

Office of the Director of  
**Telecommunications  
Regulation**

**Accounting Separation  
for Internet  
Service Provision and  
Report on Investigation into  
Indigo and *eircom.net***

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**Decision Notice D2/01**

**Document No. ODTR 01/10**

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# 1. Introduction

In August 2000, the Office of the Director of Telecommunications Regulation (“ODTR”) published a Decision Notice D9/00<sup>1</sup> on the subject of Accounting Separation. This notice discussed, *inter alia*, the further disaggregation of the Other Activities business area in the Separated Accounts to show the activities of Indigo, *eircom*’s subsidiary in the Internet Service Provision (“ISP”) market. The Director posed two questions on the issue and invited responses from interested parties. The questions were as follows:

*Q 1. Do you agree that an ISP business unit should be separately disclosed in the Separated Accounts?*

*Q 2. What activities should be included in the ISP business unit?*

Responses were received from the following parties:

- Esat Telecommunications Ltd.
- Ocean Communications Ltd.

This document summarises these responses and sets out the decisions the Director has made for the effective reporting of this business in the Separated Accounts.

On the 6<sup>th</sup> August 1999, the ODTR commenced an ‘own initiative’ investigation into possible unfair cross-subsidisation by *eircom* of Indigo following the introduction of Indigo’s ‘Go Free’ service. Subsequently, the ODTR extended its investigation to *eircom.net*. The document also details the findings of the investigation undertaken by the ODTR into the activities of *eircom*’s two ISPs, Indigo and *eircom.net*, to ascertain whether or not there is evidence of potential unfair subsidisation.

This document sets out the Director’s current position on accounting separation for Internet Service Provision and the report on the investigation into Indigo and *eircom.net*. This document is without prejudice to the legal position or the rights and duties of the Director to regulate the market generally.

## 2. Disclosure of ISP business units in Separated Accounts

In Decision Notice D9/00, the Director identified the ISP market as very important in the development of telecommunications in Ireland. She also stated that disclosure of such activities by way of the Separated Accounts contributes to an open and competitive market and assures operators that proper accounting and business relationships exist between *eircom* and its business units.

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<sup>1</sup> Accounting Separation and Publication of Financial Information for Telecommunications Operators, Decision Notice D9/00 & Issues for Further Consideration, (Document No. ODTR 00/59)

In Decision 4.4 of that Decision Notice, the Director required *eircom* to show the activities of Indigo as a disaggregated activity in the Other Activities category of the 1999/2000 Separated Accounts with comparative information for the previous period.

Following publication of D9/00, *eircom* did not respond directly to the consultation but instead sought to make representations to the Director on Decision 4.4, amongst other issues. These other issues were considered in Decision Notice D10/00 issued by the Director in September 2000<sup>2</sup>. *eircom*, in its representation considered Indigo, its subsidiary ISP, was not a provider of licensable telecommunications services and, as such, should not hold a licence. Accordingly, it argued that Indigo should not be disaggregated in the Separated Accounts.

Decision 4.4 was not altered and accordingly, *eircom* complied with the decision when publishing its Historical Cost Separated Accounts for 1999/2000 in September 2000.

To address the question of disclosure of ISPs in the Separated Accounts, the respondents considered the following issues:

- Definition of the term “ISP business” and a framework within which ISP issues can be analysed;
- Identification of where anti-competitive behaviour can take place, and where regulatory action can play a part in preventing this;
- Whether and how Accounting Separation data can be used in assessing this.

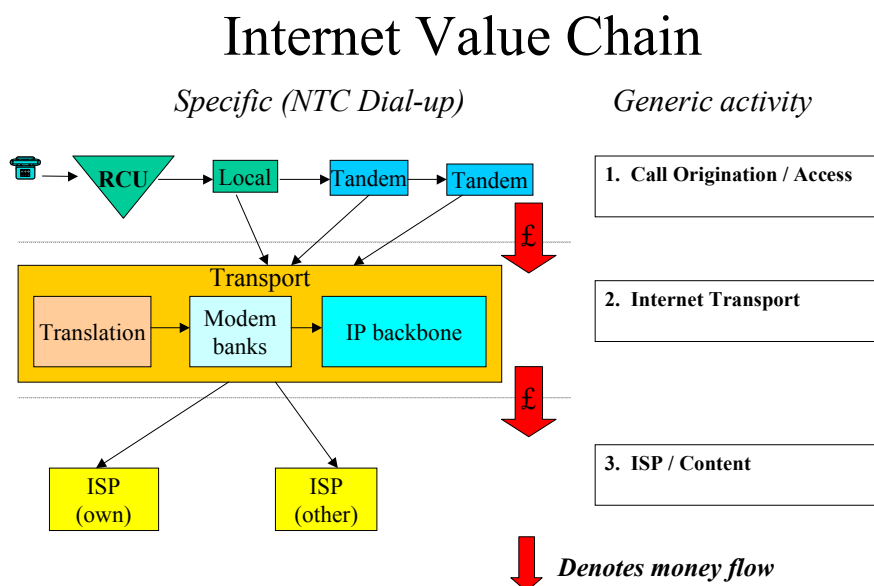
## **2.1 ISPs and the Internet Value Chain**

The respondents believe that as there is no consensus as to the meaning of the term ISP, it is important to look at the activities involved in providing Internet services to users. The broad categories involved are set out in the following diagram.

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<sup>2</sup> Accounting Separation and Publication of Financial Information for Telecommunications Operators, Supplemental Information referring to Decision Notice D9/00, Decision Notice D10/00, (Document No. ODTR 00/72)

Figure 1: Respondents' characterisation of internet services.



They suggest that while the transport and ISP/content aspects of the chain are competitive markets, that the origination aspect is not competitive, due to *eircom*'s high market share of exchange lines. To assist competition throughout this value chain, they believe that operators, apart from *eircom*, should be able to compete for termination of Internet calls and the provision of termination services to *eircom*'s ISP customers.

## 2.2 The role of regulation in preventing anti-competitive behaviour

Given the foregoing, the respondents believe that regulatory action should be focused on:

- the obligations of an operator designated with Significant Market Power ("SMP") to offer appropriate wholesale services to Other Licensed Operators ("OLOs");
- preventing unfair cross-subsidy and undue discrimination between different activities in the incumbent operator's value chain;
- ensuring that there is no undue discrimination/preference between internal and external customers (retail or wholesale).

They therefore believe it is vital that the ODTR use its powers of inspection, where appropriate, in order to deal with any potential distortion of competition.

## 2.3 Role of Accounting Separation Data

According to the respondents, the purpose of Accounting Separation is to disclose the activities of an SMP operator as if these activities were run as separate entities. The data

should separately identify upstream network business from the downstream retail business and be able to ensure that the transfer charges arising are cost oriented and non-discriminatory.

Both pricing of call origination services and provision of termination services on a non-discriminatory basis are important issues for OLOs. The ODTR must ensure fairness of such prices and services and use Accounting Separation to achieve this.

## **2.4 Requirement for Data on the ISP business**

Both respondents do not regard the publication of data on the ISP activity in the Separated Accounts as being the most important issue. Of greater importance is determining whether *eircom's* ISP is a viable stand-alone business. In this regard, Accounting Separation data can only ever be regarded as a “snapshot” of profitability whereas the respondents would expect the ODTR to consider a longer time horizon in making any judgement.

The respondents consider that it may be inappropriate for the ODTR to require *eircom* to separately identify its ISP business in the Separated Accounts. Due to issues of commercial confidentiality, the respondents feel that *eircom* should provide this information to the ODTR only. This would ensure that *eircom* does not have any concerns as to confidentiality and also that the OLOs have confidence that ODTR is able to secure such detailed information which would contribute to a more competitive market.

The Director considers that the characterisation of the Internet market provided by the respondents in their submissions is a useful one. However, she believes that the Separated Accounts have a key role in reinforcing the transparency of the economic links between the activities of the operators with SMP. She is not persuaded that *eircom's* commercial confidentiality is undermined by requiring disclosure of the type and extent of the information currently provided in the Separated Accounts.

The Separated Accounts currently identify three activities that are Internet-related. These are Calls to Internet (1891 number), Internet Services Supply and Indigo. To switch the basis of division between the activities in the Separated Accounts it may be possible to better reflect the Internet value chain by alteration and clarification of the existing disaggregated activities layout without requiring publication of commercially confidential information.

Before making changes, the Director proposes to offer interested parties the opportunity to contribute further to this issue in the upcoming consultation on wider Accounting Separation issues, which will be issued shortly.

### **Decision 2.4.1**

***eircom* will continue to present the business of Indigo as a disaggregated activity of the Other Activities business area.**

### **3. Activities to be included in an ISP business unit**

Both respondents believe that the activities included in the Internet value chain are those for which ODTR should seek further reporting, if the ODTR believes this to be an effective tool in this case. They caution, however, that given the pace of growth and change within this market, any definition of an ISP business unit may have to be revised frequently, and certainly within one year.

The Director agrees that it is useful to consider the Internet value chain when attempting to define an ISP business unit. She also recognises the evolving nature of the business at this time.

In view of the developing character of this market and the limited response received to this consultation, the Director will encourage further submissions on this matter by interested parties in the consultation on Accounting Separation before taking a decision on the issue.

### **4. Investigation by ODTR into the activities of Indigo and *eircom.net***

On the 6th August 1999, the ODTR commenced an 'own initiative' investigation into possible unfair cross-subsidisation by *eircom* of Indigo following the introduction of Indigo's 'Go Free' service. Subsequently, the ODTR extended its investigation to *eircom.net*. Following the opening of the ODTR's investigation, a number of operators complained to the ODTR (formally and informally) concerning the activities of Indigo and *eircom.net* in respect of the provision of free Internet access. Specifically, they alleged that *eircom* was cross-subsidising its "free" Internet access services. The principal matters at issue in the ODTR investigation were the potential unfair cross-subsidisation or unfair subsidisation by *eircom* of Indigo and/or *eircom.net*, two ISPs controlled by *eircom*. Such behaviour is prohibited under Conditions 14 of *eircom's* General Telecommunications Licence. Unfair cross-subsidisation of any 'Offered Service' by activities in the Relevant Market is also prohibited under Condition 14.

In this instance, the Director examined not just current profits but also the potential for future profitability. The Director would consider a cross-subsidy to have occurred where the revenues from *eircom's* Internet service provision failed to cover the costs associated with that activity over its economic lifetime. That is, the fact that accounting profits for a particular period, such as a year, are negative, would not alone be sufficient to establish that *eircom's* ISP activity was in receipt of a cross-subsidy. In addition, it is important to note that not all cross subsidisation is illegal.

In order to establish that *eircom's* ISP units are not the beneficiary of unfair cross-subsidies from other areas within the *eircom* group, the ODTR conducted both a financial and a competitive analysis of the business concerned. The financial analysis consisted of a Net Present Value analysis of the relevant cash flows associated with

*eircom's* Multimedia ISP business. In addition, work was carried out to verify the plausibility of the assumptions underlying the Multimedia ISP financial projection.

On the basis of this analysis and information provided by *eircom*, the ODTR did not find evidence that *eircom's* ISP businesses are being unfairly cross-subsidised by other parts of *eircom's* Multimedia business or by *eircom* activities in the relevant market. However, the Director will monitor *eircom's* ISPs to ensure that actual performance of the ISP business matches the forecasts in the ISP business plan.