined.

Second, it is disingenuous to respond, when asked, that the “fee is not relevant”, especially as everything in the proposed Agreement suggests that the fee is in fact relevant. This raises the obvious question of why Datalink would have included these provisions in the proposed Agreement if that were in fact the case, and strongly suggests that it is an arbitrary figure wholly unrelated to Datalink’s costs. In the circumstances, this fee would be contrary to the Regulations and should be denied.

**QUESTION A6:** Provide your view on the appropriate approach to the possible reimbursements by DataLink of the payments made by Infinity and Logic in relation to the “*Total Minimum Annual Payments*”, as discussed in paragraph 166 above.

**Flow response to QUESTION A6:** The premise of the discussion on reimbursements in paragraph 166 is that DataLink’s reservation fee “creates inefficiencies” and “prevent[s] the promotion of competition.” Flow disagrees with this premise and does not believe the imposition of a

reservation fee is per se inefficient. For these reasons, Flow believes the Authority's proposed approach to reimbursements may be unnecessary.

**QUESTION A7:** Provide your view on any other matters you consider relevant to this consultation.

**Flow response to QUESTION A7:** Flow has no other issues with regard to DataLink's reservation fees that it wishes to address at this time.

### **III. CONSULTATION QUESTIONS RELATING TO THE PERMIT APPLICATION PROCESS, INCLUDING MAKE-READY WORK, FOR THE ATTACHMENT OF COMMUNICATION CABLES TO CUC'S ELECTRICITY POLES**

**QUESTION B1:** Provide your view on what is the relevant process for issuing permits for the attachment of communication cables to CUC's electricity poles, including what you consider to be a reasonable time period in which an entity such as DataLink should process the permit applications.

**Flow response to QUESTION B1:** At this time, Flow does not object to the Authority's proposed processes for issuing permits or the allotted time required to complete each process.

**QUESTION B2:** Provide your view on whether or not the proposed amendments to the permit application process as set out at paragraph 182 above are appropriate for issuing permits for the attachment of communication cables to CUC's electricity poles.

**Flow response to QUESTION B2:** At this time, Flow does not object to the Authority's proposed amendments to the permit application process as set out in paragraph 182 of the Consultation document.

**QUESTION B3:** Provide your view on whether or not the Attachers should be allowed to perform relevant tasks relating to the *Pre-Permit Survey* and *Make-Ready Work*, in cases where timelines in the pole attachment process are not met by DataLink.

**Flow response to QUESTION B3:** At this time, Flow does not object to the option allowing Attachers to perform their own Pre-Permit Survey and Make-Ready Work, in the event DataLink does not first meet its obligations in a timely manner.

**QUESTION B4:** Provide your view on whether or not the Attachers should be allowed to use qualified contractors for *Pre-Permit Survey* and *Make-Ready Work*, in cases where timelines in the pole attachment process are not met by DataLink, and if so, provide detailed specification of the relevant process for the use of such qualified contractors.

**Flow response to QUESTION B4:** At this time, Flow does not object to the option allowing Attachers to use qualified contractors for Pre-Permit Survey and Make-Ready Work, in the event DataLink does not first meet its obligations in a timely manner.

**QUESTION B5:** Provide your view on whether or not the principles governing the permit application process, including any relevant *Make-Ready Work*, as noted and discussed in paragraphs 178 to 195 above, should be standardised and applied across all the existing, and future, pole sharing agreements.

**Flow response to QUESTION B5:** At this time, Flow does not object to the proposed principles or the uniform application to all agreements of the permit application procedures discussed in paragraphs 178-195 of the Consultation document.

**QUESTION B6:** Provide your view on whether or not the relevant sections in the article referring to *Make Ready Work/Installation*, as specified in the existing pole sharing agreements, need to be amended and, if so, provide your view on the proposed amendments in the relevant article referring to *Make Ready Work/Installation* for each of the existing pole sharing agreements, as discussed in paragraphs 191 to 195 above.

**Flow response to QUESTION B6:** Flow does not identify any further amendments to the sections regarding Make Ready Work/Installation that are required, at this time.

**QUESTION B7:** Provide your view on any other matters you consider relevant to this consultation.

**Flow response to QUESTION B7:** Flow has no other issues with regard to the proposed Pre-Permit Survey or Make-Ready Work requirements that it wishes to address at this time.

#### **IV. CONSULTATION QUESTIONS ON CHARGING PRINCIPLES RELATING TO THE ATTACHMENT OF COMMUNICATION CABLES TO CUC'S ELECTRICITY POLES**

**QUESTION C1:** Provide your view on whether or not the current pricing formula for calculation of the *“Annual Attachment Fee”* is appropriate, in particular whether it leads to cost-oriented rates for pole rental services and whether it is in compliance with the FAC costing methodology.

**Flow response to QUESTION C1:** Flow has many specific concerns with Datalink's pricing formula, which we articulate in great detail in our response to Question C2 below. Furthermore, Flow calculates two alternatives to DataLink's pricing methodology, which we present in our response to Question C5.

With regard to the formula's compliance with costing principles, it is clear from DataLink's own statements that its formula is not compliant. Per Datalink's March 2015 statement, DataLink states the charges are based on the *“value of service”* and not incremental costs. This is not a lawful basis for setting pole attachment prices under the Regulations. Further, Datalink is a monopoly provider of pole attachment services on Grand Cayman. Companies like Flow have no other option than to use poles managed by Datalink. In this context, where there are no competitive constraints on the price being charged, *“value of service”* pricing inevitably leads to unreasonable and excessive monopoly pricing.

Such overcharging based on a monopoly situation is the very harm to competition and consumers that the Regulations are intended to prevent. The Authority, therefore, needs to review Datalink's prices and pricing methodology carefully, and ensure that going forward they comply with the Regulations.

**QUESTION C2:** Provide your view on whether each of the relevant components of the pricing formula for calculation of the *“Annual Attachment Fee”*, including but not limited to:

- ***“Net Cost of Bare Pole”*** - defined as *“the net book value of poles as of the most recent annual financial statements of the Owner Utility divided by the number of poles as of the most recent fiscal year end”*,
- ***“Space Factor”*** – defined as an *“allocation of the total pole height based on the actual space used by the Attachment plus an allocated portion of the unusable space on the*

*pole*”, including the following parameters which are used for calculation of the relevant “*Space Factor*”:

- “*Unusable space on the pole*”,
  - “*Space occupied by the Attachment*”,
  - “*Number of Attachers*”; and,
  - “*Weighted average height of all poles*” or “*Weighted average height of wood poles*”
- “**Annual Carrying Charge Rate**” or “**20 year Levelized Fixed Charge Rate**”,

is appropriately specified or determined in the relevant pole sharing agreements.

**Flow response to QUESTION C2:** Flow has a number of concerns with DataLink’s pricing formula. These concerns include the following issues:

1. the Net Cost of Bare Pole is overstated;
2. the Space Factor calculation is misspecified and requires adjustment;
3. the pricing formula double counts the impact of inflation;
4. the charge for overhead in the pricing formula is excessive;
5. the calculations of the Maintenance and Administration elements of the carrying charge are flawed;
6. the cost of capital in the pricing formula is misstated and excessive; and
7. the pricing formula appears to vary across Attachers in a manner that is discriminatory.

### **1. *The Net cost of Bare Pole is overstated***

DataLink calculates the net cost of bare pole to be \$900, which we believe significantly overstates DataLink’s true net costs. Based on information provided to CWC in quarterly invoices from CUC, the net cost of bare pole varies by the height of the pole, as follows:

- 35 foot wooden pole = \$199.45;
- 40 foot wooden pole = \$371.20; and
- 45 foot wooden pole = \$1007.91.

The majority of CUC poles in the Cayman Islands, with the exception of certain poles in the George Town area, are 35 feet in height. Assuming the \$900 net cost figure cited by DataLink is based on an average cost of all installed poles or poles utilized by Attachers, it unclear how DataLink arrives at such a high figure—almost equal to the cost of the subset of CUC’s tallest, most expensive poles.



Based on our review of the most recent quarterly invoices received from CUC, the average height of installed poles is approximately 39 feet, and the average cost of installed poles is approximately \$533. Therefore, we believe DataLink's calculations overstate the true net cost of bare pole by 69% or \$367.

## ***2. The Space Factor calculation is misspecified and requires adjustment***

The Space Factor is a key element of Datalink's price-setting methodology, as it allocates to Attachers a portion of the "common" costs of CUC's poles. If this factor is inappropriately or erroneously calculated, an excessive amount of that common cost will be borne by telecommunications Attachers, who will in other words be subsidizing CUC at the expense of ICT users in the country.

We believe there are several elements of the Space Factor formula that are problematic. First, the "unusable space" is not in fact 24.5 feet. DataLink has indicated to Flow that the unusable space was calculated by adding the underground space to the ground clearance space. However, while the ground clearance might be 18.5 feet, the diagram in Appendix C to the draft Master Pole Joint Use Agreement is clear that the underground element is 5 to 5.5 feet, depending on the height of the pole, not 6 feet. This means the actual "unusable space" is 23.5 to 24 feet.

Overestimating the size of the "unusable space" being shared means Attachers will be forced to make a disproportionate contribution. In this case, it appears telecommunications users should be contributing to the cost of 23.5 to 24 feet of pole, not to 24.5 feet.

Second, the space occupied by Flow is not actually 12 inches, as the formula indicates, insofar as the contract specifies that we are to attach at the bottom of our allocated space. This makes operational sense, as the top of our allocated space is the same as the bottom of the next Attacher's space and there could be challenges if two Attachers placed their attachment in such close proximity. However, this means that Datalink's allocation of 12 inches to us, 6 inches to Logic, 6 inches to Datalink and 12 inches to C3 is not accurate. The 3-foot communications space is in effect allocated among 4 Attachers meaning each Attacher has at most 9 inches (36 inches divided by 4).

Miscalculating the size of the space actually occupied by each telecommunications user will result in telecommunications users paying an erroneous share of the costs of the poles. Each telecommunications user can actually occupy no more than 9 inches, not 12 inches, of the CUC pole. This unfairly advantages users who are assigned costs for 6 inches at the expense of users

who are assigned costs for 12 inches.<sup>1</sup> Nine (9) inches, therefore, is the figure that should be used for the “space occupied” element of the space factor formula.

Third, the “2/3” factor applied in calculating the Space Factor is inappropriate. The effect of this fraction is to allocate 2/3 of the cost of the “unusable space” to the users of the Communications Space as a whole. However, it is arguable that none of the unusable space should be allocated to Attachers because none of the unusable space is incremental to there being a Communications Space or caused by Attachers being on the pole. That 23.5 to 24 feet would be necessary and “unusable” even if there were no Communications Space because it is necessary in order to provide the necessary clearance for CUC’s use of the utility poles.

Assigning an excessive portion of the “unusable space” to telecommunications users as a group means Attachers will be paying a disproportionate contribution towards the common costs of the pole. If standard cost-causation principles are applied, as suggested by regulation 6(g) of the Regulations,<sup>2</sup> none of the costs of the unusable space should be assigned to telecommunications users. Flow has recommended to DataLink (in a February 2016 letter) a factor of 3 / 38.1 (or 7.87%) as being more appropriate. Flow notes that Datalink did not object to this in a subsequent March 2016 response to this recommendation, despite having the opportunity to do so and to justify its 2/3rds allocation factor.

Making these three adjustments to the Space Factor would result in a significantly more reasonable and cost-oriented pole attachment price. Flow recommends below, however, in its response to Question C5 that a different, simpler and fairer methodology be applied to determine pole attachment prices.

### ***3. The pricing formula double counts the impact of inflation***

The price-setting methodology appears to double count the impact of inflation. First, the net cost of a bare pole reflects the impact of inflation. Even though Datalink describes its pole inventory as “historical”, the actual inventory changes significantly over time. For example, in early 2014, Appendix C to the draft Master Pole Joint Use Agreement stated CUC had approximately 16,500 poles. The attachment to Datalink’s March 2016 letter states CUC had 17,221 poles at the end of December 2014. Finally, by late 2015, Appendix C to Agreement indicated CUC had 17,475 poles.

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<sup>1</sup> Alternatively, if each of the four telecommunications users are assigned the costs associated with 12 inches, Datalink will be recovering in total more than the actual costs associated with the 36-inch Communications Space. If this is the case, telecommunications attachers would be subsidizing CUC and electric customers.

<sup>2</sup> “[C]osts shall be borne either by the requestor or the responder or both based on whether their respective requests and compliance with those requests cause those costs to be incurred...”

Each of these new poles added to CUC's inventory would have been purchased at current, not historical, prices, in other words, at prices reflecting inflation. Further, under the terms of the current Master Pole Joint Use Agreement between Flow and Datalink, Flow pays Datalink for the cost of any poles replaced during the year. These replacement poles would also be paid for at current prices, i.e. reflecting the impact of inflation. This means that the value of CUC's pole inventory determined each year would reflect the impact of inflation.

Second, the CUC annual carrying charge rate would also reflect the impact of inflation. CUC's annual administrative and maintenance costs included in the annual carrying charge rate would necessarily change from year to year due to inflationary pressures, among other influences.

#### ***4. The charge for overhead in the pricing formula is excessive***

Flow objects to the formula's recovery of overhead expense. First, the formula appears to double count overhead expense. In particular, there is a Management & Overhead charge of 20% and a separate charge for Administrative costs of 2.2% in the carrying charge. Datalink has explained the existence of these two different cost elements as being the result of the "need" to create a separate subsidiary (Datalink) to manage the communications space on CUC's poles. This "need" was in fact driven by CUC's desire to ensure its electricity-related revenues were not taxed under the *Information and Communications Technology Authority Law*, and similarly that its telecommunications-related revenues were not taxed under electrical legislation and licenses.

However, this is a completely artificial structure which is driven by tax planning considerations and not operational or business considerations. There is no evidence that Datalink is a separate business organization, with its own staff and assets fully separate from those of CUC. CUC has in effect "created" costs which did not exist before ("Management & Overhead") or which were already included in CUC's General and Administrative costs, merely by incorporating a new subsidiary. While Flow is sympathetic to CUC's tax planning efforts, it is inappropriate to create artificial costs and then to pass them on to customers of its pole attachment services.

Second, those costs are patently excessive. Datalink's methodology asserts that Datalink's "management and overhead" costs are equal to 20% of the cost of CUC's poles per year. Given that the net cost of a CUC pole is said to be CI\$ 887, and that CUC has some 17,475 poles, this would mean that Datalink's "management and overhead" costs are approximately CI\$ 3.1 million per year. This is astonishingly high for an organization which does not appear to have its own staff separate from the staff of the parent company, which does not actually maintain the poles itself, and which has a three (3) customers other than itself (Flow, Logic and C3).

These "costs" are also extremely high in relation to CUC's. On December 31, 2015, CUC's total General and Administrative costs for 2015 were US\$ 9.1 million, or approximately CI\$ 7.5 million.

It is impossible that Datalink, an organization with three customers and limited operational responsibilities, should have management and overhead costs that are 41% of those of its parent company, CUC, with its significantly greater operations and business.

It is also noteworthy that CUC's G&A and overall operational expenses have been reasonably consistent over the last few years. The following table is derived from CUC's Annual Reports for 2009 through 2014:

<b>Year ending Dec 31</b>	<b>General and Administrative</b>	<b>Total Operating Expenses</b>
2015	9.1	164
2014	8.8	206
2013	8.9	201
2012	9.6	200
2011	9.3	193
2010	8.4	154
2009	9.6	135
2008	6.8	135

All figures in millions of USD

Datalink was licensed by the Authority in March 2012. If Datalink's USD\$ 3.75 million in "costs" were in fact real and had been reassigned from CUC to Datalink when the latter became operational, one would have expected to have seen the impact on CUC's reported costs. Yet CUC's costs did not change to that degree between 2011 and 2012, and CUC's total operating expenses in fact increased between those two years.

The conclusion is inescapable: Datalink does not in fact incur "management and overhead" costs of 20% of the net cost of the poles per year, and therefore should not be entitled to "recover" them via its pole attachment price.

***5. The calculations of the Maintenance and Administration elements of the carrying charge are flawed***

Administration expense (2.2%) and Maintenance expense (1.3%) are two separate elements in the carrying charge to the pricing formula. The percentages are calculated as CUC totals, divided by the NBV of CUC's total assets

Flow's concern is that as the assets used as divisors diminish in value due to age, these two elements will increase, even though Flow's use of the assets has not changed. This approach is patently unreasonable. For example, should CUC accelerate depreciation of its assets, or write down their asset values for reasons unrelated to our attachment activities, this would have a

significant impact on the Attachment Fee. Under the Regulations, the prices paid for access to infrastructure should be based on the incremental costs of providing that access, not on irrelevant factors such as CUC's decision to accelerate depreciation of unrelated assets.

In any event, it is not clear how CUC administration and distribution costs have any relevance to the use of the pole network by Attachers. CUC's need for utility poles exist irrespective of any use by telecommunications Attachers, and therefore those administration and distribution costs were "caused" by CUC's needs, not by our needs. Charges imposed on Attachers should be related only to any additional costs incrementally generated by our activity of attaching to these poles.

**6. *The cost of capital in the pricing formula is misstated and excessive***

Datalink has consistently failed to provide a substantive answer to why the formula applies a measure of Return on Equity ("ROE") of 15%, rather than of Weighted Average Cost of Capital ("WACC"). Despite being asked several times, Datalink's only response has been that they have "chosen" it as their "element of profitability". This answer is a problem on many levels.

First, Datalink's pole attachment service is an infrastructure service as defined by the Regulations. Under regulation 6(h) of the Regulations, prices for infrastructure sharing services:

*Shall be cost-oriented and shall be set to allow the responder to recover a reasonable rate of return on its capital appropriately employed, all attributable operating expenditures, depreciation and a proportionate contribution towards the responder's fixed and common costs.*

Use of ROE as a measure of cost of capital is not reasonable, as required by the Regulations. To the extent that Datalink has used capital, it has used debt in addition to equity capital. Its return should, therefore, be based on its WACC and not on a return on equity.

Nor is an arbitrary 15% ROE reasonable, particularly as Datalink has deployed little or no capital of its own, that is, has taken no risk with its own capital. In a response to Flow's third question (see below), Datalink identified a number of "risks" that are, for the most part, in fact risks borne by CUC ("The risk of damage to the pole due to additional attachments, risk of lengthy legal consultation regarding contractual obligations, the risk of liability incurred when Licensee do not follow safety regulations and attachment requirements relating to weight, height and number of attachments."). In these circumstances, given that the capital and risks are those of CUC, the return used by Datalink in setting its prices should be the WACC of CUC.

Despite specifically being asked, Datalink has consistently refused to provide its WACC. However, CUC notes in its last two Annual Reports that its WACC was 7.4% for both years.<sup>3</sup> Flow submits that the appropriate figure to be used by Datalink in determining its own prices cannot exceed 7.4%.

In its March 2015 response, Datalink attempts to justify its approach by arguing that electricity rate payers should not be subsidizing the cost of CUC's telecommunications business. Flow notes that at no time was it asking for a subsidy from CUC's electricity customers. However, just as CUC's electricity customers should not be subsidizing Datalink's telecommunications business, Datalink's telecommunications customers should not be subsidizing CUC. Datalink's 15% ROE approach would, clearly, lead to that perverse result.

Further, even a more reasonable WACC of 7.4% would result in Datalink's telecommunications customers subsidizing CUC's business. CUC states in its 2014 Annual Report that

*Rate base is the value of capital upon which the Company is permitted an opportunity to earn a return. The value of this capital is the average of the beginning and ending values for the applicable financial year of: fixed assets less accumulated depreciation, plus the allowance for working capital, plus regulatory assets less regulatory liabilities.<sup>4</sup>*

CUC's utility poles are included in CUC's fixed assets, which means CUC is already generating a return on those assets through its regulated Return on Rate Base ("RORB") of 7.4%. Even Datalink does not deny this. It admitted in its March 2015 letter that "The cost of CUC's assets are recovered through its rates to consumers". Allowing Datalink to generate an additional return, whether an ROE of 15% or a WACC of 7.4%, means CUC will be earning an extra profit on those same utility pole assets through its telecommunications subsidiary. If CUC is already covering the full costs of the utility poles and generating a return through its electricity rates, it is difficult to come to any other conclusion than that Datalink's telecommunications customers are subsidizing CUC. Flow questions whether this is reasonable, as defined in the Regulations, and recommends that Datalink's return be limited to its own assets.

#### **7. The pricing formula appears to vary across Attachers in a manner that is discriminatory**

Datalink's approach to establishing Attachment Fees appears to be discriminatory, and biased against us when compared to other operators.

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<sup>3</sup> See page 12 of CUC's 2014 and 2015 Annual Reports, available at <https://www.cuc-cayman.com/annual-reports>.

<sup>4</sup> Ibid.

The approach applied to us is to multiply the “net cost of a bare pole” by four factors (space, CUC carrying charge, management & Overhead, and inflation). The space factor is based on a fraction involving 4 variables, and the carrying charge is the sum of four different percentages.

A review of the Master Pole Joint Use Agreement between Logic (WestTel) and Datalink available on the ICTA website suggests a similar approach was applied, although it is difficult to be absolutely certain given the level of redaction. However, the weighted average height of poles is slightly different than that applied in our case, and Logic is said to be using only 6 inches of the pole when, as noted above, that is not really the case.

The Master Pole Joint Use Agreement between C3 (Infinity) and Datalink available on the ICTA website is also highly redacted. However, the approach to setting the price for that company appears to be rather different from that applied to us or to Logic. The “net cost of a bare pole” is multiplied by only two factors, instead of four (they appear to be the space factor and the carrying charge – which means C3 is not being charged the inflation and management & overhead factors that we have objected to above). While the carrying charge calculation methodology appears roughly consistent (the actual figures are redacted so it is not possible to be absolutely certain), in the case of the space factor, the number of Attachers and the weighted average height of the poles appears different from the figures applied to us.

The fact that Datalink appears to have decided to apply a different pricing methodology to our attachment than to C3’s attachments in particular is of concern to us. The two elements not applied to C3 (inflation and management & overhead) are inappropriate, as well as material, and would result in lower prices applied to C3 than to us. This does not appear to be consistent with Datalink’s obligations under the Regulations to have non-discriminatory prices. The solution, of course, is to exclude those two factors from the calculation of our prices.

**QUESTION C3:** Provide your view on what charging principles should be implemented in order to ensure that the costs relating to “*Make-Ready Work*” are cost-oriented and in compliance with the FAC costing methodology.

**Flow response to QUESTION C3:** Please see Flow’s response to Question C2 above. Flow does not have further comment on this issue, at this time.

**QUESTION C4:** Provide your view on whether or not pole attachments charges relating to attaching and maintenance costs should take into account any necessary adjustments based on

the relevant position of each Attacher in the Communication Space, and if so, what charging principles should be adopted.

**Flow response to QUESTION C4:** Please see Flow's response to Question C2 above. Flow does not have further comment on this issue, at this time.

**QUESTION C5:** Provide your view on any other issues relating to the appropriate charges for and charging principles applied to the attachment of communication cables to CUC's electricity poles.

**Flow response to QUESTION C5:** In this response Flow presents

A recurring concern raised by Flow in its discussions with Datalink regarding its proposed Agreement is that the prices proposed by Datalink do not comply with the Regulations. Datalink has consistently chosen not to address this concern, but this does not alter the fact that Datalink must comply with the Regulations. Therefore, in response to this question Flow presents two alternative price-setting methodologies which we believe address the deficiencies in Datalink's approach and bring it more into compliance with the Regulations. The first of these is a proposal made to DataLink in February 2016, and the second is a modification of Datalink's own methodology to address its most egregious problems.

### **1. Flow's Methodology**

In order to advance the discussions between the two companies, Flow had proposed in a February 2016 letter to DataLink an alternative methodology which would be compliant with the Regulations. This is reproduced below:

*The Regulations are clear that the costs of infrastructure sharing services ought to be reasonable, cost-oriented and based on the incremental costs of providing the services. The price-setting methodology proposed by Datalink does not satisfy those prescribed criteria. However, the following one does.*

*Annual Attachment Fee per Attachment = Net Cost of Bare Pole X Space Factor  
+ Allocation of Datalink's costs*

*Where:*

*A. Space factor = [Space Occupied + (3/38.1 x Unusable Space/Number of Attachers)]*



Pole Height  
Useful Economic Life of Pole

1. The unusable space on the pole = 23.5 feet.
2. The space occupied by the Attachment = nine inches.
3. The number of Attachers = four.
4. The weighted average height of all poles = 38.1feet.
5. Useful Economic Life of Pole = 20 years

B. Allocation of Datalink's costs:

$$\frac{\text{Datalink's approved annual audited costs} * / \text{Number of Poles}}{\text{Number of Attachers}}$$

\* select approved costs to be discussed

Flow's alternative approach would correct a number of the deficiencies in Datalink's methodology, including the miscalculation of the unusable space, the error in the space actually available to Attachers and the unfairness between Attachers in the calculation of their space, and the inclusion of irrelevant costs. Datalink, however, responded in March 2016 that it was not willing to review its methodology:

*We note your suggested formula and thank you for your efforts in this regard, we note however that while Datalink manages the administrative areas related to pole attachment, the maintenance of the poles is completely managed by CUC as is any relevant engineering and physical work to ensure safety. The formula included in the contract was included after consulting with experts in this field and after reviewing the typical methodology utilised in Canada and the USA. As discussed in our meeting on March 3rd, DataLink are willing to revisit the standards to ensure the contract reflects progressions in the industry, however, DataLink stands by the choice of this methodology as a starting point that offers transparency and fairness of applicability. The two aforementioned regions bring years of experience to a market that from a comparison standpoint is relatively new to Grand Cayman.*

Datalink's answer simply highlights the unreasonable nature of their pricing methodology. The Regulations require Datalink's prices to be based on the forward-looking incremental costs of Datalink's activities, not on the activities provided by another company. Yet Datalink admits that a major portion of the Attachment Fee, i.e. maintenance of the poles, is managed by CUC. As was discussed earlier, this cost is already recovered by CUC through CUC's rates for CUC's services.

At most, therefore, Datalink and its customers should be responsible for the incremental cost of maintaining the 3 feet used by Attachers. In this regard, Flow notes that its proposed methodology is actually slightly more favourable to Datalink, as it includes a reasonable and proportionate contribution to the costs of maintaining the poles, even though technically-speaking none of the "unusable space" is in fact incremental to the use of the pole made by the Attachers. That same "unusable space" would be required by CUC for its electricity needs, whether or not there were any Attachers or indeed any communications space.

A drawback in Flow's proposed methodology is that it still requires discussion on which of Datalink's costs should be considered. It would also require Datalink to provide annual audited financial information, something they may be reluctant to do as a wholly-owned private subsidiary of CUC. For these reasons, it may be more effective in the short term to correct the deficiencies in Datalink's approach.

## ***2. Corrections to DataLink's Approach***

As discussed previously, Datalink's approach to setting pole attachment prices contains many errors and deficiencies, including:

- i. Double-counting inflation;
- ii. An error in calculating the Unusable Space;
- iii. An error in calculating each attacher's Occupied Space;
- iv. An unreasonable space allocator;
- v. An excessive return on capital; and
- vi. An excessive Management and Overhead cost.

Most of these can be corrected and some of these are also discussed earlier. Specifically, Flow proposes that

- i. The inflation factor be removed from the equation, as inflation is already accounted for in the net book value of the utility pole assets and in CUC's costs;
- ii. The Unusable Space be set at 24 feet, as Datalink's evidence is that the buried portion of the pole is between 5 and 5.5 feet and the portion of the pole between the ground and the start of the Communications Space is 18.5 feet;
- iii. Each Attacher's space be set as 9 inches, reflecting the space actually available to them;

- iv. The Space Allocator be set as either 3 / 38.1 (reflecting the Communications Space share of the average pole) or as 3 / 14.1 (reflecting the Communications Space share of the “usable” portion of the pole); and
- v. Set the return on capital to be no more than CUC’s Return on Rate Base of 7.4%.

These five changes alone will ensure a fairer allocation of the “common” costs of the pole among the communications users and the electric utility. They allow Datalink recover “a reasonable rate of return on its capital appropriately employed, ... depreciation and a proportionate contribution towards ... fixed and common costs” as specified by the Regulations.

The last requirement of the Regulations is that the price should permit Datalink to recover “all attributable operating expenditures”. Because Datalink has not provided information on its actual operating expenditures (i.e. those expenditures which are not CUC’s, which are recovered through the contribution to fixed and common costs), it is not possible for Flow to include them directly in the price-setting methodology. Instead, Flow proposes to retain Datalink’s Management and Overhead factor for the time being. This approach is second-best, as it determines Datalink’s costs as a proportion of the cost of the pole and not on Datalink’s actual costs, but it is a practical approach.

Applying these changes to Datalink’s methodology results in the following:

- A. The Annual Attachment Fee will be calculated by the Owner Utility based on the following formula:

$$\begin{aligned} \text{Annual Attachment Fee} &= (\text{Net Cost of Bare Pole} \\ &\quad \times \text{Space Factor} \\ &\quad \times \text{CUC’s annual carrying charge rate} \\ &\quad \times \text{Management \& Overhead} + 1 \text{ (set at 20\%)} \end{aligned}$$

- B. The Net Cost of a Bare Pole equals CI \$886.97, based on the net book value of poles as of the most recent annual financial statements of the Owner Utility divided by the number of poles as of the most recent fiscal year end.
- C. For purposes of this Agreement, the calculation of net book value of poles excludes any costs associated with the Electric Utility equipment attached to the poles.

- D. For purposes of this Agreement, the net book value of poles and the number of poles in this calculation shall include all poles. Therefore, the Net Cost of Bare Pole shall be calculated based on all the Owner Utility's poles.
- E. The Space Factor represents an allocation of the total pole height based on the actual space used by the Attacher plus an allocated portion of the unusable space on the pole in accordance with the following formula:

Space factor =

$$\frac{[\text{Space Occupied} + (3/14.1 \times \text{Unusable Space}/\text{Number of Attachers})]}{\text{Pole Height}}$$

- F. The Space Factor is 5.3%, as derived from the following values for the Owner Utility as of the most recent fiscal year end:
  1. The unusable space on the pole = 24 feet.
  2. The space occupied by the Attacher = nine inches.
  3. The number of Attachers = four.
  4. The weighted average height of all poles = 38.1feet.
- G. The Annual Carrying Charge Rate is 14.7%, based on the sum of the following component percentage values:
  1. Administrative = 2.2%, based on total administrative and general expenses for the fiscal year divided by the net book value of total assets as of fiscal year end, as reported in the most recent annual financial statements of the Owner Utility.
  2. Maintenance = 1.3%, based on total distribution expenses for the fiscal year divided by the net book value of distribution system assets as of fiscal year end, as reported in the most recent annual financial statements of the Owner Utility.
  3. Depreciation = 3.8%, based on the annual depreciation expense of all poles divided by the net book value of all poles as of the fiscal year end. Depreciation and net book value for purposes of this calculation exclude any amounts associated with the Electric Utility equipment attached to the poles.
  4. Return on Equity = 7.4%, based on the Owner Utility's most recent RORB

This results in a fee of \$8.34 per Attacher per pole per year. With four Attachers, this would generate \$33.36 per pole per year for Datalink. It should be noted that this is a fee per Attacher, not a fee per Attachment. Datalink's methodology does not actually determine costs on a per-

attachment basis and therefore cannot and should not be used to determine a per-attachment price.

Flow also recommends that the price not be reviewed annually. Attachers benefit from having relatively stable prices, as it permits them to plan over a medium- to long-term horizon. The Regulations also set forward-looking prices as the standard for prices of interconnection and infrastructure sharing services. Flow recommends, therefore, that the pole attachment price be reviewed only every five (5) years, consistent with the five-year period for joint inventory of poles.

**QUESTION C6:** Provide your view on whether or not DataLink should be subject to the same terms and conditions relating to the pole sharing arrangements for attachment of its communication cables to CUC's electricity poles, including the relevant charging principles, as they apply to all the other Attachers.

**Flow response to QUESTION C6:** Flow believes that DataLink should be subject to the same terms and conditions relating to the pole sharing arrangements for attachments as all other Attachers. In fact, per the non-discrimination requirements in the Regulations, Flow believes that the uniformity of these terms and conditions to all Attachers, including DataLink, is a requirement.

**QUESTION C7:** Provide your view on any other matters you consider relevant to this consultation.

**Flow response to QUESTION C7:** Flow has no other issues that it wishes to address at this time.

## V. CLOSING REMARKS

70. Kindly send any communication in relation to this consultation to:

**Jayne Woollard**

[jayne.woollard@lime.com](mailto:jayne.woollard@lime.com)

+1 345 926 5533 (M)

+1 345 815 3550 (O)

**David Cox**

[david.cox@cwc.com](mailto:david.cox@cwc.com)

+1 758 485 7500 (M)

+1 758-453-9484 (O)

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