



TeleCayman's Comments on FLLRIC Proceeding

PUBLIC CONSULTATION ON  
FORWARD-LOOKING LONG RUN INCREMENTAL COSTING (FLLRIC)

COMMENTS OF TELECAYMAN, LIMITED  
ON  
ICTA CONSULTATIVE DOCUMENT CD (2004)1(PHASE I)

***30 August 2004***

**PUBLIC CONSULTATION ON  
FORWARD-LOOKING LONG RUN INCREMENTAL COSTING (FLLRIC)**

**Comments of TeleCayman, Limited  
To ICTA Consultative Document CD (2004)1 (Phase I)**

30 August 2004

1. TeleCayman Limited (“TeleCayman”) hereby submits the following comments on the Information and Communications Technology Authority’s (“ICTA” or “the Authority”) Consultative Document CD (2004)1, Public Consultation on Forward-Looking Long Run Incremental Costing (FLLRIC) launched 24 May 2004.
2. TeleCayman is a licensed operator in the Cayman Islands and a competitor of the incumbent operator Cable & Wireless (Cayman Islands) (“C&W”) in the Cayman Islands, for which purpose the two must interchange traffic. TeleCayman has a vital interest in the terms under which it interconnects to C&W, in particular the price it will pay. The costing exercise in which the parties are currently engaged will serve to provide justification for the prices that will be negotiated or set by the regulator for access to C&W’s facilities. C&W has every incentive to raise its competitors’ costs of doing business through excessive interconnection and access rates.
3. Regulation is therefore essential to assist the transition to a more competitive market.
4. A key determinant of the viability and sustainability of competition lies in the terms and conditions under which the incumbent provides network elements to its competitors.
5. The costing exercise in which the ICTA is currently engaged is designed to achieve three objectives:
  - Establish cost-based interconnection rates
  - Provide cost inputs for imputation tests, and

- Quantify any access deficit.
6. TeleCayman will share such insights as it may have on the role of costing generally in the transition to more competitive markets. TeleCayman applauds the seriousness of the effort in which the ICTA is engaged. Nevertheless we remain concerned about the value of costing relative to the actual costs of developing a cost-based methodology, having regard to the size of the market represented by the Cayman Islands. In short, if TeleCayman has any qualms about the process, they concern the value of a costing exercise as a whole relative to the benefits that might be obtained by other pro-competitive regulatory actions which could be taken by the ICTA, such as setting interconnection prices, or resolving disputes about them.
  7. In principle, TeleCayman supports a forward-looking long run incremental cost (“FLLRIC”) approach to costing. It balances C&W’s legitimate interest in recovering its costs and profiting from its investment, on the one hand, with the interests of the public and of its competitors in having network elements priced appropriately. TeleCayman’s principal concern, apart from the cost of the entire exercise, is that C&W’s costing document fails to make clear how it will implement the methodology and how it will ensure that rates are forward-looking. We note that it also leaves unanswered one of the three questions it was supposed to answer, the existence or not of an access deficit, which is said to require a further analysis<sup>1</sup>. We agree that this issue can be put off for the time being.
  8. TeleCayman also notes that C&W and the ICTA can take advantage of previous efforts by many international organizations and national regulatory authorities. Existing FLLRIC models provide answers to the questions posed by ICTA in the public

consultation and offer the specific methods missing from C&W's November 7, 2003 Follow-up Proposal. TeleCayman endorses the forward looking cost methodology development work undertaken by the Regional Tariff Group for Latin America and the Caribbean, under the auspices of the International Telecommunication Union's Study Group 3,<sup>2</sup> as well as other inter-governmental organizations and national regulatory agencies.

### **The Rationale for Using FLLRIC**

9. Costing methodologies are to be preferred on the basis of the purposes they serve. In the case of the Cayman Islands, the objective is to have prices based on costs that firms in a competitive market would use, i.e. the LRIC approach. The LRIC approach is generally used when the telecommunications infrastructure is advanced, which is the case in the Caymans.<sup>3</sup> The advantage of the LRIC method is that it derives costs as if the competitor were efficiently organized and were using the latest technologies.
10. Costing methodologies are a way-station in the development of facilities-based competition. FLLRIC forces the incumbent to price its network elements as if it had been previously required to invest in the latest improved technology, under the influence of competitive pressures.

### **Essential Features in FLLRIC**

11. "Methods of cost compilation should fulfil three requirements: transparency, objectivity, and practicability. Two additional candidates can be added as requirements: cost causality and need for cost recovery. The first asks for clear cause-and-effect relationships between service delivery and network elements on the one hand and underlying cost determinants on the other. The second derives from the fact that every firm needs a comprehensive

recovery of all its costs, in particular also its common costs, in order to be viable in the long run.”<sup>4</sup>

### **Treatment of Shared and Common Costs**

12. While it is impossible to eliminate all common costs, this category must be kept to minimum. 10% is usually regarded as the upper limit of unattributable common costs.

### **Use of recognized cost elements**

13. TeleCayman recommends that ICTA direct C&W to use the cost elements identified in several costing manuals created under auspices of the International Telecommunication Union, the Organization for Economic Cooperation and Development, the European Union, and national regulatory authorities such as the United States Federal Communications Commission and the Canadian Radio-television and Telecommunications Commission.

### **Auditing Safeguard and Best Practices Comparison**

14. The ICTA should require C&W to submit its books of account to external auditing once it creates and implements an FLLRIC model.

### **Access Deficit Calculation**

15. In paragraph 3.53 of its submission to the ICTA, C&W proposes that the immediate purpose of the costing exercise is to provide the basis of imputation tests and interconnect prices, and that any study of access deficits, if such exist, should be delayed. TeleCayman agrees.

### **Imputation of Costs**

16. The purpose of a costing exercise is to enable the setting of prices for network elements that compensate the carrier but which also allow for access by others to

those facilities at reasonable and non-discriminatory terms. In this regard C&W should not be allowed to discriminate in favour of itself or its affiliates. C&W should be required to impute to itself the same costs when sharing facilities with its corporate affiliates as it would when it offers retail and wholesale services to competitors.

## **Issues Raised in the Public Consultation**

### **Cost Exclusion (principle 2, Public Consultation p. 6)**

17. Should a principle be added stating that the model excludes costs that would be avoided if the service is not provided? Yes.

### **Transparency (principle 3, Public Consultation p. 6)**

18. Should parties other than C&W be able to see the results of the FLLRIC model on an ongoing basis, in order to provide the transparency of the model's application to the interested parties? Ideally, yes. If the ICTA believes this goes too far, then two methods are available to check the results: a third-party audit to ensure that C&W has applied best practices, or a comparison of C&W's interconnection, transit, special construction (non-recurring) charges, and wholesale rates with the rates charged by other similarly situated carriers.

### **Burden of Proof, Transparency Principle (at page 6)**

19. Should C&W bear the burden of proof of demonstrating that its cost studies comport with FLLRIC principles and guidelines? Yes.

### **Cost/Benefit Analysis (principle 4, Public Consultation p. 6-7)**

20. Should the use of an FLLRIC model be subjected to a cost benefit analysis? What is the appropriateness and practical effect of adopting a cost-benefit analysis of the use

of an FLLRIC? TeleCayman considers that these are not issues for the contending parties to debate in each and every instance. Settling the cost-benefits will have to be a matter of regulatory judgment. Otherwise, the debate becomes part of the overall cost of making the decision. TeleCayman has already expressed its concern for the cost-benefit relationship of the costing exercise contemplated by the Authority, relative to the merits of interconnection price setting, for instance. Multiplying the instances of this debate only adds to the costs.

**Proposed Treatment of forward-looking costs (Consultation p. 8)**

21. ICTA proposes to establish forward-looking costs in terms of best currently available technology rather than on the basis of embedded or historical costs. TeleCayman agrees. This is the essence of FLLRIC: to force pricing decisions as if they were made on the basis of best available technology, and not to saddle competitors with paying for the higher costs of older technologies .

**Proposed Treatment of Long-Run Costs (Consultation p. 8)**

22. The Authority proposes to treat long-run costs in the following manner:
  - Long run costs are the economic costs, and
  - The planning horizon used to evaluate long-run costs should span a time period sufficient to treat all inputs as variable; the horizon should be long enough so that there are no sunk costs.

TeleCayman agrees with this approach. The incumbent has no right to be compensated on the basis of obsolete or obsolescent plant, which is generally more expensive than up-to-date equipment.

**Reconciling Bottom up Reference to Current Asset Value With Top Down Forward Looking Cost Attribution (Consultation p. 8)**

23. The bottom-up approach calculates costs on the basis of an engineering model of a new network. In a top-down approach, the existing costs of the regulated firm are taken as a starting point, and a complicated set of processes are then undertaken to produce cost-volume relationships on the basis of rigorous engineering or statistical studies. TeleCayman submits that the purity of costing models frequently comes apart in the reconciliation of these two different methods of deriving costs, and further strengthens our view that some careful judgments will have to be made by the Authority to establish appropriate interconnection prices.

Respectfully submitted,

Gary Mix, President  
TeleCayman Limited

## Notes on Sources

A large body of work is available for reference in the establishment of costing methodologies. See Europe Economics, *Study on the Preparation of an Adaptable Bottom-Up Costing Model for Interconnection and Access Pricing in European Union Countries*, a Final Report for Information Society Directorate-General of the European Commission (April, 2000); available at: <http://europa.eu.int/ISPO/infosoc/telecompolicy/en/lricmain.pdf>; Andersen Business Consulting, *Study on the implementation of cost accounting methodologies and accounting separation by telecommunication operators with significant market power*, Prepared for the European Commission, DG Information Society, (July 3, 2002); available at: [http://europa.eu.int/information\\_society/topics/ecom/doc/useful\\_information/library/studies\\_extconsult/costacc.pdf](http://europa.eu.int/information_society/topics/ecom/doc/useful_information/library/studies_extconsult/costacc.pdf); Commission of the European Communities, Commission Recommendation amending Commission Recommendation 98/511/EC of 29 July 1998 on Interconnection in a liberalized telecommunication market (Part 1-Interconnection Pricing), March 20, 2000; available at: <http://europa.eu.int/ISPO/infosoc/telecompolicy/en/rec20c0en.pdf> (adopting “best practices interconnection rates”); Organization for Economic Cooperation and Development, *Access Pricing in Telecommunications* (2004); available at: <http://www.oecd.org/dataoecd/26/6/27767944.pdf>; Organization for Economic Cooperation and Development, Working Party on Telecommunication and Information Services Policies, *Developments in Local Loop Unbundling*, DSTI/ICCP/TISP(2002)5 (Sept. 10, 2003); available at: <http://www.oecd.org/dataoecd/25/24/6869228.pdf>; Organization for Economic Cooperation and Development, Working Party on Telecommunication and Information Services Policies, *Interconnection and Local Competition*, DSTI/ICCP/TISP(200)3; (Feb. 7, 2001); available at: <http://www.oecd.org/dataoecd/43/56/1894706.pdf>.

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## Endnotes

<sup>1</sup> At paragraphs 3.53 and 3.54 of C&W's November 7, 2003 proposal

<sup>2</sup> See International Telecommunication Union, Telecommunications Standardization Sector, Study Group 3, Tariff and accounting principles including related telecommunication economic and policy issues, Tariff Group for Latin America, REVISED TAL INTERCONNECT COST MODEL, conditionally available at:

<http://www.itu.int/itudoc/itu-t/tal/cost-mod/index.html>. International Telecommunication Union, Telecommunications Standardization Sector, Study Group 3, *Handbook on Costing Methodologies*; conditionally available at: <http://www.itu.int/ITU-T/othergroups/tal/index.asp>.

<sup>3</sup> International Telecommunication Union, Telecommunications Standardization Sector, Study Group 3, *Handbook on Costing Methodologies*; at paragraph 2.3, p. 10; the whole is found at: <http://www.itu.int/ITU-T/othergroups/tal/index.asp>.

<sup>4</sup> Ibid., paragraph 2.6, page 11