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Response to Consultation on

The proposed revision of the retail pricing rules for price regulated services not subject to price cap regulation (non price capped services)

ECS 16/2016

Submitted to

The Utilities Regulation & Competition Authority

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Filed by

NewCo2015 Limited

Introduction

NewCo2015 Limited (NewCo), welcomes URCA's consultation that is seeking to make the regulatory regime for retail pricing suitable for the more competitive market that will result from NewCo's anticipated entry into the mobile telecommunications market in The Bahamas.

NewCo was incorporated under The Companies Act, 1992 (as amended) on the 25th day of February 2016 in anticipation of being awarded the second mobile licence as per Section 114 of The Communications Act, 2009 (as amended). Following the award of the second cellular licence to NewCo on July 1st 2016, Cable Bahamas Ltd. has 48.25% of the shares in NewCo and has Board and management control of NewCo.

In relation to the proposed changes to the Retail Pricing Rules, NewCo believes that URCA should first conduct a formal review of the mobile market to ensure any changes in remedies are supported by observations on the market. If changes to the Retail Pricing Rules are made without conducting a market review, there is a significant risk of market failure. Specifically, there is a risk that BTC will be given too much pricing flexibility too early on in the development of the market by removing ex ante approvals with a notification scheme.

The "Club Effect"

At commercial launch of NewCo, BTC will hold 100% market share in a mature mobile market. As pointed out in NewCo's submission on BTC's response to the RAIO consultation, BTC is in an excellent position to impose a "Club Effect" on the market through discriminatory on-net/off-net pricing, thus limiting NewCo's ability to grow its subscriber base. Should BTC be allowed to do so, competition in The Bahamas will initially be based on the relative sizes of the subscriber bases of BTC and NewCo and much less on innovation, quality of service and price competition than would otherwise be the case. This is an undesirable outcome from a policy perspective and NewCo urges URCA to ensure that BTC will not be allowed to engage in discriminatory anti-competitive pricing practices.

Link to the RAIO consultation

NewCo accepts that there is a case to adapt the Retail Pricing Rules that deal with the prevention of excessive or monopolistic pricing by BTC. However the appropriate retail pricing regime relating to anti-competitive pricing behaviour is closely linked to decisions on the applicable billing protocol for mobile calls and the level of the mobile termination rate (if applicable). As set out in our response to the RAIO consultation, NewCo sees the following options in relation to billing protocols and appropriate regulatory intervention:

- **Calling party pays (CPP) + cost-oriented mobile termination rate (MTR)**. In this scenario, retail price regulation could be relaxed because NewCo would be able to replicate BTC's prices without incurring losses through the MTR. NewCo proposes to set the MTR based on 'Pure LRIC' and maintain the current approach of 'no charge' in the BTC RAIO as an interim measure.
- **Receiving Party Pays (RPP)**. This scenario would have the advantage that the existing billing protocol for fixed-mobile calls does not need to be adjusted. However, in this scenario,

stringent ex ante regulatory controls are needed to ensure BTC does not engage in anti-competitive pricing on retail mobile inbound airtime charges.

NewCo prefers the CPP scenario, but would consider the RPP scenario if the condition of setting mobile termination rates based on 'Pure LRIC' is not met.

In a RPP scenario, ex ante controls to prevent BTC from behaving in an anti-competitive manner are needed more at the point of commercial launch of NewCo than during the BTC monopoly in the mobile market, and should last until NewCo has built a substantial presence in the market and is able to constrain BTC's market power. The approach of removing ex ante controls without first addressing the billing protocol and associated issue of the mobile termination rate risks offering freedom to the SMP operator in the Bahamian mobile market at just the right time to behave in an anti-competitive manner and inflict maximum damage on the evolution of competition. This would be in direct contravention of URCA's stated goal to "ensure that all participants in the market have a level playing field while being guided by high level principles of fairness, non-discrimination and transparency".

Finally, we note that BTC should not be allowed to make the choice on the billing protocol on behalf of the market. BTC, as an SMP operator, is in a position to impose its opinions on other market players even if BTC's position is detrimental to the development of competition and the interest of consumers. It is therefore imperative that the billing protocol is either agreed by NewCo and BTC, or imposed by URCA.

Timing of changes to The Rules

NewCo proposes that any changes to the retail pricing rules should not be linked to NewCo's commercial launch but rather to a set of minimum conditions that BTC should meet, with these conditions designed to ensure efficient competition can develop. These conditions should include:

- A billing protocol for fixed to mobile (F-M) and mobile to mobile (M-M) traffic (CPP or RPP) has been determined with all parties committed to its implementation. BTC, as the SMP operator, should not be allowed to change the billing protocol once agreed (under the 'notification' approach proposed by URCA BTC would have this option)
- The Domestic mobile termination rate (MTR) has been reviewed and set based on 'Pure LRIC
- BTC has amended its RAIO as per URCA's instructions after the RAIO consultation process has been finalised
- National roaming is available to NewCo and declared 'fit-for-purpose' by URCA
- Minimum ex ante safeguards are in place to prevent discriminatory pricing practices
- Mobile number portability has been introduced in the market to lower the barrier to switch between providers.

By linking changes in the retail pricing rules to these minimum requirements for competition in the mobile market to develop, URCA will provide an incentive to BTC to comply with URCA instructions and not engage in delaying tactics. By tying changes to the commercial launch date of NewCo (and not to the above milestones) URCA is actually incentivising BTC to delay their implementation to protect its market position.

In the remainder of this document we set out our responses to URCA's detailed questions.

Responses to URCA's questions

Q1: Do you agree with URCA's rationale for performing this review of the Retail Pricing Rules for Non Price Capped Services? If not, why?

NewCo does not agree with URCA's rationale.

URCA states that "At the moment, it is unclear how the market will evolve and how the licensees will compete with each other. Therefore, URCA finds it premature to conduct a full market review at this time …."[1] And, separately: "Nevertheless, URCA believes it is appropriate to now review how the existing Rules apply to Non Price Capped Services, including mobile services, to reflect the forthcoming change in the structure of the market".

NewCo believes these two statements to be inconsistent. The process of market review requires remedies (like the retail pricing rules) to be based on the findings of a process of market definition and Significant Market Power (SMP) designation. This process is designed to ensure remedies are proportionate and based on the competition problems identified in that market. By not following this process, URCA has no solid grounds to make any changes to the retail pricing rules, because there are no findings of a market review to base these changes on. If it is 'too early to assess how the market will evolve', this raises the risk of regulatory error significantly. The result is likely to be that remedies are disproportionate and therefore disruptive to the evolution of the market.

A formal market review, NewCo believes, would reveal the implications for regulatory intervention of facilitating entry of the second mobile licence in a mature mobile market. This situation is unique to The Bahamas; in the vast majority of markets in the region the second mobile licence entered when the mobile market was going through an expansive growth phase. Customers find greater "friction" in moving from one supplier to another compared with choosing between two new suppliers. Hence the ability of the new entrant to constrain the marker power of the incumbent operator is reduced. If the impact of this difference is not recognised, URCA runs the risk of copying approaches taken in other markets[2] that may have been appropriate to a different stage of market development, but not to existing circumstances in the mobile market in The Bahamas. NewCo would therefore urge URCA to conduct a full market review of the mobile market to ensure regulatory intervention is proportionate and based on observed competition problems.

Q2: Do you agree that excessive pricing is not a significant concern going forward? If not, why?

NewCo provisionally agrees with URCA.

[1] See page 12 of the URCA consultation document

[2] Note on page 18 of URCA's consultation document "URCA considers maintaining the existing RPR might be outside the international norm"

Generally speaking, NewCo agrees that in a market where a second licensee has entered, monopolistic pricing and excessive pricing is less of a concern than in a monopoly situation. This is because NewCo will provide a pricing constraint on BTC by offering an alternative to its customers. However, it should be noted that this assumes that NewCo can compete with BTC on a level playing field. If URCA were to allow BTC to engage in anti-competitive and discriminatory pricing then BTC would be able to restrict NewCo in its ability to compete for BTC's customers. This, in turn, would allow BTC to maintain prices at a higher level than would be the case in a market where barriers to switch have been addressed. Such barriers may be removed by:

- Making available of National roaming – to ensure that NewCo can offer matching coverage at commercial launch
- Introducing mobile number portability at launch - to lower the barrier to switch between providers. This is particularly important in the enterprise market.

Q3: Do you agree that predatory pricing is not a significant concern going forward? If not, why?

NewCo agrees that in a market where a second licensee has entered, predatory pricing is not a significant concern. NewCo does question the timing of the removal of obligations on BTC to demonstrate that its temporary and permanent price changes would not foreclose the market to competitive entry. While predatory pricing is not a significant concern, the risk of it occurring is certainly higher at the point of competitive entry than during the monopolistic era.

Q4: Do you agree that margin squeeze is not a significant concern going forward? If not, why?

NewCo does not agree that margin squeeze is not a significant concern.

In a CPP scenario, BTC, through a combination of above-cost mobile termination rates (MTRs) and targeted reductions in retail pricing (by segment, for example in the enterprise market), can selectively limit competitive entry or, in extreme cases, limit NewCo's ability to compete generally. NewCo therefore urges URCA to ensure that, if a domestic MTR is included in the BTC RAIO (i.e. under a CPP regime), the MTR is set based on a forward looking and efficient costing methodology like 'Pure LRIC'.

In its response to URCA's RAIO consultation, BTC is proposing to use the existing MTR in its RAIO (currently applicable to international traffic only) to traffic originating on NewCo's mobile networks. The proposed MTR is 4.61 cents per minute. In addition, BTC is proposing to maintain the existing transit arrangement for traffic routed to its mobile switching centre, adding a further 1.04 cents per minute to the cost of terminating traffic on the BTC mobile network. It is NewCo's position that, if a domestic MTR were to be included in BTC's RAIO, the following changes should be considered:

- **Immediate review of the level of the MTR** – the glide-path set by URCA was concluded more than a year ago and the level of the MTR has been determined based on benchmarked mobile termination rates applicable in 2012 and, in some cases, 2011. The current level of the MTR of 4.61 cents is therefore based on now outdated benchmarks and a revision is timely and necessary.

- **A change in methodology -** NewCo proposes to introduce a domestic MTR into BTC's RAIO on the basis of the 'Pure Long Run Incremental Costs (LRIC)' approach recommended by the EU Commission[3] and regionally introduced by regulators in Jamaica, Guadeloupe, Martinique, Saint Barthelemy, Saint Martin and Mayotte. The mobile termination rates in these countries are set at around 0.9 $US cents.
- **Non–Discrimination** - BTC should be required to demonstrate in its separated accounts that it is charging its fixed and mobile networks the same termination rates as it is charging to NewCo.
- **Direct interconnection –** BTC should offer direct interconnection in its RAIO, allowing NewCo to route traffic directly to BTC's mobile network.

Setting the domestic MTR on this basis will reduce the incentives on BTC to engage in margin squeeze, for example by setting on-net rates below costs, and subsidising associated losses through excessive profits on its call termination revenues. It is therefore essential that URCA reviews the level of the MTR before the commercial launch of NewCo in a CPP scenario. A similar concern relates to access pricing for national roaming on the BTC mobile network. NewCo therefore proposes to make changes in the retail pricing rules relating to margin squeeze conditional on the introduction of cost-oriented rates for both MTR (in a CPP scenario) and national roaming.

Q5: Do you agree that undue discrimination is a concern going forward? If not, why?

NewCo believes that undue discrimination is a *significant* concern going forward.

NewCo is of the view that URCA potentially underestimates the impact of undue price discrimination in a mature mobile market. It is difficult to come up with examples of off-net/on-net discriminatory pricing practices that are not anti-competitive in intent and nature and most, if not all, such discriminatory practices would remove the level playing field URCA has set out to achieve. As part of its review of the retail pricing rules, URCA should assess the type of on-net/off-net discriminatory pricing it believes *is* in the interest of the development of the market. If these examples cannot be provided, then discriminatory on-net/off-net pricing (between networks) should not be allowed.

In the vast majority of countries in and around the Caribbean, the entry of the second mobile operator took place when the mobile market was experiencing a strong growth phase. This allowed new mobile entrants to attract new groups of customers onto their networks and rely less on attracting customers from the networks of incumbents to grow. This situation does not apply in The Bahamas, where the market for mobile services has been allowed to mature prior to the second mobile operator entering the market. This has profound implications for appropriate regulatory intervention in the mobile market. BTC will have 100% market share of a mature mobile market when NewCo enters, and is likely to have market power for some time thereafter. Because the mobile market is mature, competition will focus more on existing BTC customers than was the case

[3] Commission Recommendation of 7 May 2009 on the regulatory treatment of Fixed and Mobile Termination Rates in the EU (2009/396/EC).

in other markets in the region. It is NewCo's view that such competition should take place on the basis of innovation, lower prices and improved quality of service and not on the relative size of the subscriber bases of operators in the market. This is the key regulatory challenge that URCA needs to address.

NewCo's primary concern is that BTC will be allowed to impose a "Club effect" on the market by raising the cost of inter-network calling and thus increasing the barrier to switch between networks. The "Club Effect" has been described in detail in NewCo's comments on BTC's Response to Consultation on URCA's Preliminary Determination on Proposed Changes to the Reference Access and Interconnection Offer Published by The Bahamas Telecommunications Company Limited (ECS 09/2016). A short description of the "Club Effect" is attached to this submission in Annex A.

If BTC is allowed to charge low on-net retail rates, high off-net tariffs and above-cost mobile termination rates, then BTC is thus using its superior subscriber base to impose a "Club Effect" and make it more attractive for subscribers to remain on BTC's network simply on the grounds that BTC has the larger subscriber base. In the absence of ex ante regulation, it is very likely that BTC will engage in such pricing practices. Ex post reviews of undue discrimination (based on license obligations and the Comms Act) will take too long to take effect and will allow the undue discrimination practices to affect market dynamics while investigations take place. This will impact on NewCo during a critical stage of its development, i.e. the phase directly after commercial launch.

NewCo therefore proposes that any discriminatory pricing practices should be subject to URCA approval, not notification. Any on-net/off-net differentials should be treated as 'undue' if any differences in prices are not justified by the underlying costs of providing these services.

Q6: Do you agree that abusive bundling is a concern going forward? If not, why?

NewCo agrees that abusive bundling is a concern and agrees with URCA's analysis. Where it comes to undue discrimination in relation to bundles the same issues apply as listed above.

Q7: Do you agree with URCA's proposed interim measure of modifying the existing Retail Pricing Rules for Non Price Capped Services until it will undertake a full market review of retail mobile services? If not, why?

NewCo does not agree.

As stated above, only a full market review will allow URCA to identify those competition concerns that are relevant in the specific market circumstances of The Bahamas. By adapting remedies to changing market circumstances without conducting such an analysis, URCA runs the risk of imposing disproportionate remedies on the market. NewCo agrees that the change in market circumstances in the mobile market should probably give rise to changes in the retail pricing rules where it relates to excessive or monopolistic pricing. However, making changes to rules that are designed to prevent anti-competitive pricing behaviour would result in these rules being in force when they were needed less (i.e. during the monopoly era) and removing them when they are needed the most (at the point of commercal launch of the second mobile operator). NewCo considers that URCA should allow some time for the mobile market to adjust to competition before it undertakes its market review, perhaps 12 months after the commerical launch of NewCo's services.

Q8: Do you agree with URCA's proposed amendments regarding competition tests as set out in section 5.1 above? If not, why?

NewCo addresses each of the proposed modifications in turn below.

Predatory pricing

NewCo agrees with URCA's proposals.

Margin squeeze

NewCo agrees with URCA's proposals but only after URCA has ensured that the MTR is set based on 'Pure LRIC' if a CPP scenario is to apply. In a CPP billing protocol scenario, while the MTR is set above efficiently incurred costs, BTC will be able to introduce a margin squeeze into the mobile market by lowering on-net retail prices below the efficient level and still incur an economic profit through above-cost MTRs. NewCo therefore proposes that a margin squeeze test is maintained until such time that the MTR has been reviewed and aligned with efficiently incurred costs.

Undue discrimination

NewCo believes that non-discrimation obligations in section 40(4) of the Comms Act and Condition 34 in BTC's IOL are not sufficient to prevent BTC engaging in such anti-competitive undue discrimination in the mobile market.

NewCo notes that URCA's determination in its 2014 SMP Assessment that its ex-post competition powers would be sufficient to address any undue price discrimination for price capped services (e.g. BTC's retail fixed offerings) should not be extended to the mobile market on the grounds of the principle of non-discrimination under section 5 of the Comms Act. We also note that such ex ante obligations currently still apply in the fixed market.

The principle of non-discrimination is not intended to ensure that different markets are regulated in the same way. Rather, URCA should endeavour to ensure that any remedies are proportionate to the problems identified in each market. There are significant differences between the fixed and mobile markets that should give rise to different ex ante regulatory regimes. For example, the fixed market was liberalised in 2010, four years before URCA's 2014 SMP consultation. By contrast, URCA is intending to allow BTC to introduce discriminatory pricing on the basis of the orginating network of the call at the point of commercial launch of the second mobile operator, i.e. at a much earlier stage in the development cycle of the market. Furthermore, in the fixed market, most of BTC's retail fixed voice offerings do not entail minimum contract durations unlike, for example, in the mobile post-paid market in The Bahamas. Finally, because of the history of unmetered local calls to fixed and mobile subscribers in The Bahamas, it is much more difficult to impose a "Club Effect" in the fixed market than in the mobile market.

NewCo believes that such factors should be taken into consideration when assessing whether BTC should be allowed to introduce discriminatory pricing practices without URCA's approval. NewCo would favour a regime where BTC must demonstrate that undue discrimination does not occur, with URCA approving such applications on an ex ante basis.

Abusive Product Bundling of Services

NewCo fully supports URCA's proposed approach on multi-product bundles. As noted by URCA, there is a risk of BTC either leveraging its SMP into markets where it does not enjoy a position of dominance or of BTC strengthening its position in markets where it already has SMP through anti-competive bundling practices.

NewCo also agrees that a margin squeeze test on mobile-only bundles/packages is appropriate.

Q9: Do you agree with URCA's proposed notification requirements as set out in Section 5.2 above? If not, why?

NewCo believes a notification requirement may be appropriate to replace the current requirement to obtain approvals where it relates to ex ante competition tests to prevent BTC from imposing excessive or monopolistic tariffs on the market. NewCo strongly believes that discrminatory pricing practices should be subject to an ex ante test by URCA to ensure they are not 'undue'. Any on-net/off-net differentials should be treated as 'undue' if differences in prices are not justified by the underlying costs of providing these services.

Q10: Do you agree with URCA's proposed continuation of the existing pre-approval requirements as set out in Section 5.3 above? If not, why?

NewCo agrees with URCA's proposed continuation of the existing pre-apporval requirements as set out in Secton 5.3.

Q11: Do you agree with URCA's proposed amendment to the notification process as set out in Section 5.4 above? If not, why?

NewCo assumes that the current process requires URCA to confirm receipt of the SMP operator's notification to ensure that BTC is made aware that its notification has not got lost. NewCo believes there is merit in this approach to ensure BTC is not under the impression that its notification has been accepted by URCA when in fact the notification has not been reviewed due to an administrative or postal error affecting the process. It is for this reason that NewCo would propose not to change the process.

Q12: Do you agree with URCA's proposed requirement for a bi-annual margin squeeze test for Non Price Capped Service as set out in Section 5.5? If not, why?

NewCo agrees with a bi-annual margin squeeze test but only after BTC's MTR has been aligned with efficiently incurred costs based on 'Pure LRIC'. Until such time, margin squeeze tests should be applied to non-price capped services on a case-by-case basis.

Respectfully submitted

NewCo2015 Limited

RESERVATION OF RIGHTS

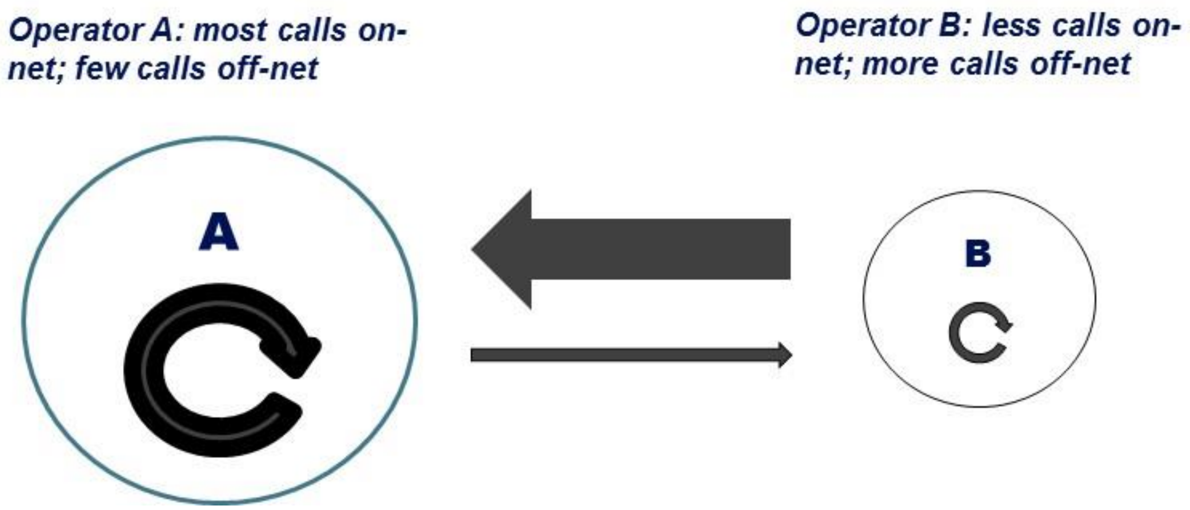
NewCo expressly reserves all rights including the right to comment further on any and all matters herein and categorically states that NewCo's decision not to respond to any matter raised herein in whole or in part, or any position taken by NewCo herein does not constitute a waiver of NewCo's rights in any way.

Annex A – The "Club Effect"

The "Club Effect" is an important phenomenon, particularly in mobile markets, through which operators with large market shares aim to limit the growth of smaller operators in the market. In practical terms, the "Club Effect" has the following impact on the competitive dynamic in a mobile market where there are substantial differences in size between the subscriber bases of the various operators. Take an example of a market with two operators, one with a large subscriber base (Operator A) and one with a small subscriber base (Operator B). The example assumes a CPP environment.

- If tariffs for on-net calls on these networks are the same and tariffs between these networks (off-net) are the same as the on-net rates, prospective customers are indifferent between these networks, all else being equal;
- If Operator A reduces its on-net rates and increases its off-net rates to Operator B this picture changes. Now, prospective subscribers will favour Operator A because there are more call options (i.e. more subscribers) on this network and the friends and family of the prospective subscriber are therefore more likely to be on this network. The lower on-net rates on the network of Operator A will start to draw in subscribers from Operator B and Operator B will start to lose market share;
- Operator B can respond in two ways:
    - Lower its own on-net rates – this is a logical move but would not be as powerful as the same move by Operator A because there are fewer call options on the network of Operator B;
    - Lower its off-net rates to match the on-net rate of Operator A – this way the subscribers of Operator B benefit from the same call options as subscribers on the network of Operator A at the same rate as subscribers of Operator A. However, Operator B has a wholesale out-payment for every minute of traffic to Operator A in the form of the MTR. If the MTR charged by Operator A is above costs, then the margin of Operator B on such calls is reduced. In addition, even if MTRs are set at costs, the high off-net rates of Operator A would still impose a "Club Effect" on the market. So Operator B can mitigate but not remove the "Club Effect";
- Whichever strategy Operator B adopts it is impossible for it to compete effectively with Operator A.

Figure 1 – The "Club Effect"



Every subscriber that joins the largest network further increases the attractiveness of that network as it means there are more people to call at low on-net rates, and an individual subscriber may receive more calls because the cost of those calls (to the on-net calling party) is lower. The "Club Effect" can thus lead to particular networks attracting/retaining subscribers much more effectively than other networks. The effect is strengthened because mobile customers tend to make calls in groups (family, friends, work colleagues). In a mature market where on-net/off-net price differentials are imposed by the incumbent operator this implies that competition does not take place for individual customers, but for groups of customers. Obviously, it is more difficult to convince entire groups of customers than it is to convince individual customers to switch providers. A mature market is therefore much more susceptible to a "Club Effect" than a growing market.

The "Club Effect" is recognised internationally as a powerful means for larger operators to limit the attractiveness of smaller operators to consumers. For example, BEREC (the Body of European Regulators for Electronic Communications) stated in 2007 that:

"Large operators can strengthen the related network effect they benefit from (and the attractiveness of their on-net offers) via two means:

- The first one is related to originating calls: when a customer makes a call to someone that is [a] subscriber of the larger network (which happens with higher probability, depending on how that customer's calling circle is distributed across different networks), he will pay the on-net price if he is also [a] subscriber of that network, or will pay an off-net price if he is [a] subscriber of the smaller network. All else being equal, his decision would then more often be to join the larger network, because the average or expected price is lower.

- The second one is related to the incoming calls, and exists because customers can be assumed to derive some utility from receiving calls. If a larger network charges a high off-net price, then customers are less willing to make calls to the other network than otherwise. Therefore, the value of a customer belonging to the smaller network is reduced, because he will be concerned that less people would call him."

If BTC is allowed to charge low on-net retail rates, high off-net tariffs and above-costs mobile termination rates, then BTC is thus using its superior subscriber base to impose a “Club Effect” and make it more attractive for subscribers to remain on BTC’s network. NewCo, having a much smaller initial subscriber base, will need to respond to this by lowering its off-net tariffs to BTC, but will incur lower margins on this traffic while BTC’s MTR remains above costs. Such an anti-competitive on-net/off-net retail price differential, combined with above-cost MTRs provides a huge and anti-competitive benefit for BTC and an unfair disadvantage to NewCo.