



BERMUDA
**REGULATORY
AUTHORITY**

**Bermuda Telephone Company
Limited**

Application for

**Change in Avoidable Cost
Percentage**

(Business Services)

Decision

Matter: AI-1484

Date: 17 December 2013

Introduction

1. On December 6th, 2013, Bermuda Telephone Company (BTC) filed a submission to the Regulatory Authority (the 'RA' or the 'Authority') for an adjustment to the avoidable cost percentage for Wholesale Business Services it has been required to offer to access seekers as a part of the *ex ante* obligations placed on operators with significant market power ('SMP Operators') by the RA in its General Determination on Operators with Significant Market Power (RM01/13-1040) (the 'General Determination'). This submission was made as a result of an indication given by the Authority to BTC in or about 27 November 2013 that cost justifications must be provided before BTC could adjust any of its wholesale prices under its proposed Model Access and Interconnect Agreement (MAIA).
2. BTC has, pursuant to the General Determination, been under an obligation to provide a MAIA that, among other things, offers any ICOL holders the opportunity to contract with BTC for the provision of access to its electronic communications network as well as certain services at a discounted rate. This obligation has been placed on BTC as a part of a package of *ex ante* obligations designed to allow other ICOL holders to provide electronic communications services in a competitive market.
3. After many months of pre-consultations and a further round of actual consultations in 2013, the Authority, by way of the General Determination, ordered, in respect of certain services which BTC was deemed a SMP operator and that BTC must provide those services at a rate that excludes avoidable costs. The percentage applied to avoidable costs was set at a rate, which is equal to the retail price of the service less 15% ('the Avoidable Cost Percentage').
4. BTC provides two broad categories of service to the General public; Residential and Business services. BTC has objected to the application of the Avoidable Cost Percentage to its Business Services. At a 27 November 2013 meeting between BTC executives and the Authority and its staff BTC voiced its concern that the Avoidable Cost Percentage was too high in the business services category. In response, the Authority confirmed its position that a change to the Avoidable Cost Percentage could only be considered in the event an SMP Operator was able to provide evidence of its actual avoidable costs, which justified the alteration of the percentage. BTC requested a week in order to provide data to meet the Authority's request for justification. The Authority sent a note of the conversation together with a request for comment on BTC's extension request to all ICOLs for comment. No party objected to the request.

The Application

5. On 6 December 2013, BTC submitted its request for an adjustment of the Avoidable Cost Percentage. The application comprised a letter of the same date. This letter concluded that

there are three cost categories that are avoidable in the provision of WLRLC business services and wholesale Leased Line services. These are:

- a. Banking and Billing Costs;
 - b. Customer Support Costs; and
 - c. Marketing and Sales Costs¹.
6. BTC's submission also included an excel spreadsheet workbook showing BTC's calculation of avoidable cost percentages, monthly revenue from business services, and an annual business expense analysis for billing and collections (the 'Cost Workbook'). This spreadsheet was provided under confidential cover for obvious reasons. BTC has argued for a reduction in the avoidable cost percentages for certain business products and services it currently offers claiming that doing so would allow the wholesale prices to accurately reflect what it claims are BTC's avoidable costs on these specific products.

The Framework

7. In the RA's most recent Interim Determination concerning BTC's Model Access and Interconnection Agreement (the 'MAIA Determination'), the RA said this in response to concerns raised by BTC during the consultation process concerning the reduction of the avoidable cost percentage (para.151);

"If BTC wishes to petition for a modification to the Remedies GD, it may do so. However, the Authority would expect to see persuasive evidence based on cost justification showing that a figure less than 15% is justified. If such a showing were made, the Authority would consider initiating a consultation to determine whether it is reasonable to modify this obligation by issuing a new general determination changing this price control."

In light of the RA's stated position on this issue, before the RA will consider how such an alteration in avoidable cost percentages could be enacted, BTC must first show "*persuasive evidence that a figure less than 15% is justified.*" It is within this context that BTC's application is being considered.

8. Ordinarily, cost model submissions are accompanied by a complete set of supporting work papers and source documents that:

¹A redacted copy of BTC's letter has been requested from BTC and will be posted when received.

- a. Clearly delineates all significant assumptions being made regarding model inputs and identifies the source documents utilized in arriving at those assumptions.
- b. Clearly and logically presents all data used in developing a model input and provides an explanation of any formula or process that is applied to this data.
- c. The source of any data relied on in the study should be clearly identifiable and readily available, if not included with the work papers.
- d. Are organized so that a person unfamiliar with the study will be able to work from the initial investment, expense, and demand data to the final cost estimate.

Ideally, the submissions include an index or detailed table of contents of the work papers and source documents along with a cross index to enable a reviewer to track key numbers through the various source documents, work papers, and exhibits.

Reasons for the Decision

9. For the reasons set out below, the Authority concludes that BTC has not provided persuasive evidence that the avoidable costs figure should be set at less than 15% for particular business services. In coming to this conclusion, the Authority has reviewed and considered BTC's letter dated 6 December 2013 together with the Cost Workbook.
10. Given the importance of pricing in the MAIA process, and understanding the work involved in developing a detailed cost study, the RA was willing to do away with the formality of a detailed and extensive cost study in favour of a more nimble, basic document demonstrating a sound justification in support of BTC's position regarding the reduction of the Avoidable Cost Percentage for certain services. This was a direct result of the consideration of balance that needed to be struck between the time and effort BTC would have had to put into producing a detailed cost study and the need for the MAIA agreement to be complete to allow access seekers the ability to compete in the electronic communications market.
11. The RA requested that BTC provide a list of all costs incurred by BTC in the provision of business services. From this list, BTC was asked to indicate the costs it determined it would avoid in relation to each service and in respect of each business service and the perspective percentages of the total cost BTC determined could be designated as an "Avoidable Cost".
12. BTC's supporting documentation for the Cost Workbook the company filed as its avoidable cost model contains no data for total costs, from which the avoidable costs were derived. BTC did not provide a list of its total costs. Rather, it only provided the costs it thought were avoidable. Neither did BTC provide any description of the methodology employed in determining

which costs BTC considered were avoidable and why. The lack of information has inhibited the RA from drawing the same conclusions as BTC, as the RA is unable to verify how BTC's avoidable costs were derived.

13. Using Marketing and Sale Costs as an example, the documentation concerning how these costs were attributed to business services and which (and how much) of these costs are avoidable merely states:

For this cost category the Company developed the total monthly costs associated with sales commissions and marketing salaries from its accounting records that are attributable to business services and are avoidable.

The RA does not consider this explanation sufficient to demonstrate how BTC developed the total monthly costs associated with sales commissions and marketing salaries, as BTC provided no further clarification in their submission of how these costs were derived.

14. The *Avoidable Cost Analysis* tab of the company's Cost Workbook shows that total sales commissions (incl. benefits) were assigned to business services², but only half of total salary costs were assigned to business services. No explanation is provided as to why these costs were assigned this way. Nor has the company provided any supporting documentation that an auditor could utilize to trace back the Marketing and Sales costs appearing in the *Avoidable Cost Analysis* tab to the company's accounting records. Thus an independent auditor has no way of knowing:

- a. The methodology by which a portion of the total monthly costs associated with sales commissions and marketing salaries was attributed to business services;
- b. The methodology employed in determining how much of those costs are avoidable; and
- c. Which subaccounts in the Marketing and Sales Cost category the costs were derived from and why.

15. When determining the three costs categories for the provision of business services, BTC provided only the categories found in the General Determination in paragraph 217

*"The RA considers that, in respect of both WLRLC and broadband resale, similar costs are relevant to the retail minus percentage including, **for example, billing, customer service and marketing costs.** This is the case given that the retail price to be used in the*

² However, this value is divided by 6 then multiplied by 12, without any reason being provided as to why this operation was being performed.

calculation is that of the unbundled retail broadband access-only service."

16. It would appear that BTC has based its calculation of the Avoidable Cost Percentage of its business services only on these three bases. For the avoidance of doubt, paragraph 217 was not meant to provide a template for the categories of avoidable costs. The inclusion of the words "for example" prior to the listing of these categories makes this position clear. In doing so, BTC did not provide other actual and theoretical avoidable costs, which would ordinarily include (but are not limited to);

- a. Product Management
- b. Accounting
- c. Number Services,
- d. Joint costs from Corporate Operations which include training, IT, and other operational costs

17. For this reason also, BTC's justification for avoidable costs is not convincing as there are a substantial amount of relevant avoidable cost that were not provided.

18. The CEO of BTC mentioned to the RA that significant portion of its November 2013 data revenue was from Carrier customers, which indicates that a large portion of its data revenue is already "wholesale" in nature. Thus the provision of business services would result in "zero avoidable costs". The RA rejects this argument on the grounds that;

First, BTC did not include any evidence of this argument in its avoidable cost submission. Although BTC provided an outline of monthly revenue, they did not provide information on which sector the revenues were from, nor did BTC specify whether the monthly revenues supplied were based on an average, taken from the previous month, or estimated monthly revenues; and

Second, any data services currently supplied by BTC to Carriers are not wholesale in nature. BTC and BCV are the only suppliers of broadband access. Without any further evidence from BTC, the RA must assume that no other Carrier currently provides broadband access to its retail customers. Thus, the RA considers it reasonable to assume that even if a large portion of BTC's data revenue was derived from Carrier customers, it is not for the purpose of selling data service to its retail customers. There has been no data provided by BTC to demonstrate otherwise.

19. BTC claims that the Avoidable Cost Percentage for its Business services should be reduced from 15% to approximately 3.08% for High Speed Service, 3.54% for Wholesale Broadband Business, 4.8% for Low Speed Service, and 7.28% for WLRLC Business Services. These percentages are substantially lower than those set by most international regulatory

bodies, including those set by the bodies considered by the Authority in its consultation on this issue earlier this year³.

Conclusion

20. BTC's cost justifications are not adequate to allow many of its assumptions to be verified. There has been no evidence or discussion put before the Authority to explain why some of the costs incurred by BTC have not been considered avoidable whilst others have. BTC is required to provide wholesale business services at retail minus avoidable costs, set at 15%. BTC is permitted to provide the RA with additional evidence for a reduction in costs, which will be taken into consideration after publication of BTC's best and final MAIA, as any further delay would hinder the completion of the MAIA process, which would ultimately damage the Bermuda consumer.
21. Should BTC elect to make a new cost submission, it is necessary for sufficient information to be provided so that the RA can validate the reasonableness of the Company's assumptions and allocations.

³ See Consultation Summary Obligations for Operators with Significant Market Power (RM01/13-1040) Section 5.1.1.7 for examples of other rates.