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TRR'S Decision On FCC's Request For Internal Review Of TRR's Order No. 2 Of 2017 And TRR's Final Determination Concerning FCC's Requests For Approval Of Pricing For Several Sales Of Leased Submarine Cable Capacity

I. INTRODUCTION

1. On 17 May 2017, TRR received a request from Fidelity Communications Corporation ("FCC"), pursuant to Section 52 of the Telecommunications and Radiocommunications Regulation Act of 2009 ("the TRR Act"), that TRR conduct an internal review of certain aspects of:

   (i) TRR's Final Determination Concerning FCC's Requests For Approval of Pricing For Several Sales of Leased Submarine Cable Capacity, ("TRR's Price Approval Determination") and

   (ii) the accompanying Order No. 2 of 2017 ("TRR's Price Approval Order").

   These two decisions were issued on 2 May 2017 and are referred to here as "TRR's Prior Decisions".

2. On 29 May 2017, FCC provided TRR with an 8-page submission, and some documents in support of its internal review request. TRR then sought further documents from FCC arising from this material, which FCC provided on 23 June 2017.

3. TRR's Prior Decisions were made after TRR had given a Draft Determination to FCC (and other interested parties) for comment, and received and considered those comments. Some of the claims made by FCC in this review request were made by FCC in response to TRR's Draft Determination, and were previously considered by TRR.

4. This Decision summarises the key issues arising in this internal review. The absence of a reference here to any specific matter raised by FCC does not mean

the matter has not been considered by TRR. TRR has reviewed and given further consideration to all of the matters raised by FCC on this review.

5. As was done in TRR's Prior Decisions, TRR has here redacted certain portions of this Decision that may or do contain confidential information of FCC or other parties.

II. DISCUSSION

A. TRR's Method For Assessing Costs, Demand And Pricing For These Specific Sales

6. FCC's contentions relate mainly to the method TRR used to assess FCC's costs and the recovery of those costs, plus a reasonable margin, and the resulting per unit prices approved by TRR for these specific sales. These TRR-approved prices were somewhat lower than the prices proposed for approval by FCC.

1. Stranded Capacity Issues

7. One of FCC's primary claims is that TRR incorrectly has assumed that all of the IRU capacity acquired by FCC is leased and revenue producing, generally and/or for the 15-year term of FCC's IRU contracts.

8. TRR has not made any such assumptions.

9. On the contrary, TRR has referred to and considered the fact that historically and currently some of FCC's capacity is not leased, and in the future there may be some amounts of unleased (or "stranded") capacity.

10. This is referred to in Paragraphs 91 – 98 of TRR's Price Approval Determination. For example, in Paragraph 93, TRR states: "A primary risk faced by FCC in entering into its IRU contracts for a committed 15 year term is that there may be periods in which all of the capacity acquired by FCC is not utilized. Due to such "stranded" capacity, FCC may incur materially greater costs than its average costs referred to in Part II above".

11. TRR also analysed and took account of this risk. This involved considering relevant market conditions, estimating the nature and magnitude of stranded capacity risks faced by FCC, and quantifying the effect on FCC of different scenarios or assumptions as to stranded capacity.

12. FCC also claims that TRR has under-estimated the likely amounts of "stranded" capacity, and should have assumed much higher amounts of stranded capacity.

13. TRR has reviewed its estimates and does not agree that its assumptions were unreasonable. TRR's approach is supported not only by the past characteristics

of this market, but also by more recent increases in demand for FCC's capacity during 2017.

14. In particular, from March 2017 to June 2017, FCC has gone from supplying [redacted] Mbps of capacity (with stranded capacity of [redacted] Mbps), to supplying [redacted] Mbps of capacity (with stranded capacity of only [redacted] Mbps). This has included an additional [redacted] Mbps of capacity demanded after TRR's Price Approval Determination.

15. TRR also has received information indicating that significant further capacity may be acquired this year from FCC, such that FCC may have no stranded capacity at the end of this year, after which demand for such capacity appears likely to increase further.

16. TRR's pricing also is consistent with FCC having significantly larger amounts of stranded capacity over time, which TRR still considers to be unlikely (as referred to in Paragraph 96 of TRR's Price Approval Decision).

17. The impact of larger amounts of stranded capacity is also addressed and mitigated by other factors, as referred to in TRR's Prior Decision. This includes the potential for material reductions in O & M costs of FCC, and for TRR to increase per unit prices in the future, if warranted, which are discussed further below.

2. Timing Of FCC's Costs & Revenues

18. FCC also takes issue with TRR's use of a 15-year period to analyse FCC's costs of supplying IRU capacity, and associated revenues. This is the period for which FCC is entitled, under its IRU contracts, to use (and earn revenue from) the IRU capacity acquired from ICL.

19. FCC says that TRR must use a shorter period than 15 years, which would correspond more closely to the period over which FCC must repay some of its major costs. These costs are FCC's monthly capacity payments to ICL [redacted], and FCC's [redacted] payments under [redacted].[1]

20. These costs are payable over somewhat different periods. For example, FCC's capacity payments [redacted]

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[1] FCC claims that, [redacted] payments must be referred to and treated by TRR as "loan" financing [redacted]. TRR disagrees, and believes these payments may be seen as involving installment payments over time for continuing property use rights. In any event, these alternatives do not affect the substance of, or the prices arrived at in, TRR's Prior Decisions.

[redacted] FCC's [redacted] has a term of about [redacted], [2] and [redacted] have a term of [redacted].

21. TRR's Price Approval Determination (at Paragraphs 26 – 27) summarized its reasons for using the 15-year period of these IRUs. TRR has reviewed these matters and FCC's further arguments in this internal review, and considers that the use of the 15-year period, as part of TRR's analysis, was not in error, and does not need to be changed.

22. FCC claims that TRR has not considered that the above costs of FCC are payable over periods less than 15 years, and TRR's approach will result in FCC not being able to cover its costs, such that it will or could go out of business, FCC also claims that this submarine cable technology will become obsolete within 7 to 10 years.

23. TRR does not agree with these claims, for several reasons.

24. First, TRR previously took account of, and here has given further consideration to, the costs incurred by FCC and when they are payable, as well as the risk of some capacity not being sold (in early or later years).

25. Second, TRR's approach did not, as FCC seems to suggest, cause TRR to set prices that currently prevent FCC from covering its costs. This is illustrated by the cash-flow analysis in **Confidential Attachment 1** (which is made available only to FCC). It shows that at FCC's current costs as reported to TRR, the maximum prices set for these sales by TRR result in FCC covering its current costs, plus a modest margin. In addition, FCC's margin increases as further amounts, but less than all, of its IRU capacity is leased.

26. TRR also notes that, since TRR issued its draft and final Price Approval Determination, there have been further increases in demand from FCC's customers (i.e. for an additional [redacted] Mbps of capacity). At this (now current) amount of capacity, and the pricing approved by TRR, FCC is able to cover its costs, and also make a significant margin. There have been recent indications of even more capacity being purchased by FCC's customers during the remainder of 2017, which may mean that all of FCC's capacity has been leased, implying even lower unit costs.

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[2] FCC objects to TRR's statement that the period for FCC's [redacted]. This was a correct statement, but also was not relied on or essential to TRR's Prior Decisions, and is not relied on here. [redacted]

27. The increased demand for and sales of FCC capacity in 2017 also indicates that TRR's approach of regulating and reducing prices may be beneficial to FCC (and the industry), by encouraging demand, and reducing stranded capacity. **Confidential Attachment No. 2** (which is made available only to FCC) shows FCC's growth in leased capacity supplied, and FCC's average price before and after TRR's Prior Decisions.

28. Third, TRR does not accept FCC's claim that this submarine cable technology is likely to be rendered obsolete or useless in a period less than 15 years. On the contrary, submarine cable technology continues regionally, (and globally), to be seen as an effective solution to growing demand for international internet bandwidth over the long term, including 15 years or more from now. This is illustrated, for example, by private and public funding for recent and continued construction of submarine cable capacity in this region (e.g. Tonga and Samoa) and the use of 15-year (or even longer) projections of cable useful life.

29. These considerations reinforce and support TRR's prior findings that its cost and risk analysis, and approved pricing, were reasonable and, if anything, conservative.

30. Overall, TRR has given careful consideration to FCC's costs, risks and returns, and does not agree with FCC's claim. This has included using conservative assumptions for key variables such as stranded capacity, and allowing for returns when less than all capacity is leased.

31. TRR also has used figures for some of FCC's costs that are conservative. For example, TRR has used the highest level of Operations and Maintenance ("O & M") charges paid to date by FCC to ICL. This involved a significant ([redacted]) increase in prior O & M charges in late 2016.

32. If ICL were to sell further IRU capacity to FCC or another customer, as appears highly likely if not inevitable in the near future, that would reduce FCC's per unit O & M charges (which arise from taking ICL's O & M charges and allocating them across all purchased IRU capacity. Further sales of IRU capacity also would continue to reduce these O & M charges. TRR also has expressed concern that the recent increase in these may be unsustainable or unwarranted, and is pursuing enquiries and discussion with interested parties about this.

33. These considerations as to O & M charges are material, as these charges currently account for over [redacted]% of FCC's total costs.

34. FCC also apparently claims that TRR's Price Approval Determination locks in an inflexible, long-term pricing regime or rule. That is not correct. TRR's Price Approval Determination only specified pricing for the amounts of capacity then being acquired by three of FCC's four customers, and makes it clear that if market conditions change and warrant it, FCC's pricing could be adjusted upward. Future

consideration of FCC's pricing also appears to be all but inevitable, as increased capacity is demanded, and approval is sought from TRR for such pricing under Order No. 1 of 2017.

35. The way in which prices can be adjusted over time is illustrated by TRR's Second FCC Price Approval Decision made today. It applies to increased total capacity amounts of [redacted] Mbps now being acquired by TVL and of [redacted] Mbps now being acquired by Digicel. The spreadsheet included as **Confidential Attachment 3** (which is made available only to FCC) shows that at these updated prices approved by TRR today, FCC is covering its current costs and making a margin, (which is likely to increase as additional capacity is leased to these, or other, customers).

B. Claims About The Amount FCC Paid ICL For The 4 x STM-1 Of IRU Capacity Acquired From ICL In September 2015

36. FCC challenges TRR's findings, in Paragraphs 20 – 23 of its Price Approval Determination, that FCC agreed to pay ICL $US[redacted] million in capacity payments for FCC's [redacted] IRU (of [redacted] capacity). This capacity was acquired under the IRU contract between FCC and with ICL, dated [redacted]).

37. FCC claims that it agreed to pay (and has paid or is paying) ICL a larger amount, of $US[redacted] million in capacity payments for this IRU capacity, and that this amount must be included in FCC's cost-base, (and be taken by TRR as ICL's sale price). On this review, FCC also has provided additional documents and information relating to this issue.

38. This claim has been the subject of prior submissions by FCC and findings by TRR. It is useful to set out TRR's prior consideration of this matter, and FCC's prior submissions, before considering the additional documents and submissions provided by FCC on this review.

39. This issue first came up in TRR's Draft Determination of March 2016, and its Final Determination of June 2016 (which related mainly to other matters in this Wholesale Market). The relevant background TRR was then aware of included:

   a) [redacted] entered into an IRU contract with ICL, which required ICL to supply [redacted] of cable capacity [redacted]

   b) [redacted]

c) [redacted];

[redacted]

40. In its submissions to TRR on 27 April 2016, FCC contended for a price and cost of $US[redacted] million for this IRU in part by stating that this includes an amount of $[redacted] million, as follows:

[redacted]

41. TRR did not accept this claim. As summarized in Paragraphs 111 – 114 of its June 2016 Determination, its reasons included that:

a) TRR was not aware of why payments to ICL [redacted] could give rise to a credit in favor of FCC [redacted];

b) Even if a payment [redacted]

c) [redacted]; and

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[3] These capacity payments apparently were around $US[redacted], comprised of $[redacted] up front and $US[redacted] in periodic payments. .

d) The primary or sole reason ICL ceased to receive payments from Wantok appears to be [redacted], (rather than FCC's acquisition of additional IRU capacity from ICL).

42. For these reasons, TRR did not have sufficient evidence to find, and did not find, that FCC paid ICL $US[redacted] million for this IRU capacity.

43. In TRR's Price Approval Determination, TRR referred to and relied on this portion of its June 2016 Determination. It also noted that it had, on 7 April 2017, requested FCC to provide specific documentation supporting FCC's claim that it, in addition to the periodic payments provided for in this IRU, paid ICL $US[redacted] million.

44. FCC subsequently provided documentation, including [redacted]

45. FCC says that these documents show that the price it has paid or effectively paid ICL included $US[redacted] million [redacted]. The gist of FCC's claim, based on these documents, is that:

[redacted]

46. The documents reviewed by TRR do not disprove or alter the conclusions TRR made previously, (namely that there is no or insufficient basis to find that [redacted] On the contrary, the further documents provided by FCC are consistent with and support TRR's prior conclusions, as referred to in Paragraph 41 above.

47. The documents provided by FCC identify that:

[redacted]

[redacted]

48. There also is no evidence of a payment, or financial benefit, to ICL of $[redacted] million from these transactions.

49. [redacted]

50. TRR also notes that the issue of what price ICL charged, and received, for this IRU may have relevance to other regulatory issues, including ICL's obligations as a dominant carrier to charge prices that are cost-based and do not involve prohibited discrimination. In particular, it may be relevant to later pricing by ICL whether it received $US [redacted] million from FCC for this IRU, as FCC claims, or a lesser amount, such as $US [redacted] million.

51. In summary, TRR has not yet reached any final decision as to the status of the above transactions, except that, for the purpose of TRR's Prior Decisions and this internal review, FCC so far has not demonstrated that it paid or agreed to pay ICL $US[redacted] million for the IRU capacity FCC acquired in [redacted], or that this was the effective price received by ICL for this capacity. If, in the future, ICL and FCC can provide documents or information sufficient to warrant a different conclusion, TRR will revisit this topic.

52. TRR also notes that FCC's claim about these matters does not have a major impact on FCC's cost base, and even if accepted, would not lead TRR to revise the pricing in TRR's Price Approval Decision. In particular, FCC has said [redacted]

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C. Other Matters

53. FCC also objected to TRR's findings that some of FCC's proposed pricing did or may have involved price discrimination that was not justified by cost or other relevant considerations.

54. These issues were not necessary to the outcome of TRR's Prior Decisions, as even if none of FCC's proposed prices were discriminatory, they still would not have been approved by TRR, as they were above the maximum prices that TRR considered were supported or justified by the relevant information as to FCC's costs, and risks.

55. TRR also has reconsidered these discrimination issues, and sees no reason to change its prior findings.

56. FCC also sought clarification of Paragraph 17 of TRR's Price Approval Decision states that it only relates to the "specific sales presented for approval" at that time, and that TRR "will make a final Determination on the further issue of whether to "implement a broader set of standardized prices or price caps (as referred to in TRR's prior Consultation Paper). FCC asks whether this means TRR's Price Approval Decision for these specific sales was not final.

57. TRR's Price Approval Decision and Order were final decisions that took effect when made. As with any final decision, they are subject to reconsideration, or modification, by TRR if circumstances warrant.[4] However, unless or until it is suspended, revoked or modified by TRR (or by Court Order), such decisions are and continue to be in effect.

58. TRR so far has not taken the "further step" referred to in Paragraph 17, of providing a schedule of maximum prices in advance that would apply in the future to different quantities and terms of capacity sold by FCC. This would be a different approach than approval in advance of prices submitted at the time of specific proposed sales.

III. CONCLUSION

59. TRR has considered all of the materials and submissions of FCC, and concluded that the maximum pricing in its Order No. 2 of 2017 is not in error and is not being revoked or modified at this time.

60. The pricing approved for specific sales of FCC in TRR's Prior Decisions is subject to further review by FCC under Part 10 of the TRR Act. This may involve a request for review and modification by TRR (for example based on materially changed circumstances) under Section 52 (3), judicial review under Section 54, or expert review under Section 54.

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[4] See, Interpretation Act (CAP 132)

61. TRR encourages FCC and other interested parties to consult with TRR about specific issues relating to this pricing, so as to avoid unnecessary disputes and legal costs.

62. TRR also acknowledges that FCC may seek to exercise the legal remedy of judicial review, subject, of course, to the established criteria and rules relating to that remedy.

63. TRR also notes that, as FCC is a Marshall Islands corporation, it may be necessary and appropriate for FCC, in connection with any judicial review proceeding brought by it, to agree to provide, or comply with any Court order to provide, security for costs in favour of TRR.

Dated 4 July 2017

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