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TRR'S DECISION ON ICL'S REQUEST FOR APPROVAL OF ICL'S PROPOSED PRICING FOR SALE OF LEASED CAPACITY

I. BACKGROUND

A. ICL's Request For TRR Approval Of Proposed Leased Capacity Pricing

1. On 25 September 2017, TRR responded to questions from several ICL customers who were interested in buying leased capacity from ICL. They stated that ICL believed it was prevented by TRR from selling leased capacity, and asked TRR to clarify this. At this time, ICL only had sales of IRU capacity. TRR confirmed to these customers and ICL that TRR had not prohibited or prevented ICL from selling leased capacity. TRR also confirmed that, pursuant to its Order, (originally made in June 2016), ICL was required to obtain TRR approval for the pricing of further sales, (whether of leased or IRU capacity).

2. The next day, day, ICL sent TRR an email, in which ICL thanked TRR for this advice, proposed future lease pricing for TRR approval under TRR's Order, and expressed optimism about ICL's relationship and future dealings with TRR).

3. TRR's Order states:

> " . . . prior to providing, or agreeing to provide, any further capacity on the ICL cable, ICL shall first obtain the advance approval of TRR for the pricing and related terms for supply of any such capacity, and in seeking such approval, shall provide substantiation that the price proposed is cost-based, and commercially reasonable, and not discriminatory or anti-competitive."

4. The reasons for this Order are detailed in TRR's prior Decisions[1] and include:

   (i) The main users of such capacity including TVL, Digicel and Telsat, have complained strongly to TRR that ICL's prices should be regulated by TRR, were "excessive", and involved ICL breaching obligations under its Licence and the TRR Act;

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[1] This Order initially was made on 1 June 2016, (as Paragraph 3 of TRR's Order No. 3 of 2016), for a period of 12 months for reasons stated in TRR's. It was extended until 31 December 2016 by TRR's Decision Nos. 1, 4 and 8 of 2017. The background and reasons for this Order are stated in the above decisions, and in TRR's "Determination And Findings Related To The Wholesale International Internet Services Market And Speedcast's Complaint Against Interchange Limited." ("TRR's June 16 Determination").

(ii) ICL is a dominant supplier in this Market and absent regulation is in a position to impose pricing terms on customers and charge excessive prices;

(iii) Excessive pricing by ICL would be likely to damage this sector, and national development, by forcing up retail prices and reducing access to internet services for the people of Vanuatu. Excessive pricing also is likely to reduce the amount of wholesale capacity that Digicel, TVL, and Telsat buy from ICL thereby harming the profits and returns of ICL and its shareholders[2];

(iv) It is a key function of TRR to review and take appropriate action to ensure that prices for such an essential and important telecommunication service are not excessive or damaging to the public interest. At the time of TRR's Order, the Government also had as a stated objective of its 100 day plan, reducing wholesale prices for ICL Cable Capacity;

(v) TRR proposed discussions and cooperative approaches between ICL and its customers seek to resolve these pricing matters, but these proposals were not actively pursued by ICL, or its customers.

5. On 3 October 2017 ICL provided TRR with the substantiation in support of its proposed price, in the form of a financial analysis, which included estimated rates of return (ROI) for ICL for the year 2018, applying its proposed pricing.

6. On 10 October 2017, TRR issued a short Consultation Paper seeking comments from interested parties on ICL's proposed pricing. By 20 October 2017, TRR received submissions from OGCIO, Digicel and TVL. In summary, OGCIO's position is that ICL's pricing should be approved as it is. TVL and Digicel claimed ICL's pricing was excessive, and that TRR should only approve much lower pricing.

B. Executive Summary Of This Decision

7. TRR has considered all of the points in the submissions received from interested parties, some of which are discussed further below.

8. TRR also has carefully considered the explanation and substantiation provided by ICL, the other cost and financial data previously supplied by ICL, TRR's financial return on investment modelling for ICL, and other relevant matters.

9. By way of summary, this Decision **approves the proposed pricing of ICL, subject to the specific assumptions or conditions included in ICL's submissions and financial analysis, namely that this price applies for all leased sales up to a "required level" of 1200 Mbps in total sales, after which prices will be reduced.**

10. For reasons stated further below, TRR firmly believes that if this pricing were continued after 1200 Mbps in leased sales, it is likely to become excessive, harmful to development of this sector and national development, and contrary to ICL's obligations under ICL's

[2] In June 2017, TRR made a presentation to ICL's Board about this Order. This covered the purpose of this Order, which is to assure that future pricing provided ICL with a substantial and adequate rate of return, and was not excessive or contrary to ICL's obligations as a dominant supplier.

Telecommunications License, and The Telecommunications and Radiocommunications Regulation Act (2009) ("the TRR Act"). ICL therefore is not approved to charge this pricing after leasing its "required level" of 1200 Mbps of capacity. It appears, in addition, that this is not a problem, as ICL does not intend to charge its price after this level of sales. These matters are discussed in more detail in Part II below.

11. In making this Decision, TRR also notes that the ICL Cable is a long term infrastructure asset, with an estimated useable life, according to ICL's documents, of 20 - 25 years, or perhaps more. This asset also has high up-front establishment costs, such that significant returns are not necessarily expected or required in the early years. Instead, it is a common and accepted practice for the pricing and returns for such long-term telecommunications infrastructure to be analysed over the long-term, (usually the life of the asset), rather than for only a brief period of one or a few years. Also, due to ICL's largest costs being fixed and incurred at the start, as increasing volumes of capacity are sold, unit costs and pricing are expected to decrease. Such decreases can still allow substantial returns in the later years, and overall.

12. There also is no one "right" answer as to what ICL's pricing should be, as there are various options over time that can provide a substantial but not excessive return over the life of the asset..

13. TRR's Decision is made in its role as an independent Regulator acting in the public interest, and taking account of the views of all interested parties. TRR's Decision strikes a balance between the interests of ICL and its shareholders in enhanced financial stability and achieving reasonable returns, and the interests of operators, and the market as a whole, in there not being excessive pricing over time, which would suppress demand and be against the national interest of increased use of internet services.

14. TRR's Decision does this by assuring a substantial improvement in financial position and return for ICL and its investors in the immediate future (as proposed by ICL), in order to establish a more sound (and less controversial) base for significant price reductions thereafter (as sought by ICL's largest potential customers for leased capacity, Digicel and TVL). Such price reductions also are important to promoting the Government's objectives of increasing internet access for the purpose of local and national development.

15. Pursuant to Part 10 of the TRR Act, ICL and other interested parties may seek reconsideration, or judicial review, of this Decision and the accompanying Order to be issued by TRR. TRR also notes that a request for reconsideration by TRR of this Decision, or a judicial review case in Court challenging this Decision, would not suspend the Decision or mean it is not binding and in effect, (unless TRR agrees to such a stay of effect, or the Court grants a temporary injunction against the decision pending the Court's final ruling).

C. ICL's Dominant Position & Sales In The Market For Wholesale International Internet Capacity

16. ICL is the owner and operator of the only submarine cable connecting Vanuatu to the rest of the world. Capacity on the ICL Cable is used to provide wholesale internet connectivity in Vanuatu, which is an increasingly important and essential service for consumers. In particular, the wholesale capacity sold by ICL is used by retail telecommunications suppliers (TVL, Digicel, Wantok and Telsat), to provide internet services to the public, as well as fixed and mobile international telephone calls, and international data circuits used by private enterprises; which all contribute significantly to national development. ICL also supplies cable capacity to the Government to meet its needs for internet connectivity.

17. ICL provides this capacity service in the Wholesale International Internet Services Market.

18. ICL has been designated by TRR as a "dominant" supplier in this Market, for the purpose of the anti-competitive conduct obligations of Part 5 of the TRR Act. The basis for this designation of dominance is summarised in TRR's June 2016 Determination.

19. This designation of dominance continues to be appropriate for many reasons, including that ICL controls an essential or bottleneck facility in this Market (the ICL Cable). ICL also has not, in its judicial review case against TRR, (or otherwise), challenged TRR's designation of ICL as a "dominant" supplier in this Market, or claimed that ICL is not "dominant"[3].

20. The Government of Vanuatu has important interests in the supply of services by ICL. These include the Government's paramount interest in pricing, service quality and financial stability of ICL being in place that promotes national development (including the Government's current plans for expansion of internet access). The Government also is customer of ICL. Finally, the Government itself, Vanuatu Post, and Vanuatu National Provident Fund are each significant shareholders in ICL, and adequate shareholder returns for ICL are accordingly, a matter of public interest and importance.

21. From early 2014, when the ICL Cable became operational, substantially all of the capacity ICL sold was purchased as long-term IRU capacity, mostly by Fidelity Communications Corporation ("FCC"). By the second half of 2017, all such IRU capacity (1240 Mbps), had been fully leased to retail telecommunications providers, such as Digicel and TVL. FCC has not acquired further capacity for resale. Accordingly, at present ICL is the sole available provider of wholesale capacity on the ICL Cable and can be considered a monopoly.

22. During 2016 and 2017, there has been a large and continuing growth in demand for such capacity. The reasons for this include increased use and availability of retail internet services by the public generally, and significant network expansion by retail internet services providers such as TVL and Digicel. The suppliers of retail internet services also have advised TRR that they expect continued strong growth in demand, so long as wholesale (and retail) pricing for internet services is not excessive so as to limit demand.

23. As market demand is growing strongly, and FCC's capacity was, by about September 2017, fully leased, retail suppliers of internet services, such as TVL, have recently, and urgently, needed additional capacity to meet customer demand. TRR has accepted the need for and reality of such sales, (subject to this decision as to ICL's proposed pricing), and has not taken action against ICL for leasing capacity, pending this price approval Decision.

24. ICL also advised that since 1 October 2017 it has made or is about to make sales of leased capacity, applying its proposed pricing, in the total amount of over 800 Mbps. These new or imminent sales involve multiple customers, including TVL, the Government, and Digicel. The decision by customers to acquire such capacity does not mean any or all of them support ICL's proposed the price. TVL, for example, has bought capacity at the proposed

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[3] A party other than ICL has claimed that ICL is part of the "Government of Vanuatu", and thus Section 3 of the TRR Act exempts ICL from Part 5 of the TRR Act. This claim is incorrect. ICL, as a private company in which the Government, VNPF and Vanuatu Post are each minority shareholders, is not part of the "Government of Vanuatu", as defined in the TRR Act or the Interpretation Act. There also is no reason why a private company and commercial business, such as ICL, in which Government and statutory entities are significant shareholders, should be free to engage in anti-competitive conduct against other private companies (for example Digicel and TVL).

price, asserted to TRR that the price is "extortionate", and agreed with ICL that ICL will charge the price ultimately approved by TRR, even if lower than ICL's proposed price.

D. Summary Of Regulatory Framework For ICL Pricing

25. TRR's responsibilities and role relating to ICL's pricing were discussed in detail in TRR's June 2016 Determination. In that Determination, after reviewing detailed information and complaints about ICL pricing from Digicel, TVL and Telsat, TRR decided to implement a requirement for TRR approval of ICL pricing, for a 12 month period (from 1 June 2016 until June 2017). During that 12 month period, no sales were made by ICL, and customer complaints about ICL's pricing continued. TRR thus extended its price approval Order until 31 December 2017.

26. TRR's responsibility and duty to monitor, and take appropriate action to regulate, the pricing of a dominant wholesale supplier of an essential facility, such as the ICL Cable, arises both from the TRR Act, and ICL's Licence.

27. For example, the TRR Act prohibits commercially unreasonable or discriminatory pricing by a dominant operator such as ICL. Section 23(2) of the Act identifies types of conduct by a dominant service provider that are deemed to be an illegal abuse of its dominance. This includes if the dominant supplier engages in "any anti-competitive conduct under section 22 in that or any other telecommunications market" (Section 23(2) (a)), "fails to supply a bottleneck facility to a service provider within a reasonable time on commercially reasonable terms and conditions." Such conduct may result in fines imposed by TRR under the Licence of the offending party, penalties imposed by a Court, and/or a Supreme Court action by a customer or potential customer claiming damages and other relief. A customer may sue a supplier who breaches these obligations for damages and other relief. TRR's powers include seeking penalties from the Supreme Court, and other remedies, for any such breach.

28. Clause 12 of ICL's Licence also prohibits such excessive pricing by it, and provides for TRR to monitor and enforce ICL's Licence obligations.

29. The TRR Act also provides, more generally for TRR to engage in "cost-based" price regulation. Section 36 of the Act, "General principles for tariff regulation," provides:

> "The Regulator may adopt any approach to tariff regulation of service providers that is consistent with the Act, including, but not limited to, price Cap regulation, rate re-balancing, and other forms of cost-based regulation."

30. Cost-based pricing is pricing that allows for the supplier to recover its costs and earn a reasonable rate of return, but not an excessive return that damages market outcomes, including service utilisation and consumer welfare.

31. Cost-based pricing for a long-term telecommunications asset, such as the ICL Cable (or FCC's IRU rights in that Cable) takes account of the projected returns over the life of the asset, having regard to relevant factors such as anticipated demand and risk. This process necessarily involves making, on the basis of available data, assumptions as to future matters and reasonable returns having regard to the risks taken and other relevant factors.

E. Summary Of Submissions By Interested Parties

1. The Government's Comments On ICL's Proposed Pricing

32. The Office of the Government Chief Information Officer (OGCIO), part of the Prime Minister's Office, provided comments on behalf of the Government.

33. The Government stated a "favourable" view of the proposed ICL pricing and that it should be approved by TRR "as it is", and as soon as possible.

34. The comments by OGCIO in support of ICL's proposed price were mainly as follows:

> "Since the arrival of the cable in 2014, there has been steady demand for more bandwidth capacity from retailers and ICL as an entity is entitled to make its determinations based on the market.
>
> While there has been complaints from retailers about the high cost of bandwidth, we have to be mindful that Vanuatu is a small market and ICL has a commitment to its shareholders to be profitable and pay dividend [redacted]. Therefore the prices set forward are deemed to be reasonable in the best interest of ICL as a company and its shareholders."

2. TVL's Comments On ICL's Proposed Pricing

35. TVL strongly opposed ICL's proposed price, and stated that ICL should not be allowed to impose this price on customers such as TVL who had no other potential supplier for such capacity. For example, TVL stated:

> "TVL's decision to purchase at US$285 per Mbps should not be viewed as our acceptance that it is a reasonable or non-abusive price. There is simply no alternative given our requirements."; and
>
> "ICL's proposed 'take it or leave it' price of US$285 per Mbps per month is clearly exorbitant and not at all cost-based."

36. TVL also stated that ICL's proposed price is above the price TVL is paying for leased capacity from FCC, and that this alone shows ICL's proposed price is excessive:

> "It does not stand to reason that cost-based pricing from FCC would be cheaper than cost-based pricing from ICL given that the capacity supplied by FCC is sourced from ICL, and FCC's pricing presumably includes a mark-up over the costs that ICL passes onto FCC."

37. TVL also objected to ICL's proposed price because it applied the same price regardless of the quantity bought by a customer from 1 – 1000 Mbps:

> "However, the price level [$285 Mbps/month] is only part of the problem with ICL's approach to pricing. The fundamental problem is the absence of a tariff schedule with tiered pricing that reflects some level of discount for purchases of larger volumes or longer duration. Tiered pricing of international bandwidth is standard in other countries. Without it customers such as TVL are unable to gauge how they might best adjust or plan their purchase commitments over time for pricing

efficiency. There is also no incentive given to purchasers to increase their purchase volumes or bring them forward in time."

38. TVL also stated that if ICL were allowed to impose its proposed single price for all customers, this would "depress demand, and impose all of the social costs that come from monopoly pricing" and that such a price could not be "cost-based", as required by TRR's Order.

39. TVL also says that "ICL should be compelled to introduce a tariff schedule with some form of tiered pricing" (i.e. where prices are lower for larger quantities purchased).

3. Digicel's Comments On ICL's Proposed Pricing

40. Digicel also submitted comments. These were generally in agreement with those of TVL, in that Digicel believes ICL as a dominant supplier should not be allowed to impose its pricing on customers, and that ICL's proposed price is excessive and should be regulated by TRR so that it is substantially below the pricing of FCC.

41. Digicel also agreed with TVL that it was not reasonable or valid that ICL's proposed price was significantly higher than the prices being charged by ICL's customer (FCC) for leased capacity:

> "This does not make logical sense as FCC's pricing included a margin between the price it was charged by ICL and the prices that it charged other service providers, including Digicel. In Digicel's submission, the price determined by the TRR in relation to capacity sold by FCC should be used to establish a 'ceiling price' for subsequent capacity sales that are made directly by ICL. From this ceiling price should be deducted the resale costs and margin applied by FCC."

42. Digicel also stated that it did not know FCC's margin, but believed a reasonable ICL price would be no more than $US200/Mbps/month.

43. Digicel also objected to ICL seeking to include its proposed price in a long-term contract (3 years), and stated that any pricing approval by TRR should be "on an interim basis only and that term commitments of no more than year are applied during which time a proper analysis of ICL's costs should be undertaken." Digicel gave a number of reasons, including that there "are ongoing questions about the cost of supply of capacity and how future pricing should be structured."

44. Digicel also stated that in order to be given a fair and adequate opportunity to comment on ICL's pricing, it would need ICL to provide access to the ICL financial analysis, and substantiation, relied on by ICL for that price. Digicel also says the lack of such information, and the pricing proposals of ICL, are causing damage to the industry and, also, to ICL itself, and that lower pricing would benefit both the industry, consumer, and ICL:

> "The approach to setting prices for access to ICL's cable capacity has been characterized to date by a paucity of information and seemingly arbitrary pricing proposals by ICL . . .
>
> This has led to a situation where international cable capacity pricing remains very high compared with international benchmarks and is suppressing market development and demand for bandwidth. This is to the detriment of consumers, and, ironically, means that ICL and its shareholder are missing the increased revenues and associated benefits

that would arise if bandwidth prices were lowered to levels enjoyed in other comparable countries."

Digicel respectfully submits that it is time for a more transparent, holistic and forward looking approach is taken to ICL's cable pricing that takes into account existing capacity commitments and sales and which reflects the likely growth in demand that would arise if reasonable prices were applied. This could include a "shared risk" approach where users of capacity could provide either binding or non-binding forecasts of future capacity needs which could then be used as a basis for any cost/price modelling."

45. TRR has proposed such a cooperative "win-win" approach in the past, as an alternative to regulation, but so far the interested parties have not actively engaged with TRR to implement such an approach. That is one reason why TRR adopted, as a last resort, the price approval Order being implemented here. Contrary to some public accusations against TRR, it does not believe this involves "over-regulation" of ICL. TRR simply has adopted the least burdensome type of approach available, as an alternative to doing nothing and letting ICL charge whatever prices it wants (over the strong objection of its major customers).

46. TRR also again encourages ICL and its customers to engage in cooperative discussions with TRR to establish "win-win" cost-based pricing for the period after this price approval, namely after ICL has sold 1200 Mbps of additional capacity. Based on current demand trends, this milestone may be reached by mid-2018. As stated above, such volume-based discounts can produce improved financial results for ICL, as well as lower costs for retail internet users.

4. Submissions On The Appropriate ROI for ICL

47. Cost-based pricing refers to pricing that covers costs, including a reasonable Return on Investment (ROI). A decision about cost-based pricing for ICL therefore requires consideration of what is a reasonable ROI for the ICL cable.

48. TRR also has received submissions about what percentage Return on Investment (ROI) is reasonable, but not excessive, for ICL.

49. ICL's substantiation for its pricing calculated that its proposed price would provide a rate of return of 25% in 2018 on shareholder monies invested (assuming during 2018 ICL had leased 1200 Mbps of capacity at this price). ICL also stated:

> "It is normal for investors in greenfield projects such as this to expect an ROI in the vicinity of 15-30% p.a. Given the patience of ICL shareholders [in not earning returns so far] and the time it is taking to evidence returns, an annual ROI of 25% is seen as a respectable ambition, at least in the short term."

50. TVL stated that a reasonable rate of return on the total project investment would be about 8%, and this would need to be calculated on average over the life of the investment, and not for one or a few years only:

"A regulated ROI on submarine cable infrastructure is typically in the range of 8 – 10%[4]. This recognises the trade-off inherent in such nationally significant infrastructure between the need to provide a reasonable return to private investors and the negative effects that allowing undue returns can have on economic development.

Whatever the target ROI may be, it cannot be an annual expectation. It is the average of the annual ROI over the life of the investment. The return period for submarine cables investments is usually quite long and in the order of 15-20 years. . . . This means that the annual ROI in the early years of the investment is usually well below the target or regulated ROI, but raises above the target in its latter years. Accordingly, a reasonable expectation in year 5 would be an annual ROI of between 3-5%, and between 11-13% in year 10, continuing to increase thereafter to achieve and average annual ROI over 15 years of 8-10%. These figures would of course be lower if the assumed return period was longer than 15 years."

51. Digicel stated that it had not sufficient time to finalise its views on a reasonable rate of return, and that, based on a recent cost study of fixed and mobile networks, estimated that such a rate of return approximately 15.42% - 16.07%.

II. ANALYSIS OF ICL'S PROPOSED PRICING

A. Summary OF ICL's Proposed Pricing, Substantiation & Supporting Reasoning

52. ICL initially proposed and explained its pricing in an email to TRR on 26 September 2016. ICL then provided further explanation and substantiation to TRR in a document provided in full on 3 October 2017 entitled "Return on Investment Assessment"[5]

53. ICL's proposed pricing is as follows:

    (i) A price of $285/Mbps/Month, which applies to any amount of capacity acquired by a customer from 1 – 1000 Mbps and requires each customer to commit to buy capacity in this range of amounts for a 3-year term; and

    (ii) ICL may offer lower pricing, for customers who acquire more than 1000 Mbps of leased capacity).

54. ICL's assumptions and claims in support of this proposed pricing included the following:

    (i) Since the Cable began operating during 2014, ICL had paid down substantial debt and supplied a significant amount of capacity, but had not made any significant profit. ICL says its investors have now waited long enough, and patiently, to receive some

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[4] See for example page 36 of the presentation by Polyconseil to the World Bank regarding the costs and pricing of submarine cables in Pacific island countries at http//siteresources. worldbank.org/EXTEDEVELOPMENT/Resources/BIRDBIRD_Revisedversion.pdf

[5] This document contains details of ICL costs and revenues, which are confidential to ICL, and which are not disclosed in co this Decision, other than as provided to ICL and the Government (as shareholder).

returns, and its pricing should in 2018 provide a significant return, which could be used to pay down debt and/or for dividends or other business purposes;

(ii) ICL's proposed price of $285 per Mbps per month, if applied to "required level" of capacity sales of 1200 Mbps in total, would provide ICL with a return on shareholder capital invested of about 25% in 2018 (assuming this level of capacity sales during that year). ICL says this would be a "respectable" but not overly large return, especially when considered with prior years in which little or no return was earned.

(iii) ICL's price will be revised downward after it has sold the required level of capacity (1200 Mbps)[6]. ICL notes that such reductions are standard in the industry, as increased sales result in lower unit costs.

B. TRR's Analysis Of ICL's Proposed Pricing

1. General Considerations

55. TRR generally agrees with the comments of TVL and Digicel that cost-based pricing for an asset such as ICL's Cable typically is done over the life of the asset, and not just for one or a few years. As TVL says, this can be measured by an average annual ROI based on the total ROI over time.

56. ICL adopts a different and less complicated approach. In particular, ICL seeks to justify its pricing, for a limited period of a year or so, on the basis that this pricing provides a reasonable, but not excessive return (of about [redacted]% on shareholder invested capital of $US [redacted]), for this limited period. The limited period is until the required level of capacity sales is achieved, which ICL says may be in Year 5. After that this level of sales is reached, ICL agrees that pricing should reduce.

57. ICL has sought to justify its proposed price over a short term, based on it being a reasonable return for this relatively early point in the Cable's life, when no real returns have yet been earned. ICL also relies in part on the importance of the Government, and statutory entities VNPF Vanuatu Post, being shareholders who should not be left for long periods with little or no return

58. TRR does not believe such a focused approach means that ICL's approach should be rejected. Especially in a small market such as Vanuatu, and it is not always necessary to have a full and detailed cost analysis, for the life of the investment.

59. TRR also notes that an important benefit from approving ICL's proposed pricing is that it would provide enhanced financial stability and strength to ICL. This is not merely a private benefit to ICL and its shareholders (due to allowing ICL to reduce debt and/or pay dividends). Such a financial injection for ICL also will set a more solid foundation for future price reductions, which would stimulate demand and enable retail pricing to be more attractive to the people of Vanuatu.

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[6] ICL's Rate of Return Assessment states: "[redacted]

60. Digicel and TVL take a different position, namely that significant returns or enhancing ICL's financial position should be deferred until later in the life of the ICL Cable, and that ICL and the market will be better served by ICL pricing that, from today, is less than ICL's proposed price, as this will stimulate demand and promote access.

61. In dealing with these competing arguments, TRR believes it is highly relevant that, since 1 October 2017, there already has been very significant demand shown for ICL leased capacity.[7] In particular, TRR is advised that customers require, and either have or are ready now to purchase, over [redacted] Mbps of capacity, even at ICL's proposed price.

62. This indicates that the "required level" for ICL capacity sales at the proposed price (1200 Mbps) is likely to be reached within less than 1 year (i.e. by the end of 2018). ICL's proposed price therefore likely would only need to apply for a year or so to provide ICL with an enhanced financial strength and stability, as per its submissions to TRR.

63. This means that there is not likely to be a significant downside to approving ICL's proposed price, so long as this approval is for this limited period, such that prices then begin to reduce (as proposed by ICL).

64. TRR believes that these considerations are sufficient to warrant it approving ICL's price for a limited period (i.e. until ICL leases its required level of total leased capacity sales (1200 Mbps). TRR therefore approves ICL's pricing as applied up to the sale of this total amount of capacity, but not for any larger total amounts of capacity.

65. This approach balances the interests of ICL, the Government, ICL customers, and most importantly, the development and availability of internet services, over time, in Vanuatu. In particular, ICL's prices will be higher than customers want for a relatively short period, but this will set a firmer financial footing for ICL (and its investors) to materially decrease after this. The later price reductions also are during a period in which one major operator has stated that demand for internet services is likely to be suppressed, unless prices paid to ICL are reduced.

66. TRR also requests that ICL and its customers take steps to ensure that their contracts implement this decision. This could be done, for example, by having the contracts provide that the ICL proposed (and now approved) price is subject to review, and not mandatory, after the required level of capacity is sold by ICL, and that ICL will propose price reductions for such later periods.

2. Financial Analysis

67. The outcome described above also is supported by TRR's analysis of ICL's costs and annual cash flows, which is based on documents and information provided by ICL (such as audited accounts.).

68. TRR's analysis contains confidential information of ICL, which it has not consented to TRR providing to other parties (such as Digicel and TVL). Accordingly, TRR refers to the results of this analysis here only at a high level, in ways that do not disclose ICL's confidential information.

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[7] According to Digicel and TVL, this is due to their customer requirements for internet increasing significantly, and ICL being the only viable source for meeting that increased demand.

69. TRR's cash flow analysis is consistent with that provided by ICL for the 2017 and 2018 years, in that both show ICL earning a similar, and substantial return on shareholder capital, if ICL's proposed price is applied to ICL's required level of sold capacity (1200 Mbps).

70. TRR's analysis also covers the period(s) beyond 2018 and shows that, if ICL's proposed price is continued in subsequent years (e.g. in 2019 and/or 2020), with demand increasing at expected rates, this annual rate of return quickly becomes excessive. For example, the return increases, with moderate demand increases, to over [redacted]% in 2019, and even more in 2020.

71. TRR also has conducted a further financial analysis by TRR of ICL's proposed pricing, over the expected life of the ICL cable, and applying appropriate WACC[8] figures. This more detailed analysis, although not necessary to this Decision, also support it. This analysis also shows that, if ICL's proposed price is applied for a limited period (i.e. until capacity of 1200 Mbps is leased), ICL can thereafter significantly reduce prices and still earn significant returns that are above expected rates of return (WACC) on total capital invested for submarine cable investments. [9]

3. Other Considerations – Lack Of Tiered Pricing

72. As referred to above, TVL has objected to a single price for all amounts of capacity purchased by a given customer from 1 – 1000 Mbps

73. TRR agrees that such quantity discounts are common in the industry and are beneficial by providing incentives for larger purchases, encourage greater commitments and risk taking by wholesale customers, and can stimulate more vigorous down-stream retail competition, which can benefit both the industry and cable owner. For example, this has always been, and remains, the pricing structure for leasing by FCC.

74. TRR also agrees that a failure to have any such discounts across a large range of purchases also may involve pricing that is not cost-based.

75. In this instance, however, the problem is not sufficiently large to justify TRR not approving ICL's pricing on this basis. The main reasons for this are:
    (i) ICL has stated that it will give volume discounts for leased capacity above 1,000 Mbps;

    (ii) ICL proposes its pricing only for a limited period (i.e. until 1200 Mbps are sold at this price, and it appears that level of sales is likely to be reached during the second half of 2018);

    (iii) The $285/Mbps/Month is put forward for approval as a maximum price. Customers and ICL may continue to negotiate for volume discounts, in particular by the customer offering to purchase larger amount for a price lower than $285/Mbps/Month.

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[8] WACC stands for "Weighted average cost of capital". It is the average rate of return a company expects to compensate all its different investors. The weights are the fraction of each financing source in the company's target capital structure. Any return above the WACC is a greater than expected, or reasonable, return.

[9] TRR's calculation of WACC is available on request to ICL and other interested parties.

(iv) As proposed by TRR (and supported by Digicel and TVL), ICL and its customers may get together and arrive at reduced pricing based on a "shared risk" approach in which customers must purchase specified volumes to get lower pricing.

4. Future Steps Re ICL Sales & Pricing

76. Following this approval Decision, ICL and its customers can now proceed to provide services and apply ICL's proposed price, for the period approved by TRR, which will cover a significant volume of new capacity and increased use of the ICL Cable.

77. This period also will allow the parties' time to seek to resolve differences about pricing after this required level of capacity is sold.

78. Digicel and TVL have both stated that this should be done in a more cooperative process in which ICL and its main customers agree total volume increases, and on that basis, reduced prices that benefit ICL by increasing demand, and revenues, and benefit customers by reducing unit costs and providing better value.

79. TRR has in the past supported this approach, and is willing to assist the parties to implement it, in order to reduce disputes or resort to more formal regulatory processes.

III. CONCLUSION ON ICL'S PROPOSED PRICING

80. For the reasons summarised in this Decision, TRR intends to issue a formal Order, to the following effect:

Pursuant to Order No. 8 of 2017:

(i) ICL's proposed price for leased capacity of $US285/Mbps/Month is approved for all sales by ICL of leased capacity up to the "required level" of total leased sales as proposed by ICL, being 1200 Mbps.

Signed on 10/11/2017

REPUBLIC OF VANUATU
OFFICE OF THE TELECOMMUNICATIONS REGULATOR
BUREAU POUR LE RÉGLEMENT DE TELECOMMUNICATIONS
RÉPUBLIQUE DE VANUATU

Dalsie Baniala
Telecommunications and Radiocommunications Regulator