



CABLE & WIRELESS
TURKS & CAICOS ISLANDS

LIME

Submission to the Telecommunications Commission

on Price Caps Regulation in the Turks and Caicos Islands

14 November 2008

Cable and Wireless (TCI) Limited (hereinafter referred to as “**LIME**”) is pleased to provide the following comments in response to the “Price Caps Consultation Document” published by the Turks and Caicos Islands Telecommunications Commission (“**Commission**”) on 30 September 2008. We will respond to each of the Commission’s questions in turn below.

Question 1: Please comment on the objectives set out above including, as may be applicable, suggested modifications to the listed objectives and/or alternative objectives.

LIME agrees that incentive based regulation in the form of a price cap has a number of important advantages over traditional rate of return (“**ROR**”) regulation. In particular, price cap regulation is better able to mimic the outcome of a competitive market in that it provides the regulated firm an incentive to minimise its costs by increasing productivity, whilst ensuring that consumers also benefit in the form of lower prices. Ultimately, the success of a price cap regime can be judged by how quickly it can be removed and the market mechanism left to work to ensure that firms supply the goods and services that consumers want, at prices that allow firms to make a normal rate of return, whilst also encouraging innovation and investment in new goods and services, either by existing firms in the market or through new entry.

The Commission suggests the price cap regime would have six objectives:

- i) to foster the availability of reliable, affordable and high quality telecommunications services throughout the country;
- ii) to provide the service provider incentives to improve efficiencies, invest in new plant and equipment and be more innovative;
- iii) to provide the service provider with a reasonable opportunity to earn a fair return;
- iv) to ensure that consumers share in the expected efficiency gains through lower prices;
- v) to foster competition in the TCI telecommunications market; and
- vi) to minimize regulatory procedures to the greatest extent possible keeping with the above-noted objectives.

On the whole, LIME believes that the specific objectives that have been identified by the Commission reflect this overarching aim of mimicking as far as possible the outcomes that would be seen in a competitive market. For example, the first objective of fostering the availability of reliable, affordable and high quality telecommunications is exactly what one would hope to see resulting from a competitive market so it is entirely appropriate to include this as a specific objective of the price cap regime.

The price cap also needs to be designed in such a way that the second objective can be met, namely to provide the regulated firm with the economic incentive to reduce its operating costs through improving efficiencies, whilst also encouraging investment in

new plant and equipment. To this end, the third specific objective of ensuring that the price cap allows the regulated service provider with a reasonable opportunity to earn a fair return will be absolutely crucial.¹ Indeed, this objective will also help to ensure that the fourth specific objective, of ensuring that consumers will benefit from any efficiency gains through lower prices, can be met. Imposing costly, burdensome regulation on a firm will have the opposite effect.

With respect to the fifth objective of the price cap, namely to foster competition in the TCI telecommunication market, this will be dependent on the exact nature of the price cap constraint. If the constraint is set too tightly such that prices are at or very close to cost, then this could actually deter new entry by equally efficient firms. Of course, entry by a firm that is more efficient than the regulated service provider could still be possible.

Furthermore, there may be other ways to foster competition in particular services rather than relying on the price cap mechanism. For example, an effectively administered competition law regime would ensure that firms would have the right incentives to behave in a fair, competitive way as they will understand that if they were not to do so, they would face punitive fines and also potentially suffer adverse reputational effects.

Finally, and with respect to the final objective of minimizing regulatory procedures to the greatest extent possible, LIME believes this will be an important feature of the price cap regime in TCI. Price cap compliance issues need to be as simple and straightforward as possible in order to keep the regulatory burden on all parties to an absolute minimum. The precise design and structure of the price cap will be key to this, and LIME will comment further on this in its response to Question 11 below. The Commission should also

- avoid onerous in-period (i.e. over the course of the Price Cap Regime Period) reporting of regulatory service profitability,
- choose reporting requirements that minimise the complexities arising from bundling, discounting and promotions, and
- the processes for notifying any price changes related to price cap services, and for regular compliance reporting, should be as streamlined as possible.

¹ We note that some of the Consultation Document's wording raises some questions as to whether the Commission's approach to determining the variables of the price cap index will capture this objective. In particular, the I factor is said to be "designed to permit the service provider to recover...some of its unavoidable annual input price changes." We do not agree with this statement. Overall the price cap index should be designed to permit the service provider to recover *all* its unavoidable annual input price changes. What costs are not to be permitted to be fully recovered are those that *are avoidable* through efficiency gains. LIME does not raise this point as a main point in the body of its response as we believe that this may be more of a word choice issue than a substantive difference in policy viewpoint.

Question 2: Please provide an assessment of the performance of the Initial Regime based either on the proposed price cap objectives set out in Chapter 2 or, if preferred, on an alternative basis.

In LIME's view, the Initial Regime has been a success, and has achieved most of the objectives of the Commission for the New Regime, as listed in the response to the previous question:

- First, although we do not believe basic access service earns a reasonable rate of return, the existence of the choice of various access and calling packages has meant that LIME has been able to achieve a level of service revenue capable of reliably maintaining existing service levels, while at the same time offering consumer a range of affordable price points.
- With respect to service provider incentives, the interim nature of the Initial Regime has created a degree of uncertainty that has put a question mark over the business case for investing in next generation access technology. In other words, it has not been clear whether the Commission would allow the Company to earn a fair rate of return on new investment in the country.
- In terms of providing LIME an opportunity to earn a fair rate of return, we believe that the Initial Regime has provided that opportunity overall, but not necessarily with respect to specific services.
- With respect to allowing consumers to share in expected efficiency gains through lower prices, we believe the Initial Regime has achieved this: in real terms, all prices have decreased in TCI.
- In terms of competitive entry, the Initial Regime strongly encouraged competitive entry into the TCI telecommunications market such that normal competitive processes, and not regulation, could reduce prices to consumers.
- Finally, the regulatory compliance burden associated with the Initial Regime was proportionate to the size of the TCI market and to LIME's resources.

It is one of the unfortunate ironies of this proceeding that it is likely to result in a far more burdensome regulatory regime than the current regime, but is not likely to better achieve the Commission's objectives than the Initial Regime.

Question 3: Please comment on the general approach the Commission should adopt for the purpose of establishing the New Regime including, but not necessarily, limited to the guiding principles, objectives and/or practices and the application of the principle of proportionality.

LIME believes it will be important to ensure that the New Regime is based on best international practice but also that it is appropriate and proportionate for a jurisdiction the size of TCI. LIME believes that it will be important to be clear from the outset of the objectives of the price cap as this will enable the performance of the price cap to be reviewed as objectively as possible. LIME refers to its specific comments on these objectives in response to question one above.

A proportionate approach will require the design of the price cap itself to be as simple and straightforward as possible as this will ensure that the regulatory burden on both LIME and the Commission is minimised. By contrast, a complex price cap will only increase the burden – and therefore the costs – of the price cap to the regulated firm. These costs will ultimately feed through to the prices that consumers have to pay.

Question 4: Please comment on the appropriateness of the Principal Pricing Constraint, as proposed in Equation #A.

LIME believes that the specification of the Equation A is appropriate and consistent with international best practice. We give our comments on the detail of the index below under Question 6.

Question 5: Please comment on the appropriateness of the formula for the calculation of the PCI, as proposed in Equation #B.

We believe that the specification for the price cap index is consistent with international best practice. We give our comments on the individual components of the index below under Questions 7, 8 and 19.

Question 6: Please comment on the appropriateness of the formula for the calculation of the API, as proposed in Equation #C.

Again, we believe that the formula set out in the document is appropriate and consistent with international best practice. One of the most important conceptual elements here is that the formulation “carries over” the API from year-to-year within the price cap period. This effectively allows the regulated firm to create “headroom” for subsequent years in the price cap when implementing price decreases earlier than required. Or, put another way, by carrying the API from one year to the next, the proposed price cap regime does

not discourage early price reductions. This is clearly to the benefit of consumers in the TCI.

We do not have a conceptual issue with the rest of the formula. However, in terms of practical implementation, we believe that the choice of how the W's and P's are to be reported is crucial to determining how burdensome the compliance requirement will be for the regulated firm. Three particular implementation issues stand out.

First, we note that only if a rate element has associated revenue does it "count" in the calculation, i.e., if W is zero, the rate element does not contribute to the API. There are therefore two general approaches to reporting rate elements in the API calculation:

1. All rate elements are reported whether they have associated revenue or not, and
2. Only those rate elements that have associated revenue are reported.

The first approach is much more burdensome than the second to implement as it requires the regulated firm to determine in advance all the rate elements it currently *could* be selling. This is quite difficult as it means system interrogations to determine such things as whether rate elements are associated with active or legacy products. The second approach only requires the regulated firm report on the rate elements it is actually selling, which is a relatively simple output from standard billing system reports. An example of a compromise approach, which has worked in the Eastern Caribbean, is that the initial reporting contains all rate elements with associated revenues, i.e., actually sold. In subsequent filings, those initial rate elements never disappear even if they do not earn revenue in subsequent years. New rate elements are added when revenue becomes associated with them. In the compromise approach, the list of rate elements therefore grows year after year.

Second, another issue is whether the prices used should represent promotional or discounted prices or just standard prices. LIME realises that by using promotional and discounted prices in its API calculation, it would be easier for LIME to demonstrate compliance with the price cap constraint. However, given the size of the business and given the resources necessary to track promotions and discounts, standard prices should be used instead. This is approach successfully used in Barbados.

Third, with respect to bundling, there are numerous problems to be dealt with here. In particular, there is the potential issue of how to decide to which basket a bundled service belongs. There are also likely to be issues as to how rate elements are to be reported.

We believe that the best way to deal with bundled products is to recognise that, so long as the regulated components of the bundle are available on an unbundled basis and regulated, the prices for bundled products are effectively capped. We note that this is the approach to bundles that Barbados has applied in its price cap regime. Other regulatory issues related to bundled pricing – e.g. tying or predation – are not best addressed by price cap regulation and are properly outside the scope of the Price Cap Regime.

Question 7: Please comment on the proposal to use the Bahamas CPI as the I-factor. If you disagree with this proposal, please provide alternative proposals, including rationale.

We believe that ultimately the best solution would be for the TCI Government to develop and maintain a CPI. We would ask the Commission to at least explore the possibility of that happening with the Government. In the meantime, LIME understands and is comfortable with the use of the Bahamas CPI as a proxy. There will be some technicalities to work through, such as what is the most recent twelve-month period that can be reliably obtained from the Bahamian authorities, but nothing that should prevent its use.

Question 8: Please comment on the appropriateness of using the Forward-Looking Approach, as described above, to calculate the X-factor. If an alternative approach is proposed, provide all relevant details of the approach and the supporting rationale.

LIME believes that it will be appropriate to use a Forward-Looking Approach to calculate the X-factor. Such an approach attempts to set the value of X based on a view of the rate of return over the price cap period and does not penalise the regulated company for what may have happened in the past. The value of X is not only based on expected changes in productivity but also on expected changes in revenues and costs due to changes in the competitive environment following liberalisation.

One of the most common types of forward-looking approaches--used by a number of telecommunication regulators including those in Ireland, the UK, Australia and, closer to home, Jamaica, the ECTEL member countries and Barbados--is to set an X-factor that allows the regulated operator to earn a rate of return on capital employed (“**ROCE**”) that is equal to its cost of capital. This cost of capital is the minimum rate of return that investors require from an investment of similar risk, in order to be persuaded to put money in the business. Competition tends to reduce the ROCE overtime and therefore a forward looking approach seeks to set a value of X that is based upon predictions of the opening and closing ROR, taking into account market forecasts.

A detailed explanation of such a model can be found in the Office of Utilities Regulation’s (“**OUR**”) document – *Jamaica Price Cap Model Description*, July 2001. As the OUR stated:

A critical objective of the model is ensuring that C&WJ has an opportunity to earn its cost of capital while operating under the new regime. The model provides a tool ... to investigate the consequences of different pricing parameters. It can therefore, be used to inform the

appropriate level of initial prices for the Price Cap plan and the X factor to be used for price adjustments in subsequent years.²

Oftel (the predecessor to Ofcom in the UK) used a financial model that sought to predict BT's costs and revenues throughout the price cap period with changes in productivity, market demand and market share being accounted for. Assumptions as to price elasticities of demand, cost-volume elasticities and asset-volume elasticities were required as although the costs were based on BT's regulatory accounts it was reasonably assumed that only a proportion of costs would be variable during the price cap period³. The value of X was set so that the value of BT's rate of return projected by the financial model for the last year of the price control was equal to BT's cost of capital⁴.

It should be noted that other regulators have attempted to reach a forward-looking approach by making forward-looking adjustments to historical approach. The Australian case is an example of this. Sappington (1999 & 2002)⁵ also describes various necessary adjustments to a historically determined X factor:

- If competition in unregulated markets forces the firm to reduce prices more rapidly than its overall productivity growth rate will permit, then it can be appropriate to reduce the X factor in order to allow a higher rate of growth for regulated prices
- Increasing competitive pressures may lead to a higher productivity rate however this competition may lead to output growth rates for the incumbent falling more rapidly than their input growth rates leading to a reduction in their realised productivity growth rates.

As market share is lost and international settlement rates fall then LIME can expect to be experiencing drops in output sold and hence revenues. The case of Jamaica testifies to the fact that settlement rate revenue has dropped far faster and market share loss to mobile calling has been far greater than regulators expected.⁶

LIME believes that the forward-looking approach that the Commission describes provides a more explicit and comprehensive way than making various adjustments to a historically-determined X.

² Office of Utilities Regulation's (OUR) Jamaica Price Cap Model Description, July 2001.

³ Paragraphs B29 and B30 in Oftel Price Control Review, October 2000.

⁴ Paragraph B7 in Oftel Price Control Review, October 2000.

⁵ Chapter 7, Handbook of Telecommunications Economics, Volume 1, Edited by Cave, Majumdar and Vogelsang.

⁶ See the OUR's comments in Modification to LIMEJ's Price Cap Plan and Proposed Rules for International Telecommunication Services, Consultative Document, OUR, Tel 2002/05, August 30, 2002 at sections 4.7 and 4.8.

Question 9: Please comment on the view that the Price Cap Services for the new Regime should be based on the services included in the Dominance Finding.

LIME agrees that *ex ante* regulation in the form of a price cap should only be imposed where the market mechanism is not considered to be an adequate constraint on prices. In the absence of sufficient competitive forces to constrain prices, price cap regulation is recognised as being an appropriate form of incentive based regulation as it can mimic the results of a competitive market. Price cap regulation (if properly designed and implemented) gives the regulated firm the incentive to increase its productivity and therefore minimise its costs, whilst ensuring that consumers benefit from lower prices.

It is important to ensure that only those services that are not considered to be sufficiently constrained by competition are included in the price cap. In line with best international practice, this can be achieved by including in the price cap only those services that have been identified as being supplied by a firm that has been determined to be dominant in the supply of those services. Or, to put it another way, regulating services that do not need to be regulated, whether through price cap regulation or other forms of regulation, could create perverse disincentives to invest and result in fewer choices for consumers.

Unfortunately, the Commission does not appear to have considered whether the list of services included in the Dominance Finding actually ought to be regulated. Rather, the Commission has assumed that, because LIME's Licence says for example that LIME is dominant over "domestic public telephone services provided over the Licensee's fixed network", LIME must in fact be dominant in the market for such services. In LIME's opinion, an assumption does not represent an analysis of the relevant telecommunications markets in the TCI, or of competition in those markets.

In this respect, LIME is somewhat puzzled by the suggestion to include inbound international calls within the price cap for price cap modelling purposes. LIME does not set a retail price for these calls and cannot be considered to be dominant in their supply. Indeed, it could be argued that there is countervailing buyer power with respect to international inbound calls as any attempt by LIME to increase the termination rate it charges to international operators would only result in them switching to an alternative domestic carrier (namely Digicel and/or Islandcom) for termination.

Question 10: Please comment on the appropriateness of the proposed Price Cap Services for the New Regime, as listed above.

The Commission has proposed that a minimum of ten categories of services be included in the New Regime:

1. business and residential access installation charge;
2. business and residential access;
3. domestic (fixed-to-fixed) calling;

4. domestic (fixed-to-mobile) calling (net receipts);
5. international (outbound) standard calling (net of outpayments);
6. international (outbound) discount calling (net of outpayments);
7. domestic leased lines
8. international leased lines
9. enhanced services/VAS (associated with fixed access lines, including but not limited to Voicemail, Caller ID, etc.)
10. payphones

The criteria applied by the Commission for including a service in this list are unclear at best. It appears the Commission has chosen these services solely because they can be included in one of the categories of services included in the Dominance Finding. There is no evidence that the Commission considered whether the services listed above are competitive, or whether they are substitutes for them, or indeed whether any benefit to the public would in fact arise if they were regulated.

For example, the value of including “payphones” in the New Regime is limited. The dramatic increase in mobile penetration has resulted in equally dramatic declines in domestic and international calling originating from payphones. The benefit to the public and the “proportionality” of regulating what is now at best a largely marginalized service is rather limited.

In the case of the domestic and international calling services included in the list above, there is no evidence that the Commission considered whether mobile calling services are reasonable substitutes for fixed calling services in the TCI market. In an environment where the total number of fixed lines in use likely represent less than 10% of the total number of active mobile phones in the country, it is close to preposterous to suggest that mobile-to-fixed, mobile-to-mobile, mobile-to-international calling services are not substitutes for fixed-to-fixed, fixed-to-mobile or fixed-to-international calling services, respectively. Yet, this is in fact what the Commission is suggesting by including fixed-originated domestic and international calling services in the New Regime.

Question 11: Please comment on the appropriateness of the number, content and specification of the proposed Price Cap Baskets described above. If an alternative approach is proposed, provide all relevant details of the approach and supporting rationale.

LIME believes that in order for the Commission to come to a conclusion with respect to the structure of the Price Cap Baskets, it must first understand both the current situation and the drivers of the finances for these products. Based on the foregoing discussion, it is clear that the Commission is likely to produce a forward-looking model for LIME's regulated services. Until that model has been completed, it would be premature to come to a firm conclusion on the appropriate structure for the Price Cap Baskets.

Based on our view of the current situation of the finances of the Company and the current market conditions, we believe that very few, if any, of the regulated products are actually making above-reasonable rates of return. Moreover, as previously discussed, considerable competitive pressures exist on most fixed service pricing. In these circumstances, we believe the Commission could simplify much of its proposal.

The Commission's proposal for Basket 4 is appropriate. We also believe that the Commission may well be convinced, after it examines the financials and market drivers, that there are other services that are sufficiently competitively constrained to be added to its list of Basket 4 services. For example, international outbound calling is one of those services where it is clear that mobile call rates are an effective constraint on fixed call rates. These services are also not that profitable.

With respect to the Commission's proposal for Basket 3, we believe a more appropriate alternative would be to simplify the Basket 3 control by setting $X=I$ for these services—even on an individual basis—effectively requiring that current prices are the caps. Prices for these services are subject to significant competitive constraints and, in the case of IPLCs, countervailing buyer power.⁷

We do not believe that the Commission's proposals for Baskets 1 and 2 are the most effective from a public policy point of view. We believe it is better to put residential access installation and rental prices under a separate pricing constraint (i.e. by removing all other services from Basket 1). We do not believe residential access earns a reasonable return. As a result, we believe that LIME should be given the possibility of increasing its residential access basket API equal to rate of inflation, i.e., $X=0$.

The Commission should place the residential calling and VAS services that were removed from Basket 1 in with the proposed Basket 2 services, and determine the X for that Basket residually. That is to say, because the Commission will have existing or market-driven rates for international services and $X=0$ rates for residential access services, it then can use its forward-looking price cap model to derive an X for the fixed calling, VAS and business access services Basket, such that the overall return to the firm moves to the target level of return.

Question 12: Please comment on the need for, nature of (if any) and proposed general criteria for the other pricing constraints.

LIME would not be averse to a maximum limit on individual service price jumps, but it would be averse to such limits if they were set lower than inflation increases. For example, we could see that, even with all the other price cap constraints, the Commission might want to put a limit of, say, 10% on the annual price increase of any one regulated

⁷ Buyers of the Company's IPLC services are typically large corporate customers with knowledge of prices charged in other markets and with the ability to choose other providers or even to self-provide international data services. In these circumstances, LIME's ability to increase its prices is severely constrained.

product. However, such a limit should be replaced by the rate of inflation should inflation exceed 10%.

Question 13: Please comment on the proposed framework and criteria described above for the categorization of new services.

It will be important to ensure that the proposed framework for the categorisation of new services is such that it does not undermine the incentives on LIME to innovate, both in terms of completely new services and in terms of new ways of offering existing services, such as through service bundles. LIME is therefore concerned that the phrase "... provides the same kind of functionality..." is too vague and could result in too many new services being unnecessarily added to the Price Cap. Furthermore, it does not believe it would be appropriate or even necessary to include in the price cap a new telecommunications service that is a combination of predominantly or exclusively Price Cap Services. So long as the individual components of that bundle can also be purchased separately LIME sees no need to also classify the actual bundle as a Price Cap Service. Consumers will already be protected by the fact that they can obtain the individual components of the bundle at regulated rates whilst the bundle itself will have to be offered at a discounted price compared to the sum of all the individual components, otherwise no consumers will be interested in purchasing the bundle.

Question 14: Please comment on the proposed framework described above for the treatment of market trial and short-term promotions.

With respect to the proposed framework on market trials and short-term promotions, LIME finds that 10 days notice is overly onerous and would in effect prevent LIME from reacting to developments in the market in a timely manner. We do not understand why the Commission would need more than a week to review a market trial or promotion and would ask the Commission to consider a 5-day notice period instead. It should be kept in mind that the Commission would have powers to call off the market trial or promotion on an *ex post* basis, were it were to discover concerns after the launch.

Question 15: Please comment on the appropriateness of the proposed Price Cap Year, as described above.

LIME endorses the proposal to adopt the LIME Fiscal Year as the Price Cap Year. It is not clear what benefit would actually be gained from deliberately creating a "disconnect" between the New Regime and the financial systems of the only company to be regulated under that price cap regime (other than perhaps increased fees for the accounting profession).

Question 16: Please comment on the appropriateness of extending the provisions of the existing Initial Regime to March 31, 2009.

LIME supports extending the provisions of the Initial Regime to 31 March 2009. Attempting to craft new and detailed regulatory provisions specifically for the Bridge Period would consume time and resources of both LIME and the Commission for little net benefit to the public. This exercise would be wholly disproportionate and would fail the Commission's sixth objective for the New Regime.

Question 17: Please comment on the appropriateness of applying the pricing provisions included under the Initial Regime to the Price Cap Services to be included in the New Regime during the proposed Bridge Period.

LIME does not support this proposal. In line with our comments above, this would in effect create a special "interim" regime for a very short period, with increased compliance obligations imposed on LIME for little or no net benefit to the public. In particular, none of the Commission's six objectives for the New Regime would be achieved by such a proposal.

Question 18: Please comment on the proposal that the Price Cap Regime Period be four years, from April 1, 2009 to March 31, 2013.

LIME does not object to a four-year Price Cap Regime Period. This period strikes an appropriate balance between the need to review the impact of a price cap regime on a reasonably frequent basis and the need to provide the regulated company a certain degree of certainty in how its retail services are to be regulated. A four-year period is also consistent with international practice, as four-year periods have been implemented in other jurisdictions in the Caribbean at various times.

Question 19: Please comment on the proposal to include a Z-factor in the price cap index formula.

LIME agrees with the proposal to include a Z factor in the price cap index formula. The inclusion of a Z factor is standard practice in price cap regulation as it helps to mitigate the risks associated with exogenous events that could not possibly have been foreseen by the regulated firm or the regulator at the time the price cap was set. The inclusion of a Z factor therefore enables adjustments to be made to the price cap constraint to limit extreme variations in the profitability of the regulated firm due to unforeseen and significant exogenous events.

LIME notes that best international practice with respect to the application of a Z factor is to recognise that exogenous events need not be specific to the telecommunications sector

for them to have a significant and adverse impact on the regulated firm. For example, Sappington⁸ has identified three distinguishing features of significant exogenous events, namely:

- The event and their financial implications are beyond the control of the regulated firm
- The event affects regulated suppliers disproportionately
- The event has a large financial impact on the regulated firm⁹

Under these criteria, significant exogenous events that could trigger the Z factor could include changes in the taxation regime and import duties; significant interest rate fluctuations; significant exchange rate movements, etc., none of which are specific to the telecommunications sector but could significantly and disproportionately affect the regulated firm's profitability. Of particular relevance to the Turks and Caicos Islands, especially given recent experience, would be extreme and unpredictable weather conditions, such as hurricanes. Whilst the effects of a major hurricane are likely to be felt by all sectors of the Turks & Caicos economy, LIME could be affected disproportionately due to the amount of its infrastructure that is exposed to the elements and the urgency with which it would be required to restore communications during a time of natural disaster. This could be expected to have adverse and disproportionate effects on its profitability that could warrant adjustment through the Z factor.

Question 20: Please comment on the proposed criteria and other arrangements described above in relation to the administration of exogenous cost changes.

As indicated above, LIME does not believe it is appropriate for the Commission to limit the circumstances under which it would contemplate applying a Z factor only to events that are unique to the telecommunications sector. This is counter to best international practice, which recognises that events that are not confined to the telecommunications sector can still have a significant and disproportionate effect on that sector. The most recent example of this for the Turks & Caicos Islands is of course Hurricane Ike, which hit the islands in September 2008 and caused major damage. It was an event completely outside LIME's - or anyone else's - control, but obviously not unique to the telecommunications sector. Nonetheless it had a significant effect on LIME due to the need to make urgent repairs of overhead cables, masts and other infrastructure.

LIME would therefore urge the Commission to remove the criterion for an event to be unique to the telecommunication sector as one of the necessary criterion for a Z factor to be applied.

⁸ Sappington in Chapter 7 Handbook of telecommunications Economics, Volume 1, Edited by Cave, Majumdar and Vogelsang

⁹ The reference to regulated firm is intended to imply the portion of the firm that relates specifically to those services subject to price control.

Question 21: Please comment on the proposal to include, on a basket-by-basket basis, carry-over of headroom.

As we have stated in our response to Question 6. We believe that it is appropriate to have carry-over in the price cap specification as is currently formulated in the Commission's Price Caps Consultation Document.

Question 22: Please comment on the proposed arrangements for notification of price changes, as described above.

The Ordinance and the Pricing Regulations contain a relatively detailed code governing price change notification procedures. To the extent that they are included in the Ordinance and the Regulations, it is not open to either LIME or the Commission not to apply them.

LIME notes, though, that the procedures set out in the Ordinance and the Regulations will have the effect of placing LIME at a severe competitive disadvantage in the TCI market. Whereas all other service providers will have the flexibility of deciding when and how to announce price decreases to their customers and to the general public, LIME will be required to give its competitors (along with its customers) seven days' prior notice of any price decreases. This will be more than enough time for LIME competitors to plan, implement and announce countervailing competitive measures. While it is clear how this will harm LIME, it is not clear how these procedures will assist the Commission in achieving its objectives of providing the service provider with incentives to be more innovative or of providing the service provider with a reasonable opportunity to earn a fair return.

LIME believes that it should be required only to give the Commission advanced notice of a price reduction. This will preclude competitors from gaining an unfair advantage in a competitive market. Further, LIME does not believe any customer would be disadvantaged or indeed upset if they receive the benefit of a price reduction without prior notice. We ask the Commission to request a change to the Pricing Regulations to remove the requirement to provide prior notice to users of price reductions, as that requirement serves no public policy purpose and is harmful to the regulated company.

Question 23: Please comment on the appropriateness of the proposed arrangements for the Rate Change Compliance Filing, as described above.

Question 24: Please comment on the appropriateness of the proposed arrangements for the Annual Compliance Filing, as described above.

LIME acknowledges that it would be reasonable to require of a regulated company some level of Compliance Filing obligation. LIME also notes that the Pricing Regulations

require an ex post Annual Compliance Filing. LIME submits, however, that the Commission's proposal goes well beyond what is required by the Regulations and well beyond what is reasonable.

The goal of the Compliance Filings is to ensure the regulated company is in fact complying with its regulatory obligations, and LIME would agree to arrangements that serve to achieve that goal. However, compliance arrangements should not be designed to ensure the regulated company's costs are increased, its ability to respond to changes in the marketplace is decreased as a result of unnecessary paperwork and bureaucracy, and the regulator's staff assumes unnecessary costs and burdens. Unfortunately, this may be precisely the effect of the Commission's proposal to require filings before the fact, during the fact and after the fact.

LIME submits that it is sufficient to require Rate Change Compliance Filings, to monitor the regime as services and rates evolve, and an ex-post Annual Compliance filing, to review the operation of the regime at the end of the year.

Question 25: Please comment on the appropriateness of the proposed regulatory reporting requirements as described above.

The Commission proposed that LIME be required to file:

- Annual audited Statutory Financial Statements
- Annual Regulatory Statements, showing, inter alia, service and overall return on mean capital employed and a reconciliation to the audited Statutory Financial Statements, and
- Biennial updated versions of the Enhanced Allocation Model ("EAM") that is to say, an EAM for FY2009-2010 to be submitted by July 1, 2010 and another for FY2011-2012 to be submitted by July 1, 2012.

LIME agrees with a requirement to require to file annual audited statutory financial statements. In fact, this appears to be a requirement in all licences, per section 14(g) of the Telecommunications Ordinance, and should not properly be considered an element of the New Regime.

LIME considers the second and third requirements listed above, regarding filing separate regulatory statements and updating the EAM, to be unacceptable and inconsistent with the intent of the New Regime. Filing separate regulatory statement will significantly increase its financial reporting costs.

Further, models such as the EAM are important elements of ROR regulation, as knowing costs are necessary to determining whether a return is reasonable or not. An updated EAM is also important at the beginning of a price cap period, as it is an input in determining "going-in" rates.

However, the fundamental purpose of price cap regulation is to regulate prices without reference to ROR regulation. Once a price cap regime has been implemented, the company's costs are no longer relevant to regulation of that company's prices. Rather, the company is given an incentive to reduce its costs, as it must adjust prices in accordance with the X-factor, but it is permitted to retain the benefit of any additional efficiencies above and beyond what it must pass on to consumers through periodic rate reductions. In this context, the regulator only needs to review the company's prices, and does not need to review the company's costs. Requiring time- and resource-intensive updates of the EAM is, therefore, unnecessary.¹⁰

¹⁰ We understand that there will be a requirement to run another EAM and produce regulatory accounts for the review of the price cap plan towards the end of this plan's life, but not over the course of the life of the EAM.