Commission for
Communications Regulation

Assessment of Eircom's Universal Service Fund Application for 2009-2010– Response to Consultation and Determination

NON CONFIDENTIAL

Response to Consultation and Decision document

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Chapter 1

1 Introduction

1.1 The European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) Regulations 20011, ("the Regulations"), provide that a universal service provider ("USP") may submit a request for funding ("application") for a claimed net cost (including intangible benefits) of meeting the Universal Service Obligation ("USO") and that the Commission for Communications Regulation ("ComReg") is obliged to assess such a request.

1.2 Eircom submitted an application on 31 May 2012 for funding in respect of the provision of USO services for the 2009-2010 financial year[1], in line with Decision 32[2] of ComReg's Decision paper, *"Decision on the Costing of universal service obligations: Principles and Methodologies"*, ("D04/11"). ComReg has assessed the application for funding submitted by Eircom in respect of its consistency with the principles and methodologies prescribed by ComReg in D04/11.

1.3 ComReg set out its preliminary views of Eircom's application for funding for the period 2009-2010 in Consultation 13/45[3], having had regard to the provisions of ComReg D04/11, the Regulations and the recommendations made by ComReg's consultants TERA Consultants and Oxera Consulting. Additionally Consultation 13/45 set out ComReg's preliminary view with respect to the assessment of whether the positive net cost estimated represents an unfair burden.

1.4 This document sets out ComReg's final view and determination of Eircom's application for funding for 2009-2010, in accordance with D04/11 and the Regulations.

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[1] ComReg document 12/57, http://www.comreg.ie/_fileupload/publications/ComReg1257.pdf

[2] Decision 32 of D 04/11 states *"Eircom, the current USP, may submit a request for USO funding to ComReg in respect of its financial period 1 July 2009 to 30 June 2010. If Eircom intends to submit such a request to ComReg, it shall do so no earlier than 1 month, and no later than 6 months following the effective date of this Decision, ComReg may extend this deadline, but only where it considers that there are exceptional reasons for doing so."* ComReg granted Eircom a number of extensions in respect of any application for funding for the period 2009/2010, resulting in changes to the original date of 30 November 2011 to 31 May 2012. http://www.comreg.ie/_fileupload/publications/ComReg1214.pdf

[3] ComReg (2013), "*Consultation and Draft Determination on the Assessment of Eircom's Universal Service Fund Application for 2009-2010*", May 2013

Chapter 2

2 Executive Summary

2.1 Overview

2.1 Eircom is designated as the USP until June 2014. Therefore, Eircom may make applications for USO funding, should it so choose in respect of its financial periods 2009-2010, 2010-2011, 2011-2012, 2012-2013 and 2013-2014. Any application must be in accordance with ComReg Decision D04/11.

2.2 D04/11 provides both the basis upon which the application is to be prepared by the USP and the assessment to be undertaken by ComReg. D04/11 was published having carefully considered respondents' views in respect of ComReg Consultation and Draft Decision *'Costing of universal service obligations: Principles and Methodologies'*, which was published on 7 March 2011[4]. D04/11 details ComReg's approach with regard to the assessment of a USO funding application, including the methodologies to calculate a net cost and the principles that require considering, when establishing if an unfair burden is associated with a positive net cost arising from the provision of the USO.

2.3 ComReg's assessment of Eircom's application, which is detailed in ComReg Consultation and Draft Determination 13/45, published in May 2013. This Response to Consultation and Determination, ascertains whether Eircom adhered to the principles and methodologies in calculating a net cost arising from the USO provision, as set out in D04/11.

2.4 ComReg's approach to the assessment of Eircom's application for the 2009-2010 and subsequent applications will be undertaken on a case by case basis and each application will be assessed on its own merits and consulted on in a similar manner.

2.5 ComReg set out its preliminary views of Eircom's application for funding for the period 2009-2010 in Consultation 13/45, with regard to the applicable provisions of ComReg Decision D04/11, the Regulations and the recommendations made by ComReg's consultants TERA Consultants and Oxera Consulting. Following this detailed assessment, ComReg estimated a positive net cost of €5.1m and considered that the positive net cost was not an unfair burden to Eircom for the period 2009-2010.

[4] ComReg (2011), "*Costing of universal service obligations: Principles and Methodologies",* ComReg Document 11/15

2.6 Consultation 13/45, in line with the provisions of D04/11, also provided guidance in the form of recommendations on the improved quality and suitability of the data provided and the methodologies implemented as part of the application by Eircom, that would be required to support future USO Fund applications, as relevant.

2.7 Consultation 13/45 also sought the views of respondents, with respect to the following consultation questions:

Consultation 13/45 Questions		Chapter reference
1	*"Do you agree with ComReg's preliminary view that consultancy costs incurred in respect of any application do not form part of the direct net cost? Please provide detailed reasoning to support your views.*	5
2	*"Following ComReg's assessment, detailed in Chapter 4, do you agree with ComReg's preliminary view that the direct net cost for 2009-2010 is €7,139,331? Please provide detailed reasoning to support your views."*	5
3	*"Following ComReg's assessment, detailed in Chapter 5, do you agree with ComReg's preliminary view that the intangible benefits estimate for 2009-2010 is €2,043,786? Please provide detailed reasoning to support your views. "*	7
4	*"Following ComReg's assessment, detailed in Chapters 4 and 5, given ComReg's preliminary view that the direct net cost is €7,139,331 and that the intangible benefits are €2,043,786; do you agree with ComReg's preliminary view that the positive net cost for 2009-2010 is €5,095,545? Please provide detailed reasoning to support your views. "*	8
5	*"Following ComReg's assessment, detailed in Chapter 6, do you agree with ComReg's preliminary view that a positive net cost of €6,225,219 or €5,095,545 for 2009-2010 is not an unfair burden on Eircom? Please provide detailed reasoning to support your views."*	10

2.8 There were seven responses to Consultation 13/45 from the following respondents:

- ALTO;
- BT Communications Ireland Ltd ("BT");
- Eircom Group ("Eircom");
- Magnet Networks Limited ("Magnet");

- Telefónica;
- UPC Communications Ireland Ltd ("UPC"); and
- Vodafone.

2.9 ComReg has considered the views of the seven respondents to Consultation 13/45, included in Document 14/03s. This Response to Consultation and Determination sets out ComReg's final position which is that there is a positive net cost of €5.1m for the 2009-2010 period and that this positive net cost does not represent an unfair burden to Eircom. A summary of ComReg's final positions with respect to each consultation question set out in Consultation 13/45 is as follows:

ComReg's final position(s) **Summary**	
1	Having considered the views of respondents, ComReg remains of the view that consultancy costs incurred by Eircom in respect of any application for 2009-2010 do not form part of the direct net cost of the USO.
2	Having considered the views of respondents, ComReg remains of the view that the direct net cost of the USO for 2009-2010 is €7,139,331.
3	Having considered the views of respondents, ComReg remains of the view that the intangible benefits estimate of the USO for 2009-2010 is €2,043,786.
4	Having considered the views of respondents, ComReg remains of the view that the direct net cost is €7,139,331 and that the intangible benefits amount to €2,043,786. As such, ComReg is of the view that the positive net cost for 2009-2010 of the USO is €5,095,545.
5	Having considered the views of respondents, ComReg remains of the view that a positive net cost of €6,225,219 or €5,095,545 for 2009-2010 is not an unfair burden on Eircom.

2.10 Given the highly commercially sensitive nature of much of the information relevant to the assessment of Eircom's application, ComReg has strictly maintained the confidentiality of the relevant information, as it is obliged to do under Regulation 15 of the European Communities (Electronic Communications Networks and Services) (Framework) Regulations 2011[5] ("the Framework Regulations") and in accordance with its guidelines on the treatment of confidential information ("Confidentiality Guidelines")[6]. At the same time, ComReg has ensured that the consultation process has provided sufficient information for the issues to be comprehensible and for stakeholders to be able to both respond to it and understand the principles of the key issues. Where information of a confidential/commercially sensitive nature is discussed in this document and the consultants' reports, the relevant information has been redacted and a ✂ symbol has been inserted.

2.11 For the purpose of completing this consultation process, ComReg commissioned expert reports from TERA and Oxera to assist it with its review of Eircom's USO fund application and the determination in respect of an unfair burden. The reports (non-confidential versions) are appended to this Response to Consultation and Determination in order to provide further detail and enhance respondents' understanding of the issues.[7] ComReg also sought advice from Oxera on three issues raised by Eircom in its response to Consultation 13/45[8], as set out in document 14/03a.

[5] S.I. No. 333 of 2011
[6] ComReg (2005), "*ComReg's Guidelines on the treatment of confidential information*", 05/04
[7] These reports have been redacted as appropriate.
[8] Oxera (2013), *"Review of eircom's response to ComReg's consultation on the 'Assessment of Eircom's Universal Service Fund Application for 2009-2010",* December 2013

Chapter 3

3 Overview of assessment

3.1 Overview

3.1 The USO, in brief, ensures basic fixed line telephone services are available to end users at an affordable price. The scope of universal service is defined by the Universal Service Directive ("the Directive"). The Directive was transposed into Irish law on 1 July 2011 by the Regulations.

3.2 D04/11 provides both the basis upon which the application is prepared by the USP and for the assessment to be undertaken by ComReg. D04/11 was published having carefully considered respondents' views in respect of ComReg's Consultation and Draft Decision *'Costing of universal service obligations: Principles and Methodologies'*, which was published in March 2011. D04/11 outlines the principles and methodologies as to how ComReg will assess a USO funding application and the principles it will consider in establishing if there is an unfair burden associated with meeting the USO provision if a positive net cost arises.

3.3 Eircom was designated as the USP in 2003 and 2006, and has been redesignated from 1 July 2010 to 30 June 2012 and from 1 July 2012 to 30 June 1014.[9]

3.4 Eircom, as the designated USP for those specified periods, may submit applications for USO funding in respect of its financial periods 2009-2010, 2010-2011, 2011-2012, 2012-2013 and 2013-2014, should it so choose, subject to D04/11. The funding application being assessed throughout this document is for the provision of USO services for the 2009 - 2010 financial year.

3.5 As set out in the relevant ComReg Decisions, Eircom as the USP must comply with specified obligations in respect of the following:

– Provision of access at a fixed location;

– Directories;

– Public pay telephones;

– Specific measures for users with disabilities;

[9] ComReg (2012), D07/12, 12/71, *"The provision of telephony services under Universal Service Obligations"*, http://www.comreg.ie/_fileupload/publications/ComReg_1271.pdf, June 2012

- Geographically averaged pricing; and
- Control of expenditure.

3.2 Overview of the USO fund application process

3.6 Eircom submitted an application[10] on 31 May 2012 for funding in respect of the provision of USO services for the 2009-2010 period (year-end 30th June 2010). ComReg issued an information notice in relation to the application on 1 June 2012, ComReg document 12/57.[11] In its application, Eircom highlighted that its application sought to follow *"the guidance provided by ComReg in Decision D04/11 of 31 May 2011 to the extent that it was possible and sought to ensure(d) compliance with each individual decision contained in D04/11*[12]."

3.7 Eircom engaged with consultants WIK Consult ("WIK") and Amárach Research ("Amárach") to assist in the preparation of its application. For the purpose of supporting its application in adherence with Decision 22 of D04/11, which requires that *'Financial information shall be provided with an appropriate audit opinion or appropriate report...'*, Eircom engaged PricewaterhouseCoopers (PwC) to discuss and agree the most appropriate form that any such assurance over the application should take. Arising from this ComReg entered into a tripartite engagement with Eircom and PwC to formulate a set of specific procedures to be carried out on the funding application. The parties to the Agreed Upon Procedures ("AUPs")[13] engagement (in this case Eircom, PwC and ComReg) are responsible for determining whether the scope of the procedures specified is sufficient for their respective purposes in connection with the USO Funding application.

3.8 A report was provided by PwC setting out the specific findings arising from the AUPs carried out on Eircom's funding application. This report has been reviewed by ComReg and TERA as part of ComReg's assessment of the USO funding application submitted by Eircom, and ComReg has considered and assessed the findings.

[10] Eircom (2012), *"Costing of Universal Service Obligations: Application for funding of Eircom Limited pursuant to Regulation 11 of the Universal Service Regulations",* 31 May 2012

[11] http://www.comreg.ie/_fileupload/publications/ComReg1257.pdf

[12] Eircom (2012), *"Costing of Universal Service Obligations: Application for funding of Eircom Limited pursuant to Regulation 11 of the Universal Service Regulations",* 31 May 2012

[13] An AUPs engagement is carried out in accordance with the International Standard on Related Services 4400 'Engagements to perform Agreed Upon Procedures Regarding Financial Information' and does not constitute an examination made in accordance with generally accepted auditing standards. An AUPs engagement is not an audit or a review, the objective of which would be the expression of an audit opinion on the relevant Services.

3.3 Overview of ComReg's assessment

3.9 ComReg's assessment of Eircom's application for funding sought to ascertain whether Eircom adhered to the principles and methodologies set out in D04/11[14]. The approach set out in D04/11 with respect to the assessment and the subsequent determination of whether a resulting positive net cost (if any) constitutes an unfair burden, falls under the following headline areas:

- The assessment of the principles and methodologies for calculating the USO direct net cost;
- Principles and methodologies for calculating the intangible benefits of the USO through the provision of USO services; and
- Approach to a determination of an unfair burden.

3.10 ComReg engaged with external consultants TERA Consultants ("TERA") to undertake an independent review[15] of the principles, methodologies and calculations of the direct net cost element of Eircom's funding application. Separately, Oxera Consulting Ltd ("Oxera") was commissioned by ComReg to undertake an independent review and provide its view[16] on WIK's estimation of the intangible benefits generated through the provision of the USO.

3.11 In undertaking the assessment of whether the proposed positive net cost represented an unfair burden to Eircom, ComReg engaged Oxera to also assess the application submitted by Eircom in the context of D04/11, the Regulations and relevant European precedent. As this was the first time an exercise of this nature has been undertaken in the context of the Irish market, ComReg informed its assessment with a practical framework developed by Oxera based on its interpretation of the relevant decisions set out in D04/11.

3.12 In concluding its assessment, ComReg considered respondents' views to Consultation 13/45. This document details ComReg's Response to Consultation and Determination in respect of a positive net cost and whether the positive net cost represents an unfair burden on Eircom.

[14] ComReg (2011), *"Report on Consultation and Decision on the costing of universal service obligations: Principles and Methodologies"*, 31 May 2011
[15] TERA Consultants (2013), *"Assessment of Eircom's USO funding application"*, 1 February 2013
[16] Oxera Consulting (2013), *"Assessment of WIK's calculation of intangible benefits*", 1 February 2013

3.13 As highlighted in D04/11 *"there may be circumstances where modifications are required to ensure that any limitations that are discovered are overcome"* and "*it is (equally) important to ensure that all stakeholders are aware of the possibility that ComReg will require some degree of flexibility going forward"*. Having undertaken its assessment, ComReg found that clarifications, modifications and a degree of flexibility was required to ensure the most accurate assessment. As such, clarifications were sought between ComReg, TERA and Oxera with the co-operation of Eircom and its consultants throughout the assessment period. As a result, some necessary adjustments were made by Eircom to its application. Further detail on these clarifications and adjustments are discussed in Consultation 13/45, the respective consultants' reports and this Response to Consultation. To assist with the accuracy and compliance for future funding applications, ComReg in consideration of the advice of TERA and Oxera, has made recommendations for future assessments.

Chapter 4

4 Assessment of the direct net cost

4.1 Overview

4.1 The legal basis for the assessment of an application is the Directive, as transposed by the Regulations. The Directive provides that for a calculation of a direct net cost "…*the net cost of USO is to be calculated as the difference between the net cost for a designated undertaking of operating with the USO and operating without the USO*."[17] In addition, *"…Due attention is to be given to correctly assessing the costs that any designated undertaking would have chosen to avoid had there been no universal service obligation. The net cost calculation should assess the benefits, including intangible benefits, to the universal service operator."*[18]

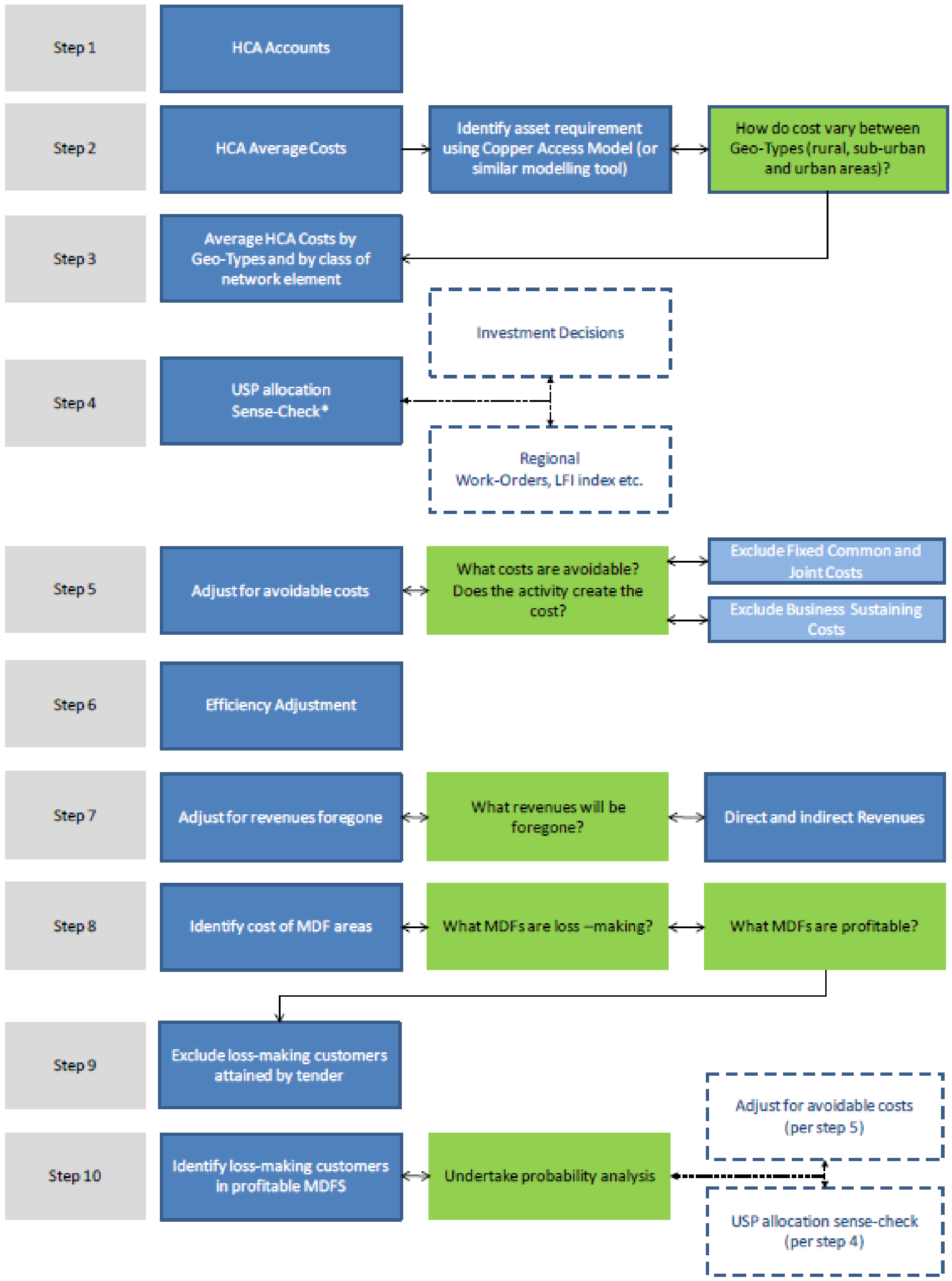
4.2 Key to estimating the direct net cost is the definition of the avoidable cost. D04/11 prescribes that "in order *"to identify the "true" cost of the USO, the net cost calculation must take into account those costs that the USP would directly avoid without having the USO (i.e. the requirement to serve "uneconomic" customers)".* In assessing the direct net cost, ascertaining the efficiency of the USP is required, "*the USP is not compensated for inefficient decisions in the past or costs incurred inefficiently….it is only efficiently incurred costs which should be reflected in the net cost calculation."*

4.3 Where the USO services, as listed in paragraph 2.3 *"can only be provided at a loss and where it would not have been provided by a commercial operator, ComReg considers it appropriate to include the associated avoidable costs and revenues in a net cost calculation."*[19]

4.4 Figure 1, set out overleaf, gives an overview of the assessment of the net cost in the context of the overall determination of whether a resulting positive net cost (if any) represents an unfair burden on the USP.

[17] Part A of Annex IV to the Directive, transposed as Part A of Schedule 2 to the Regulations
[18] Ibid.
[19] ComReg (2011), *"Report on Consultation and Decision on the costing of universal service obligations: Principles and Methodologies",* 31 May 2011

Figure 1: Overview of net cost calculation and unfair burden assessment methodology



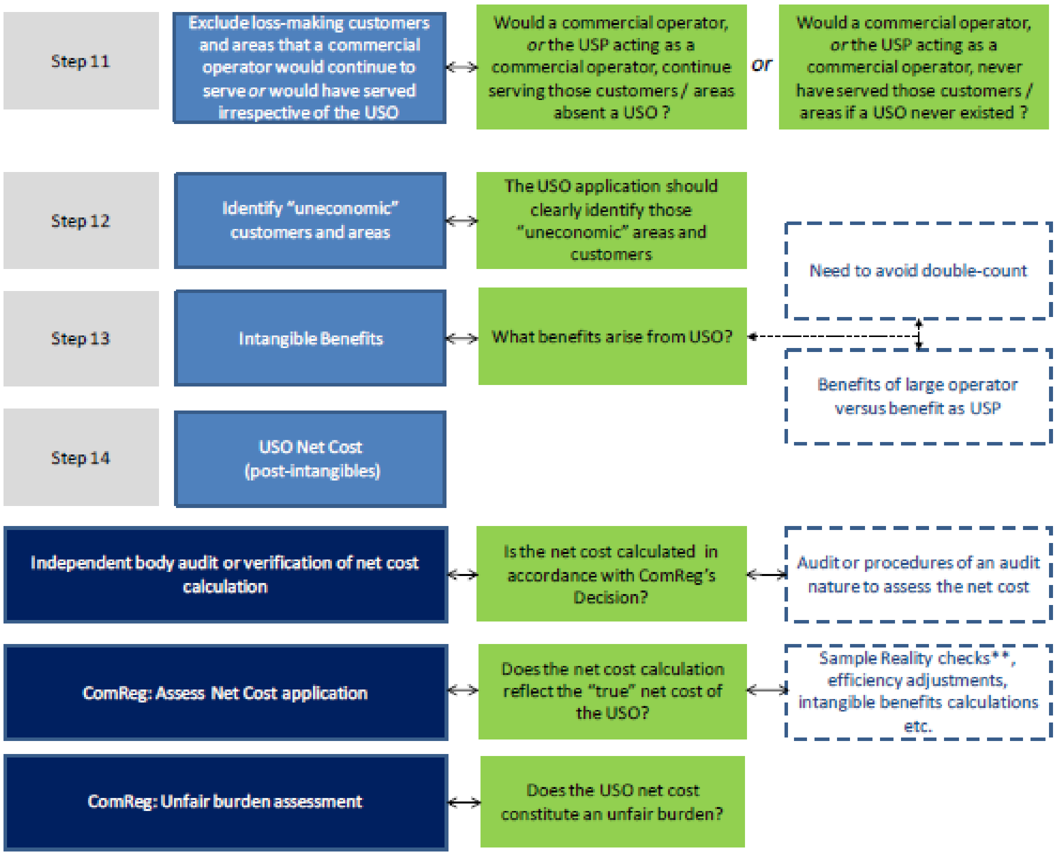


Figure 1: Overview of net cost calculation and unfair burden assessment methodology
Source: ComReg (2011), "Report on Consultation and Decision on the costing of universal service obligations: Principles and Methodologies", 31 May 2011

4.2 Application

4.5 In order to establish the direct net cost arising from the provision of USO services for the 2009-2010 period, Eircom compared the avoidable costs and foregone revenues arising as a result of its USP status for the 2009-2010 financial period to the counter-factual scenario where the provision of USO services to uneconomic customers would not otherwise have been served by a commercial operator and the USO would not have been required. In other words, the net cost, as calculated, equates to the difference between the avoidable costs attributable to the provision of the USO (both direct and indirect) minus revenues (both direct and indirect) attributable to the provision of USO services.

4.6 A summary of Eircom's estimates of the direct net cost submitted on 31 May 2012[20], included in its funding application, are set out in the table below and fall under the following headings:

[20] http://www.comreg.ie/_fileupload/publications/ComReg1257.pdf

- Uneconomic areas;
- Uneconomic customers in economic areas;
- Directory enquiry services and printed directories;
- Payphones;
- Services for disabled users, which include special services and special equipment; and
- Consultancy fees.

USO Service **Direct net cost (a)**	**Section reference**	**Eircom €**
Uneconomic Areas	4.4	514,095
Uneconomic Customers	4.5	6,313,884
Directories	4.6	-
Payphone	4.7	88,608
Services for disabled end users	4.8	54,250
Consultancy fees	4.9	750,000
Direct net cost		**7,720,836**[21]

4.3 The assessment

4.7 ComReg commissioned specialist consultants, TERA, to undertake an assessment of the direct net cost element of Eircom's USO funding application with respect to its adherence to D04/11. TERA's detailed analysis of the application is set out in its report.[22] TERA assessed the methodologies and principles of Eircom's approach and is of the view that Eircom's application is in line with D04/11, as listed in Table 3, below. TERA made recommendations with respect to specific areas of the application to be included in future USO funding applications. For future applications, as relevant, ComReg advises that these recommendations are incorporated into future assessments submitted by Eircom.

[21] The actual sum is €7,720,837

[22] ComReg document 13/45a, TERA Consultants (2013), *"Assessment of Eircom's USO funding application"*, 1 February 2013, Annex 1

4.8 The first step in TERA's assessment of Eircom's funding application involved gaining an understanding of the approach and calculation of the foregone revenue and avoidable operational expenditure ("OPEX") and capital expenditure ("CAPEX") cost data in terms of its origination, interpretation, and implementation in the context of timing, geographic allocation and efficiency. The next step in the assessment process focused on the methodology and subsequent calculation of the net cost of each of the USO services provided by Eircom as listed in paragraph 4.1.

4.9 Decision 1 of D04/11 prescribes the costing methodology required, *"(The) HCA methodology, properly adjusted for efficiencies and taking account of the costs that could have been avoided by the USP without having the USO, is the cost methodology that must be used to calculate the net cost of the USO"*. TERA confirmed that the HCA methodology has been applied appropriately by Eircom. TERA confirmed that "*the depreciation method follows historical accounting rules"* and the *"return on capital is based on the Net Book Value of ass*ets. *Where costs have been fully depreciated the NBV is zero according to the accounts and both depreciation and return on capital is zero"*, in accordance with Decision 12 of D04/11.

Table 3: Compliance with Decision 1 and 12 of D04/11

D04/11 Decision	ComReg's Assessment
1	Based on the assessment and review undertaken by TERA, ComReg was satisfied that Eircom's funding application adequately satisfied the criteria set out in Decision 1.
12	Based on the assessment and review undertaken by TERA respectively, ComReg was satisfied with the depreciation method applied by Eircom.

4.3.1 Revenue data

4.10 This sub-section focuses on the recognition and calculation of relevant foregone revenue included in Eircom's funding application. A summary of the findings of ComReg's assessment is set out in Table 4, with further detail set out in paragraphs 4.11 to 4.21.

4.11 In accordance with the requirement of Decision 3 of D04/11, Eircom stated in its application that "*USO revenue shall be calculated on the basis of both the direct and indirect revenues that an operator would forego as a result of ceasing to provide services to uneconomic customers"*, revenues that are foregone from disconnecting an uneconomic area. As such ComReg was of the view that the net cost calculation submitted correctly considers the actual revenues Eircom would forego if the provision of services to uneconomic customers or areas was no longer required.

4.12 Eircom extracted revenue data for the purpose of its application by identifying the relevant Service Order Codes (SOCs) within the Corporate Data Warehouse (CDW). Cognisant of Decision 29[23], sampling was used by Eircom to establish full year revenue data at main distribution frame ("MDF") level both for retail and wholesale direct revenues where complete detailed data on revenues generated was not available.

[23] In accordance with Decision 29 of D04/11, *"Sampling may be used for certain aspects of the modelling of net cost, for example the assumptions driving the size of replacement calls. Where sampling is used, samples must be sufficiently representative of the population being sampled. Where applicable, any application of a sampling methodology by the USP must accord with ComReg Decision D07/10."*

4.13 The definition of relevant direct revenues is outlined in Decision 4 and Decision 5 of D04/11. Direct revenues are those directly invoiced to a customer or another authorised operator (“OAO”). Indirect revenues, as defined in Decision 6 of D04/11, include services that are not directly invoiced to a customer. Direct revenues included in Eircom’s application are primarily generated from retail services invoiced directly to customers and wholesale services directly invoiced to alternative operators. Indirect revenues included in Eircom’s application are primarily generated from interconnection revenues, leased lines, revenues from calls from economic to uneconomic customers and replacement calls. The revenue categories provided by Eircom are detailed in TERA’s report.

4.14 Eircom excluded certain revenues from the calculations for a range of reasons including services not being based on the copper network, revenues not being intrinsic to any one MDF, revenues not generated on Eircom lines and unavailability of data and / or of immaterial value. TERA highlighted that only three of the 28 categories including *“interconnect links”, “freefone national”* and *“freefone international”* were excluded. As these categories cumulatively constitute only 2% of total revenue, TERA did not seek further information given the potential complexity in gathering the information. Given that any impact to total revenue foregone is immaterial, ComReg was satisfied with the estimation, but recommends complete indirect revenue data is provided in future applications.

4.15 With respect to the time allocation of revenue and its treatment in Eircom's calculation, TERA highlighted the calculation with respect to one-off charges. Decision 4 of D04/11 states that *"One-off connection charges: where the revenue should be allocated over the expected life of the customer"*. However, Eircom's application distinguishes between two types of one-off charges: Reasonable Access Threshold (RAT) and all the other one-off charges. Eircom's application confirmed that *"(A)ll other one-off charges are allocated to the year in question. Hence all one-off charges that are billed in the 2009/10 are allocated to 2009/10".* Eircom however maintains that the allocation rule it has chosen to adopt is appropriate with respect to its interpretation of Decision 4 of D04/11. To assess the impact of Eircom's methodology, Eircom was requested to undertake scenario analysis by TERA. Eircom subsequently ascertained that the impact to the net cost would drop by 1%, should charges be allocated over the correct period, as prescribed by Decision 4 of D04/11. TERA's assessment concluded that this amount was immaterial. ComReg nonetheless highlighted revenue allocation as an area for improvement in future funding applications, ensuring revenue is allotted over the expected life of the customer and methodologies undertaken align with Decision 4 of D04/11.

4.3.2 Data sampling and geographic allocation of revenue

4.16 As outlined in paragraph 4.12, sampling was used to establish annual revenue data for retail and wholesale direct revenues where data was incomplete. Sampling methods were applied to direct revenue, as only calling party aggregated data was available for the whole year. Further detail regarding the application of sampling methods is set out in section 1.1.3 of TERA's report. TERA highlighted in its report, that direct retail revenue data for the months of June, July and December (typically holiday months) and wholesale direct data for the month of June was provided. Given potential seasonality issues, TERA highlighted the risk surrounding the application of sampling. Following TERA's query, Eircom undertook substantial statistical analysis to assess any material variances arising from the use of sampling methods and as a result of this analysis TERA was assured that the impact of Eircom's approach to sampling with respect to seasonality was minimal. However, with respect to future applications, ComReg recommends that in order to mitigate the reliance on sampling methods and any potential seasonality risk in future applications, Eircom source complete data on inter-MDF and intra-MDF calls.

4.17 Gaining assurance with respect to the use of sampling for geographic allocation where there was a lack of complete data was more complex. Having sought clarification on the issue, TERA confirmed that the difference arising from the approach in contrast to TERA's recommended approach was minimal and did not distort the net cost estimation, as detailed in its report. ComReg in agreement with this does however recommend that complete data on inter-MDF and intra-MDF calls is provided in future assessments, in line with the requirements of Decision 7of D04/11.[24]

4.3.3 Replacement call revenue

4.18 Decision 6 of D04/11 states that "*replacement calls shall be estimated and added to the net cost calculation (but only in circumstances where uneconomic areas or customers have been firstly identified as commercially uneconomic)*". Where a customer is disconnected, Eircom made the assumption that the disconnected customer will make replacement calls using another fixed line or mobile network and stated in its application that *"net revenue received from replacement calls reduces the revenue foregone from serving uneconomic areas"*. Eircom considered the assumed percentage replacement rates in the context of two underlying hypotheses set out below:

- It is considered more difficult for a disconnected customer to locate another fixed line within reasonable proximity when an entire area is disconnected and as such, the replacement rate is lower; and
- Disconnected customers are more inclined to make replacement calls using the mobile network, rather than using a fixed line.

4.19 TERA assessed the appropriateness of each methodology by assessing the following areas:

- Eircom's formula in the calculation of the average replacement rate between fixed lines and mobile networks for outgoing calls;
- Eircom's formula in the calculation of the average replacement rate between fixed lines and mobile networks for incoming calls;
- Replacement call data used by Eircom; and
- European benchmark replacement revenue rates.

[24] Decision 7 of D04/11 requires that *"Where it is clearly demonstrated that due to a lack of information beyond the control of the USP, that it is not practicable for indirect revenues to be calculated in accordance with Decision No. 6, the USP may use an alternative approach, provided that it is properly supported with reasonable assumptions."*

4.20 With respect to the European benchmark, TERA ascertained that the replacement rate for outgoing calls on fixed lines is linked to the mobile penetration rate. In Portugal and Italy where it is high, the replacement rate on fixed lines is low (1% and 1-5% respectively). Contrastingly, in Belgium where the mobile penetration rate is low, the replacement rate on fixed lines is high (9% to 13%). As such, TERA considered Eircom's application of a replacement rate ranging between ✂ to be appropriate. With respect to the replacement rate on the mobile network, the Belgian, Italian and Portuguese regulators show that the replacement rate on the mobile network is high, with Belgium giving a range between 77% and 81% (2005). To calculate the replacement revenue, only the revenue obtained by Eircom in the disconnection should have been considered. TERA outlined that to calculate the replacement rate for outgoing calls made by disconnected customers, the outgoing replacement rate should be multiplied by Eircom's market share to consider only calls replaced from Eircom's network. For replacement rates of incoming calls, the treatment should be different; it is the calling party who pays and not the disconnected customer, consequentially the key consideration is if the call is replaced. As such, TERA highlighted that *"the replacement rate is equal to the simple proportion of the replaced calls and without multiplying by market shares".* Eircom considered TERA's view outlined above and appropriately modified the formula for incoming calls. Based on TERA's detailed analysis and Eircom's formula modification, ComReg considered the modification and adjusted the net cost, as appropriate.

4.21 A summary of revenue related decisions and ComReg's preliminary view with respect to compliance is set out below in table 4.

Table 4: Compliance with Decision 3, 4, 5, 6, 7 and 29 of D04/11

D04/11 Decision	ComReg's Assessment
3	ComReg was satisfied with the calculation of USO revenues on the basis that Eircom has adequately included direct and indirect revenues that it would forego as a result of ceasing to provide services to USO services to uneconomic customers.
4 & 5	ComReg was satisfied that the revenue scope for direct revenue incorporated by Eircom corresponds to the definitions set out in Decisions 4 and 5.
6	ComReg was satisfied that the revenue scope for direct revenue incorporated by Eircom corresponds to the definition set out in Decision 6. In addition to this, based on TERA's detailed analysis and findings, ComReg considered the principles and methodology of Eircom's approach to replacement calls to be appropriate.
7	ComReg was satisfied that given the lack of certain data Eircom altered its approach where appropriate. ComReg however recommends the provision of all

	available data in future applications. To substantiate the assessment of Eircom's adherence to the requirements of this decision, ComReg refers to comments included in paragraphs 4.12 - 4.17 of this document.
29	ComReg was satisfied that data sampling was required when certain data could not be sourced, and that the requirement to do so was reasonably justified by Eircom.

4.3.4 Cost data

4.22 As outlined in D04/11, *"(A)pplying the principle of avoidable costs involves identifying those costs that the USP would directly avoid without having the USO (i.e. the requirement to serve "uneconomic" customers)*".[25] The avoidable cost concept is a fundamental determinant of the net cost calculation. D04/11 substantiates this and outlines ComReg's decision that *"for a cost to be deemed avoidable, it must be directly attributed to a given service. ComReg recognises that while some relevant overheads may not be directly apportioned in the HCA accounts, for example certain costs associated with exchange sites (if deemed uneconomic in their entirety), they are directly attributable to the uneconomic exchange — and should the USP identify that exchange as an area which without having the USO, it would no longer serve, then, for the purposes of the net cost calculation, it would be considered avoidable."*[26]

4.23 Decision 2 of D04/11 requires that *"USO net costs shall be calculated on the basis of "all" capital costs and "all" operating costs that could be avoided on a HCA basis, as if the provision of services to uneconomic customers by a commercial operator was not required under a USO. It is only the portion of costs, both capital and operational expenditure for the given financial year, that can be directly attributed to the USO service (i.e. the service activity creates the cost) and which could have been avoided without the USO, which are included in the net cost calculation".*

4.24 Decision 8 of D04/11 states that *"(T)he avoidable costs included in the net cost calculation, shall be those costs reflecting the provision of the USO which a commercial operator would not ordinarily have provided, and which were incurred in the most efficient way. These costs shall relate to: (a) the avoidable capital costs associated with CAPEX i.e. depreciation; (b) OPEX; and (c) overheads for the appropriate financial year".* Decision 9 states that *'ComReg may use a number of methodologies to determine the appropriate level of costs that would have been incurred by an efficient operator, in order to determine the quantum of adjustments necessary to the USP's net cost calculation'*.

[25] Paragraph 3.20, D04/11
[26] Paragraph 3.41, D04/11

4.25 Therefore based on these decisions, TERA's assessment of costs took the following approach:

- Cost categories included in the USO model and whether they correspond to all services when identifying and calculating revenues;
- Avoidability of costs;
- Allocation of costs to MDFs; and
- Efficiency.

4.26 With respect to costs allocated to the Local Access Network, Eircom outlined the following *"(T)he accounts for the Local Access Network Business include the costs and capital employed associated with providing and maintaining these connections.* ✂. With respect to costs allocated to the Core Network, Eircom outlined the following "(*T)he Core Network Business provides a range of interconnection services internally and externally in order to allow the customer of one operator to communicate with customers of the same or another operator, or to access services provided by another operator. These services include the switching and conveyance of calls."*

4.27 Analysis of local access network OPEX included in Eircom's application was undertaken by TERA with respect to avoidable costs pertaining to the Local Access Network. As part of the assessment of Eircom's approach and data submitted, TERA set out the following key elements of their analysis:

- Cost categories included in Eircom's application;
- Cost categories defined as avoidable or partially avoidable;
- The allocation of costs to MDFs; and
- The rationale and application of the efficiency.

4.28 In line with TERA's assessment of local access network OPEX, geographical allocation and determination of cost drivers which included revenue, working lines, equipment spend, faults, physical provides by service and equipment, ComReg is of the opinion that local access network OPEX data submitted is appropriate and reflective of real-life cost drivers. Local access network CAPEX included cable, poles and radio access (etc.) costs and as set out in Eircom's application. Local access network CAPEX was primarily extracted from Eircom's assets register. Following a review of the cost data files, Eircom outlined that depreciation and net book value ("NBV") can reliably be identified by MDF area for most assets. TERA however recommended an adjustment as a result of a clarification sought throughout the assessment with respect to ✂ exchange, which was excluded from the analysis due to a negative depreciation value. The negative value related to a number of vendor credits associated with the ✂ exchange which continued to be processed through the asset register in 2009-2010.

4.29 TERA did highlight, however, that *"Avoidability analysis at a customer level is more complicated".* Eircom stated that *"customer level avoidability depends on customer's location, with avoidability being higher in isolated areas rather than dense areas"*. Cost categories for the local access network such as network rates, costs of repair, costs elements of line cards provisioning for access network were assessed by Eircom in terms of their estimated avoidability and categorised as one of the following:

- Fully avoidable;
- Partially avoidable; or
- Unavoidable.

4.30 TERA's analysis showed that the categorisation of local access OPEX by the respective degree of avoidability was incorporated appropriately by Eircom. However, TERA also highlighted that the calculations for a range of avoidability values and cost code detail have not been provided by Eircom and as such TERA were unable to form a solid view on overall avoidability. However even though granular data on the level of avoidability for each individual cost category could not be assessed, TERA did assess the main cost categories and confirmed that they agreed with the general principles of categorisation approach. As such, based on the method applied, TERA was satisfied that the same principles would have been applied to the remaining cost categories and the lack of data does not significantly impact the net cost. Giving consideration to the analysis undertaken by TERA, ComReg was satisfied with the approach adopted, but does recommend more detailed information is provided in future applications. For further detail, refer to TERA's report.

4.31 Local access CAPEX cost categories were primarily ascertained in the accounts at an MDF level and as highlighted by TERA *"data reflects the actual depreciation profile"*[27]. For all remaining CAPEX cost allocation keys were applied. Avoidability analysis at a customer level proved more complex, further detail is set out in section 1.2.1.2 of TERA's report. Eircom made the following assumptions with respect to avoidability: overhead cables are fully avoidable outside housing areas and underground cables are only partially avoidable; overhead cables in isolated areas, the portion of the cable that is outside a housing area was considered avoidable and the portion of the line within a housing area was not avoidable and underground cable outside a housing area, avoidability increases with line length.

4.32 TERA agreed that Eircom's approach, outlined in paragraph 4.31, to separately treat overhead and underground cable is reasonable given the data availability and the level of model complexity. However, TERA advised that it would be useful to check whether this assumption gives realistic cost curves based on field studies and the Copper Access Model ("CAM") for the estimation of the net cost for future years. ComReg recommends a cost function is constructed for several representative MDFs, based on a bottom-up approach to address this issue by using actual geographic configurations.

4.33 For each core network cost, both OPEX and CAPEX, TERA Consultants assessed the avoidability level estimated by Eircom; a summary of its findings is set out in section 1.2.2 of the TERA report. TERA noted that Eircom makes the assumption that core cost curves are linear. Although broadly satisfied with Eircom's approach, TERA recommended the use of minimal increments instead of maximal increments in the development of cost curve to strengthen the robustness of the estimation in future assessments.

4.34 As highlighted by TERA, *"(A)n efficiency correction on OPEX has been made using line fault index, which is one of the parameters recommended by ComReg for adjustment"*. Adjustments were integrated by Eircom to local access costs to reflect a ✂ than that specified by ComReg (14.5%)[28], specifically to actual and predicted maintenance costs associated with customer carriers and the copper overhead and underground networks. It is ComReg's view that the principle of an efficiency adjustment was correctly applied and implemented by Eircom.

[27] TERA Consultants (2013*), "Assessment of Eircom's USO funding application"*, 1 February 2013
[28] ComReg (2011), document 11/38, *"Costing of universal service obligations: Principles and Methodologies",* 31 May 2011

Table 5: Compliance with Decision 2, 8 and 9 of D04/11

D04/11 Decision	ComReg's Assessment
2	Based on the assessment and review undertaken by TERA, ComReg was satisfied that Eircom's funding application adequately satisfied the criteria set out in Decision 2.
8	ComReg was satisfied that Eircom's funding application has been prepared on an avoidable cost basis, reflecting the costs incurred in the provision of the USO which a commercial operator would not ordinarily have provided, considering both OPEX and CAPEX for the 2009-2010 period.
9	ComReg was broadly satisfied that Eircom has adopted the appropriate methodologies in the preparation of cost and efficiency estimates.

4.4 Area Model

4.35 Decision 11 of D04/11 states that *"(U)neconomic areas shall be identified at an MDF level".* Eircom's Area Model identified economic areas by establishing relevant revenue and costs for each MDF, double counted revenues were then eliminated and leased line revenues were distributed. TERA confirmed that given the complexity of the calculation, Eircom's approach sufficiently met the requirements of Decision 11 of D04/11. Analysis of revenue and cost data assumptions, as summarised at the outset of this chapter and in further detail in TERA's report, confirm the accuracy of Eircom's data.

4.36 TERA also added that particular attention should be paid in future applications to cost categories whereby costs incurred may vary significantly from year to year, owing to severe weather conditions for example.

Table 6: Compliance with Decision 11 of D04/11

D04/11 Decision	ComReg's Assessment
11	ComReg was satisfied that Eircom met the requirements of Decision 11, by identifying uneconomic areas at an MDF level.

4.5 Customer Model

4.37 Decision 10 of D04/11 prescribes that *"(T)he net cost calculation shall not include those customers who were originally considered "uneconomic" but who have now become profitable. The net cost calculation also does not include those customers attained as a direct result of a competitive tendering process (who are deemed "uneconomic")".*

4.38 As data on a customer level could not be sourced, Eircom applied a probability based approach to ascertaining the portion of uneconomic customers and the resulting net cost. The individual steps undertaken by Eircom included the following:

- Estimation of net revenue of all customers;
- Estimation of the avoidable access cost distribution at an MDF level, applying line length as the cost driver;
- Ascertaining the economic profile of customers by assessing the probability of the anticipated cost being less than the average anticipated revenue on an interval basis; and
- Ascertaining the number of uneconomic customers and the corresponding net cost based on the findings.

4.39 Although mindful of the allowances of Decision 14 of D04/11 which prescribes that *"(T)he USP may calculate uneconomic customers in economic areas using a probability analysis. However, the identification and allocation of these costs must be consistent with Decision No. 12. The parameters and assumptions used in the probability analysis must be clearly documented and duly reasoned as to the circumstances why the USP considers the customer uneconomic",* ComReg considered that Eircom's use of probability somewhat hinders the ability to identify individual uneconomic customers. TERA highlighted that given the complexity of optimising the approach, the use of probability in the customer model in this instance is appropriate. ComReg, in agreement with this view, however encourages the use of complete data where possible in future assessments.

Table 7: Compliance with Decision 10, 12, 13 and 14 of D04/11

D04/11 Decision	ComReg's Assessment
10	ComReg was satisfied that Eircom met the requirements of Decision 10, by excluding customers who were originally considered "uneconomic" and have now become profitable.
13	ComReg was broadly satisfied that Eircom met the requirements of this Decision. As there was a lack of information which was beyond the control of Eircom, Eircom appropriately applied a probability approach, as per the below, in order to identify customers. Given the complexity of the task to identify each uneconomic customer by its number, the probabilistic approach was considered reasonable.
12 & 14	For the purpose of the customer model, ComReg was satisfied that Eircom has adhered to the requirements of Decision 12 and Decision 14 with respect to the use of probability analysis in the identification and allocation of uneconomic customers in uneconomic areas.
25	ComReg was satisfied that Eircom's application identified uneconomic customers appropriately and adequately considered the approaches to their identification as advised by ComReg.

4.6 Directories and directory enquiry services model

4.40 Decision 17 of D04/11 outlines the requirement to the approach and calculation of the net avoidable cost for the provision of a printed directory. As outlined in the Eircom funding application, the provision of printed directory services was outsourced by ✂ . The company provided the relevant services to Eircom during the application period. Revenue estimates provided by Eircom were based on the following:

- ✂

4.41 Costs incurred by Eircom with respect to directories and the directory enquiry services include regulatory obligations where they arise and brand positioning payments. TERA consultants queried brand positioning payments and why these are made, and considered the implication of these payments to the overall direct net cost calculation and the corresponding intangible benefits arising. ✂.

4.42 In respect of Directory services, while Eircom's application claimed that the mandated services (Printed Directory and National Directory Database ("NDD"))[29] are economic for 2009-2010, ComReg notes that without the NDD obligation, Eircom would not be able to sell licences for directory enquiries or the direct marketing extract. Eircom submitted a value of zero in its application in respect of directory services. ComReg was of the view that any revenue associated with the NDD which exceeds the cost of the NDD should be included as a negative net cost value as this revenue would not be available to Eircom absent the designation to maintain the NDD. ✂. Recognising the level of analysis involved in establishing the level of avoidability with respect to this cost, Eircom estimate that of these costs ✂.

4.43 There was no net cost claimed for directories for 2009-2010.

Table 8: Compliance with Decision 17 of D04/11

D04/11 Decision	ComReg's Assessment
17	ComReg was satisfied with the approach, assumptions and calculations applied by Eircom in arriving at the directories avoidable cost estimate, with the exception of a necessary adjustment with respect to the NDD, as detailed in paragraph 4.42.

4.7 Payphone model

4.44 Decision 16 of D04/11 prescribes the approach to be adopted in the estimation of the avoidable net cost and outlines that *"for each public payphone that is connected to a single exchange site, the access cost for a payphone will be the same access cost as that of any line at the exchange site on which it is connected. The avoidable access costs shall be calculated as an estimate per line at the exchange site to which the public payphone is connected".* Estimates submitted by Eircom only considered uneconomic payphones and is therefore in accordance with the requirements of D04/11. Eircom considered all payphones with negative costs to be uneconomic and has identified uneconomic payphones in economic areas as relevant to the USO estimations to mitigate the risk of double counting in the area model.

[29] http://www.comreg.ie/consumer_initiatives/direct_marketing_opt-out_register.492.566.html

4.45 The payphone model identifies payphone call revenue, advertising revenue and WIFI revenue. Payphone call revenue was provided on a payphone by payphone basis, advertising and WIFI revenue was provided on a national level. Having undertaken analysis of the approach and supporting calculations, TERA confirmed that the revenue categories and cost allocation drivers applied by Eircom are appropriate.

4.46 TERA assessed Eircom’s approach and calculations, and based on Decision 16 of D04/11 and clarifications provided by Eircom, the payphone net cost increased to €93,906, as a result of the following adjustments, which are discussed in greater detail in section 2.6 of the TERA report:

- The calculation of the marketing benefit was added;
- WIFI costs were incorporated;
- The modeling formula of the MDF economic indicator and input on call volumes were updated;
- Revenue sourced from regulatory accounts was updated to include all the relevant revenues;
- A single payphone was excluded due to a fault in revenue registration; and
- The modeling formula for the net cost calculation was updated to include advertisement revenue.

4.47 TERA, having sought the necessary adjustments, confirmed the methodology and calculations contained in the payphone model were in line with ComReg’s guidance.

Table 9: Compliance with Decision 16 and 27 of D04/11

D04/11 Decision	ComReg’s Assessment
16	Having discussed minor issues with Eircom and having rectified these in the calculation of the net cost, ComReg was satisfied with the adjusted estimation of €93,906.
27	ComReg was of the view that sufficient information on economic payphones was provided by Eircom, particularly in respect of their location and proximity to other payphones operated by Eircom.

4.8 Disabled services model

4.48 Decision 18 of D04/11 outlines the requirement to the approach and calculation of the net avoidable cost for the provision of disabled services.

4.49 Eircom outlined the key cost and revenue generating components involved in the provision of disabled services. These included text relay, specialised equipment, free directory enquiry and braille bills. Eircom subsequently identified the costs and revenues associated with each component. Detail in respect to the calculation of the net cost of each service is set out in section 1.7 of TERA's report.

4.50 Following clarifications, the adjusted net cost is equal to €44,651.

Table 10: Compliance with Decision 18 of D04/11

D04/11 Decision	ComReg's Assessment
18	ComReg was satisfied with the approach, assumptions and calculations applied by Eircom in arriving at the disabled services avoidable cost estimate.

4.9 Consultancy fees

4.51 Eircom's funding application included an estimation of €750,000 of 'Incremental Consultancy and Audit spend' which it considered "*an estimate from Eircom and represents incremental cost of preparing a claim for USO in accordance with ComReg's decision".* No further justification or reference to this figure was made in the funding application. At the final stages of the assessment period, at ComReg's request, Eircom provided further detail. This detail indicated a cost of €881,915, based on accompanying invoices. The consultancy costs were made up of various costs attributable to consultants involved in the preparation of the application.

4.52 ComReg was of the preliminary view that consultants' fees are not allowed in so far as they relate to the preparation of the USO funding application. Further reasoning includes the following:

- ComReg was of the preliminary view that consultancy fees are not a part of the net cost with respect to the Directive, the Regulations and European precedent as these costs have not been directly incurred as a result of the provision of USO services. ComReg considered that this is reinforced in Part B of Annex V to the Directive which states: *"The recovery or financing of any net costs of universal service obligations requires designated undertakings with universal service obligations to be* *compensated for the services they provide under non-commercial conditions";*

- Decision 2 of D04/11 states that "*It is only the portion of costs, both capital and operational expenditure for the given financial year that can be directly attributed to the USP service (i.e. the service activity creates the cost*[30]*) and which could have been avoided without the USO, which are included in the net cost calculation*"; and

- ComReg was of the preliminary view that the cost of making such an application constitutes a commercial cost which inherently carries risk, should a positive net cost constitute an unfair burden or not. It should be noted that ComReg considered that the cost attributable to preparing an application should decrease over time.

4.10 Overlap with intangible benefits

4.53 As part of its assessment, TERA investigated any overlap between direct net cost estimates and intangible benefit estimates to ascertain whether there was evidence of double counting and to ensure input values were correct and consistent. Throughout the assessment as a result of clarifications and minor model changes, TERA made adjustments to direct net cost calculations impacting intangible benefits and Oxera made adjustments to intangible benefits where required. Consistent with comments made by Oxera noted in Chapter 6, key assumptions and calculations which would substantiate information provided by Eircom could not be provided as it would have been too time-consuming and complex to provide. TERA provide detail of its findings with respect to the inter-relation between direct net cost calculations and the calculation of intangible benefits in Chapter 3 of its report.

4.54 TERA concluded that the application in the context of potential overlap between the direct net cost estimations and the intangible benefits' estimations was in accordance with D04/11. ComReg has considered the TERA report and is satisfied that the risk of overlap has been addressed and there is no evidence that any overlap exists.

4.11 ComReg's view as per Consultation 13/45

4.55 ComReg was of the view that clarifications and certain adjustments during the assessment of any application are unavoidable, in particular in the first application given the complex nature of the exercise. ComReg was of the view that the impact of the recommendations for future applications still does not have a material impact in respect of the 2009-2010 application and that the data submitted by Eircom was acceptable for the purpose of this application.

[30] Also refer to paragraph 3.41, D04/11

4.56 In summary, ComReg was satisfied that Eircom's application was fit for purpose and the methodologies applied by Eircom met the principles of D04/11, giving particular consideration to Decision 20. ComReg was of the preliminary view that the direct net cost was €7,139,331 (after a total downward adjustment of €581,506), as follows:

USO Service Direct net cost (a)	Section	*Eircom €*	*Adjustment €*	*ComReg €*
Uneconomic Areas	4.4	514,095	31,701	545,796
Uneconomic Customers	4.5	6,313,884	141,094	6,454,978
Directories	4.6	-	-	-
Payphone	4.7	88,608	5,298	93,906
Services for disabled end users	4.8	54,250	9,599	44,651
Consultancy fees	4.9	750,000	(750,000)	-
Direct net cost (a)		**7,720,836**[31]	**(581,506)**	**7,139,331**

[31] The actual sum is €7,720,837

Chapter 5

5 Assessment of the direct net cost – Consultation issues

5.1 ComReg assessed the direct net cost component of Eircom's application for funding for the period 2009-2010 in accordance with Chapter 4.

5.2 A summary of ComReg's preliminary view with respect to each component of the direct net cost, post-assessment, is set out below:

- Uneconomic areas;
- Uneconomic customers in economic areas;
- Directory enquiry services and printed directories;
- Payphones;
- Services for disabled users, which include special services and special equipment; and
- Consultancy fees.

Direct net cost	***ComReg €***
Uneconomic Areas	545,796
Uneconomic Customers	6,454,978
Directories	-
Payphone	93,906
Services for disabled end users	44,651
Consultancy fees	-
Direct net cost	**7,139,331**

5.3 ComReg remains of the view that Eircom's application was fit for purpose, giving due consideration to the fact that it was the first application for funding and assessment of its kind.

5.1 Consultants' Costs

5.1.1 Consultation Issue

5.4 Eircom's funding application included an estimation of €750,000 of 'Incremental Consultancy and Audit spend' which it considered "*an estimate from Eircom and represents incremental cost of preparing a claim for USO in accordance with ComReg's decision".* No further justifications or references to this figure were made in the funding application. At the final stages of the assessment period, at ComReg's request, Eircom provided further detail. This detail indicated a cost of €881,915, based on accompanying invoices. The consultancy costs were made up of various costs attributable to consultants involved in the preparation of the application.

5.5 ComReg was of the preliminary view that consultants' fees are disallowed and do not form part of the net cost, in so far as they relate to the preparation of the USP funding application.

5.6 ComReg's first consultation question asked the following;

Consultation Question 1
Do you agree with ComReg's preliminary view that consultancy costs incurred in respect of any application do not form part of the direct net cost? Please provide reasoning to support your view.

5.1.2 Summary of respondents' views

5.7 ALTO, UPC, Vodafone, BT, Telefónica and Magnet state in their respective submissions that they are in favour of ComReg's preliminary view, that consultancy costs incurred in respect of any application do not form part of the direct net cost.

5.8 Eircom disagrees with ComReg's preliminary view and states that it does *"not agree that the consultancy costs incurred in respect of preparing applications should be excluded from the direct net cost".* Eircom is of the view that *"consultancy costs clearly fall into the category of avoidable costs if there had been no USO".*

5.9 ALTO, UPC and BT are of the view that costs could not have been directly incurred as a result of the provision of USO and although not stated, were unlikely to have been incurred in 2009-2010, the funding period under review. Magnet is of the view that consultancy costs incurred are *"optional"* and are not *"core"* in the provision of universal service obligations to an end user.

5.10 ALTO states that *"expenditure undertaken by Eircom was entirely discretionary and should be clearly excluded under the heading of inefficiencies"*. ALTO, UPC and BT highlight that the hiring of three consultants, resulting in a cost of €881,915 was the second largest cost claimed by Eircom and higher than the combined cost claimed for uneconomic areas, payphones, directory services and disabled services. ALTO is of the view that consultation costs are *"wholly disproportionate and unreasonable"*.

5.11 Vodafone adds that *"consultancy costs incurred in the preparation of the funding request would have been incurred even absent the USO and so they are not part of the direct net cost of providing USO",* owing to the fact that the modelling carried out for the purpose of the application is *"substantially"* the same as ascertaining the breakeven point for PSTN connections any *"rational profit maximising entity"* in assessing what connection requests it should refuse to meet or not meet.

5.12 Eircom is of the view that consultancy costs were incurred in order to comply with the requirements of D04/11. Eircom referred to the requirements of Decision 22 of D04/11.[32] Owing to Decision 22 of D04/11, Eircom is of the view that it had *"no discretion to avoid these costs when preparing and submitting its application for funding due to the requirements imposed on it by ComReg under D04/11"* and that *"consultancy costs are solely and directly attributable to eircom's USO designation"*. Eircom's interpretation of the Regulations[33] causes it to be of the view that it is *"unfair that ComReg should seek to place the financial burden of its responsibilities solely on the USP"*.

[32] Decision 22 of D04/11 requires that; "*An independent declaration shall be signed off by the Board of Directors of the USP and it must accompany the application. (The required declaration is included in Schedule 1). Financial information shall be provided with an appropriate audit opinion or verification report, where the Auditor (as approved by ComReg and who may be a person, or a corporation sole, or a body corporate, or an unincorporated body) has in no way assisted with the preparation of the USO funding application*."

[33] European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) Regulations 2011 (SI 337 or 2011), Regulation 11 (7) - "*The accuracy of the accounts or other information, serving as the basis for the calculation of the net cost of an obligation, shall be audited or verified, as appropriate, by the Regulator or by a body approved of by the Regulator and independent of the undertaking concerned*."

5.13 With respect to ComReg's preliminary view that *"consultancy fees are not a part of the net cost as these costs have not been directly incurred as a result of the provision of USO services",* Eircom is of the view that it is being burdened to provide services to the State to support Government objectives relating to social inclusion and that "*the consultancy costs have been incurred solely to satisfy the requirements of D04/11".* Eircom is of the view that ComReg has incorrectly interpreted the Directive and that the challenges faced by Eircom in its request for compensation through an application present non-commercial conditions.

5.14 In respect to the timing of costs and the relevant application period of 2009-2010, it is Eircom's view that *"costs (that) can be directly attributable to the USP service and this is the case even though the consultancy activity occurred in a later financial year"*. Eircom argues *that "it is standard practice for audit fees, for example in the preparation of statutory accounts, to be recognised in the year to which the audit activity relates"*.

5.15 In response to ComReg's preliminary view, surrounding the issue of commerciality and the risk associated with an application for funding, Eircom states that the *"Universal Service is not a commercial activity and as such this observation is not relevant"* and adds that in *"a normal commercial arrangement for the procurement of services, the costs of administering the contractual terms would be built into the compensation model"*.

5.16 In the context of international precedent, Eircom argues that in France *"the net cost of the USO includes calculation and audit costs".*[34]

5.1.3 ComReg's assessment of responses

5.17 ComReg maintains its view that consultants' fees are disallowed in so far as they relate to the preparation of the USO funding application and not to the provision of USO services. This is in accordance with the scope of D04/11, the Regulations and the Directive, whereby the net cost is required to be calculated based on the avoidable cost associated with the provision of USO services.

[34] http://www.arcep.fr/uploads/tx_gsavis/12-0484.pdf

5.18 ComReg remains of the view that consultancy fees are not a part of the net cost with respect to the Directive, the Regulations and European precedent as these costs have not been directly incurred as a result of the provision of USO services. As ComReg stated in Consultation 13/45, this is reinforced in Annex IV Part B of the Directive[35] which states: *"The recovery or financing of any net costs of universal service obligations requires designated undertakings with universal service obligations to be compensated for the services they provide under non-commercial conditions".*

5.19 In response to Eircom's view with respect the timing of consultancy costs, set out in paragraph 5.14, Decision 2 of D04/11 states *that "It is only the portion of costs, both capital and operational expenditure for the given financial year that can be directly attributed to the USP service (i.e. the service activity creates the cost*[36]*) and which could have been avoided without the USO, which are included in the net cost calculation"*.

5.1.4 ComReg's final position – Consultants' costs

5.20 Having considered the views of respondents, ComReg remains of the view that consultancy costs incurred in respect of any application are disallowed and do not form part of the direct net cost.

5.2 Direct Net Cost

5.21 In light of the assessment of the direct net cost, ComReg requested respondents' views on the following question:

Consultation Question 2
Following ComReg's assessment, detailed in Chapter 4, do you agree with ComReg's preliminary view that the direct net cost for 2009-2010 is €7,139,331? Please provide reasoning to support your view.

[35] Recovery of any net costs of Universal Service Obligations
[36] Also refer to paragraph 3.41, D04/11

5.2.1 Eircom's USO obligation

5.2.1.1 Summary of Respondents' views

5.22 Vodafone states in its response that *"(I)t would appear that ComReg has not taken proper account of the fact that eircom has NOT delivered a fit for purpose Universal Service as eircom has failed to meet the minimum service quality standards that ComReg has determined as being appropriate"*. Vodafone adds that *"For a request for funding to be valid the undertaking must have actually met its obligation".*

5.23 Using Decision 02/08[37] as an example of performance targets (as prescribed by Regulation 10(4)[38] and Regulation 11(1)[39]), Vodafone and BT state respectively that ComReg itself has set out that Eircom has failed to meet the mandated performance targets under all headings. Following this decision, Vodafone and BT state that in the information notice 10/08, ComReg stated that Eircom failed to meet the performance targets set out in Decision document 02/08. BT states that *"industry should not be required to bear the burden of the USO for 2009 to 2010".* To support its view, BT reiterates the following points which are addressed in greater detail throughout this paper:

- Failure to meet USO targets;
- Insufficient financial information provided to accurately assess the application;
- Insufficient evidence that Eircom sought to avail of more efficient access to meet its USP obligations, such as using Fixed Cellular solutions or NBS; and
- Perception that Eircom's operating cost base was higher than that of an efficient operator, making the claim overstated.

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[37] ComReg 2008, Quality of Service Performance Targets, 08/37, 28 May 2008

[38] Regulation 10(4) of the Regulations provides that *"The Regulator may, in addition, specify the regularity, content, form and manner of information to be published, including possible quality certification mechanisms, under this Regulation for the purpose of ensuring that end-users, including disabled end-users, and consumers have access to comprehensive, comparable, reliable and user-friendly information".*

[39] Regulation 11(1) of the Regulations provides that *"Where an undertaking designated as having an obligation under Regulation 3, 4, 5, 6, 8 or 9 seeks to receive funding for the net costs of meeting the obligation concerned, it may submit to the Regulator a written request for such funding".*

5.24 Vodafone is of the view *"whether this cost represents an undue burden on eircom is unnecessary as there are more fundamental reasons why it does not constitute such a burden".* In addition to this ALTO reiterates the requirements of S.I. 308 of 2003 and D04/11, stating that even though no unfair burden has been found *"the performance criteria associated thereto have not been complied with".* ALTO adds that ComReg should reconsider applications until appropriate *"clarification on service performance and determinants has been fully investigated".*

5.2.1.2 ComReg's view

5.25 In response to operators' views in relation to the suggested interplay between compliance, including with quality of service targets, and the determining of a net cost or an unfair burden. ComReg is of the view that Eircom's compliance or failure to comply does not automatically cause an application not to be fit for purpose nor indeed does it influence the determination of the net cost incurred or of an unfair burden.

5.26 It is ComReg's view is that the issue of unfair burden involves a more global assessment of the effect of all USO obligations that Eircom is subject to, and not just the subject-matter of the targets. ComReg does not consider that it would be correct for ComReg to simply look at the targets/target compliance and to conclude that because Eircom had fallen short of the targets, it could not be burdened by the USO requirements that it is subject to. ComReg, is therefore of the view that it is not correct to consider compliance to the extent that where Eircom may have fallen short of target requirements it could not have incurred a net cost or be burdened by any of the USO. ComReg notes as well that the net cost arises as a result of Eircom's efforts to meet USO targets.

5.27 Avoidable costs incurred by Eircom for the purpose of meeting its USO are allowed for under D04/11, avoidable costs can be incurred irrespective of targets being met. It is ComReg's view that compliance with performance targets is a separate issue and that this is dealt with in accordance with the Regulations. ComReg is of the view that non-compliance with quality of service targets is not a cause to reject an application and as such, does not render an application not fit for purpose.

5.2.2 Data Verification

5.2.2.1 Summary of respondents' views

5.28 ALTO and Magnet are of the view that *"the apparent lack of verifiable data and the scale of the flaws in Eircom's application are such that ComReg should consider reversing its preliminary finding"*, owing to the fact that *"There must be a verifiable and verified direct net cost".*

5.29 In UPC's view an estimation that increases the net cost that is not sufficiently verified and validated by ComReg *"should be rejected by ComReg".* Magnet states that the data set out in Consultation 13/45 *"should be verified in greater depth rather than complicity accepting eircom's approach and figures".*

5.30 In this context, BT queries Eircom's claim for uneconomic customers, stating that is the most significant estimate of the net cost[40]. BT states that this figure is estimated *"from a probability formula"* and that *"neither the formula nor the input figures are provided".* In the context of intangible benefits, workings and formulae are provided; however in the case of the direct net cost, the commensurate level of workings is not provided. In addition to this BT states that where 1% or 2% variances have occurred owing to differing methodological approaches taken by TERA, the overall impact of these immaterial differences is not quantifiable and an informed response cannot be provided by industry as to their agreement with the direct net cost.

5.31 Vodafone states in its response that it *"is clear that the figure that ComReg proposes to use for net direct cost is too high and cannot be relied upon to determine the size of any potential Universal Service Fund"*.

5.2.2.2 ComReg's view

5.32 With respect to the Decisions 23, 24, 25 and 28 of D04/11 relating to the provision of data, financial models and supporting information, ComReg recognises the substantial data provided and the efforts made by Eircom to ensure information was comprehensive and accurate.

5.33 Where Eircom was unable to source relevant information, it adopted alternative approaches. ComReg is satisfied that where such approaches were used, Eircom has not materially overstated or understated costs and/or revenues of the USO and has in principle complied with the principles outlined in Decision 19[41] of D04/11. The application and assessment required a large quantity of information to be submitted by Eircom. ComReg notes that Eircom has made significant effort to source the relevant information from internal IT systems and other sources as relevant.

5.34 With respect to operators' views regarding incomplete data and unverified inputs, ComReg remains of the view that the data submitted by Eircom meets the principles established in D04/11 and specifically Decision 29 of D04/11, which states that *"Sampling may be used for certain aspects of the modelling of net cost"*.

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[40] c.€6.3m (uneconomic customers) of c.€7.72 (direct net cost)

[41] Decision 19 of D04/11 prescribes that the *'USO funding applications shall be consistent and in accordance with this Decision and Decision Instrument'*.

5.35 Cognisant of Decision 13[42], ComReg remains of the view that where the lack of information was beyond the control of Eircom, Eircom appropriately applied a probability approach, particularly in the instance of identifying uneconomic customers in economic areas. It remains ComReg's view that given the complexity of the task of identifying each uneconomic customer by its universal account numbers ("UANs") or STD code, in Eircom's case, the probabilistic approach was reasonable for the purpose of the assessment of the 2009-2010 application. ComReg recognises the significance of the direct net cost attributing to uneconomic customers and reaffirms that *"the impact of the recommendations for future applications does not have a material impact in respect of the 2009-2010 application and that the data submitted by Eircom is acceptable for the purpose of this application"*[43]. ComReg similarly maintains that clarifications and certain adjustments during the assessment of any application are unavoidable, in particular in the first application, given the complex nature of the exercise.

5.36 ComReg did not take values submitted by Eircom at face value, but submitted them to extensive assessments undertaken by its consultants. Eircom provided further information where ComReg's consultants' identified issues and areas where further information with respect to inputs and calculations was required to fully assess the application. Similarly, ComReg's consultants assessed the methodologies implemented by Eircom, and came to the view, having made necessary adjustments to Eircom's estimations, that none of the adjustments made prejudiced the outcome of the assessment. As the assessment detailed in Consultation 13/45 was based on the decisions set out in D04/11, it is clear that compliance with the principles of D04/11 could be achieved through various methodologies and ComReg's consultants requested clarification on some items to increase the accuracy of calculations. As such, a degree of flexibility was incorporated to allow all parties to gain assurance as to the most accurate estimation. Where TERA or indeed Oxera suggested alternative approaches, these alternatives were designed to refine methodologies and reflecting the requirements of D04/11 in the most effective manner.

[42] Decision 13 of D04/11 states the following, *"Uneconomic customers in economic areas shall be identified based on universal account numbers ("UANs"). However, if ComReg is satisfied, because of a lack of information beyond the control of the USP, that it is not practicable to identify uneconomic customers by UAN, the USP must demonstrate that the use of an alternative approach has the equivalent effect of identifying those customers."*

[43] ComReg (2013), *"Consultation and Draft Determination on the Assessment of Eircom's Universal Service Fund Application for 2009-2010"* ,13/45

5.37 In addition to this, ComReg reiterates that the information provided by Eircom underwent a rigorous and detailed independent audit. As stated in Consultation 13/45, the PwC report set out its findings arising from specifically designed AUPs and its assessment of Eircom's application. The report was reviewed by ComReg and TERA as part of ComReg's assessment of Eircom's application. With respect to sampling undertaken for the purpose of the intangible benefits estimate, Oxera note the inadequacy of the sample size. The shortcomings with respect to the survey size were addressed by Oxera to its best efforts; Oxera, as stated in Consultation 13/45 *"provided a step-by-step approach to assessing the shortcomings of the approach adopted in section 2.3 of its report".*

5.38 With regard to the materiality of adjustments and indeed issues relating to improved methodologies ComReg is of the view that where a positive net cost is at the upper end of a materiality threshold at the stage of determining whether a positive net cost is in fact an unfair burden or not, the aggregate of adjustments to estimates would be further evaluated if the overall impact of adjustments could materially affect the determination of an unfair burden.

5.2.3 Compliance with D04/11

5.2.3.1Summary of Respondents' views

5.39 Respodents including ALTO, Magnet, Telefónica, BT and UPC are of the view that the scale of incomplete data and unverified inputs and ComReg's apparent leniency with respect to adherence to D04/11 hinders the ability to accurately respond to Consultation 13/45 and as such their ability to agree with Question 2 of the Consultation 13/45. Telefónica states that it has concerns as to whether the *"calculation of the net cost is based on assumptions and incomplete data"* and as such *"cannot accept that the value arrived at is a correct net cost*".

5.40 UPC is of the view that *"there has been inappropriate use of sampling and incorrect geographic allocation of revenue in eircom's application"*. In this instance, when this proves to be an increase in the direct net cost, UPC stressed that increases to the net cost calculation, when based on sampling, *"should be excluded if their inclusion is not properly validated"*[44].

[44] Paragraph 4.16 of 13/45 states that *"Sampling methods were applied to direct revenue, as only calling party aggregated data was available for the whole year"*

5.41 Eircom specifically notes ComReg's comments at paragraph 4.39[45] *"regarding the use of a probability analysis to calculate uneconomic customers in economic areas"* and states that this matter *"has been the subject of previous discussion and we would remind ComReg that it is simply not practical, reasonable or proportionate to build and maintain a costing model at the individual customer level"*.

5.42 Respondents have expressed concern as to the scale of divergence by Eircom from the ComReg methodology specified in D04/11. ALTO, Magnet and UPC claim that *"ComReg's approach on numerous points appears to be predicated on the assumption that eircom (and its consultants) will rectify deficiencies in future applications".* UPC claims that *"the current application (2009 – 2010) should stand or fall on its own merit or lack thereof"* and *"ComReg should not accept in the current application or future applications, 'fixes' which result in figures falling short of unequivocal verification".*

5.43 ALTO and Magnet submit *"that it must be the case that the applicant, in this case Eircom, must include robust and verifiable data to make up any bona fide case for funding of this nature"* in the context of the first test in the assessment of an unfair burden, whereby "(*T)here must be a verifiable and verified direct net cost*".

[45] Paragraph 4.39 of D04/11 states the following: "*Although mindful of the allowances of Decision 14 of D04/11….ComReg considers that Eircom's use of probability somewhat hinders the ability to identify individual uneconomic customers. TERA has highlighted that given the complexity of optimising the approach that the use of probability in the customer model in this instance is appropriate. ComReg, in agreement with this view, would however encourage the use of complete data where possible in future assessments.*"

5.2.3.2ComReg's Views

5.44 As outlined in D04/11 and highlighted in Consultation 13/45 *"there may be circumstances where modifications are required to ensure that any limitations that are discovered are overcome"* and *"it is (equally) important to ensure that all stakeholders are aware of the possibility that ComReg will require some degree of flexibility going forward"*[46]. Having undertaken its assessment, ComReg recognises that the need for clarification, modifications and a degree of flexibility is required in this assessment process, as the principles outlined in D04/11 are high level. However, specific application of the principles is required in certain circumstance. Clarifications were sought throughout the assessment period between TERsA and Oxera with the co-operation of Eircom and its consultants. As a result some necessary adjustments were made to the application to optimise its compliance with D04/11. To further substantiate and strengthen future applications for funding, the consultants, TERA and Oxera have made recommendations for future assessments which are discussed throughout this paper and detailed further in each consultants' report.

5.45 In response to operators' views on Eircom's deviation from D04/11, ComReg maintains that the assessment was conducted in adherence with Decision 37 of D04/11[47] and confirms that the application met the principles outlined in D04/11. While evaluating whether recommended improvements to the methodologies could be incorporated into future USO fund applications, ComReg remains of the view that the clarifications and adjustments of the assessment (both increasing and decreasing the estimation of the direct net cost and intangible benefits) are unavoidable. This is a particular issue that needed to be addressed in the first application given the complex nature of the exercise.

5.46 As such, when undertaking the assessment, clarifications were sought between TERA and Oxera with the co-operation of Eircom and its consultants throughout the assessment period; details of key interactions are included in Consultation 13/45. As a result of its assessment, ComReg found that clarifications, modifications and a degree of flexibility was required to ensure the most accurate assessment. TERA and Oxera made recommendations with respect to the reasonable methodologies applied by Eircom, for alternative or more effective methodologies for future assessments. ComReg would expect that these recommendations are applied in future applications.

[46] ComReg (2011), "Report on Consultation and Decision on the costing of universal service obligations: Principles and Methodologies", 31 May 2011

[47] Decision 37 of D04/11 states that on "*receipt of the first USO funding application, ComReg will actively continue to evolve and refine a number of potential methodologies for the purposes of valuing the benefits of the USO".*

5.47 With respect to whether the cumulative impact of adjustments affected the conclusion regarding the existence of an unfair burden, it is ComReg's view that the aggregate of adjustments for the 2009-2010 application remains immaterial and does lead to a direct net cost or positive net cost that is inaccurate or unverifiable. Also refer to paragraph 5.38 of this document.

5.48 ComReg is satisfied that the methodologies implemented by Eircom for the purpose of its application met the principles of D04/11.

5.2.4 Transparency of Information

5.2.4.1Summary of Respondents' views

5.49 Operators are of the view that the redaction of commercially sensitive information has led to a disproportionate approach to the assessment and consultation process. In Vodafone's view it is *"impossible to meaningfully assess whether the ultimate costs of USO arrived at by ComReg and its advisors have been properly derived".*

5.50 ALTO, BT, Vodafone and UPC outlined their views with respect to the level of redaction and the availability of information. BT is of the view that the lack of information available prevents respondents ascertaining *"whether the specific financial value is correct or not"*. Owing to the level of redactions, Vodafone states that it is unable to *"intelligently assess"* Consultation 13/45 and supporting documents. ALTO states that as a result of the *"lack of detail provided by ComReg in the consultation documents, [it] is not in a position to agree or disagree with ComReg's calculation"*. Vodafone state that "it has been impossible to identify areas where the assessment method proposed will yield an overestimate for net direct cost", owing to *"the level of redactions"*. UPC claims that the lack of information in the context of the customer model represents over 90% of the direct net cost. UPC states that increased transparency with respect to information concerning uneconomic customers should be disclosed by ComReg to avoid an "unbalanced consultation process".

5.51 ALTO, Magnet and UPC are of the view that the consultation process *"has not been sufficiently transparent".* BT states that *"key pieces of information are not supplied or unreasonably redacted",* which in BT's view prevents it from *"conducting an informed financial analysis of whether the outcome is reasonable*"[48]. Similarly, Magnet and UPC state they are unable to evaluate ComReg's draft decision. As a practical example Vodafone states the following ",*"(W)e do not know if the ComReg assessed net cost of €5m is spread across 1,000 lines or 1,000,000 lines i.e. whether the net cost is on average €5,000 per line per annum or €5 per line per annum".* Vodafone also states that *"Even if the data itself is properly considered confidential then, at a minimum, consultees should have an opportunity to comment on its provenance. (The provenance of the information may be such as to undermine the reliability of the data or lessen the weighting it should be accorded)".*

5.2.4.2ComReg's Views

5.52 In response to these views regarding the level of redaction and the availability of information, ComReg remains of the view that it has maintained the confidentiality of the relevant information, as it is obliged to do so under Regulation 15 of the European Communities (Electronic Communications Networks and Services) (Framework) Regulations 201110 ("the Framework Regulations") and in accordance with its guidelines on the treatment of confidential information ("Confidentiality Guidelines")[49].

With respect to the consultative process, ComReg is of the view that sufficient information for the issues to be comprehensible and for interested parties to respond to it has been provided. In the context of the assessment of the existence of an unfair burden, the rationale and relevant data is provided. ComReg also notes that its consultation process and the level of information provided exceed similar USO Fund assessments in other European countries.

[48] BT provides the following case to support its claim; *Lord Woolf M.R giving the judgment of the Court of Appeal in R v North and East Devon Health Authority, Ex p Coughlan (2001) QB 213*
[49] ComReg (2005), *"ComReg's Guidelines on the treatment of confidential information"*, 05/04

5.2.5 Access at a Fixed Location

5.2.5.1 Summary of Respondents' views

5.53 ALTO, Magnet and UPC claim in their response that Eircom, ComReg and its consultants incorrectly interpreted the Directive in the assessment of Eircom's application and as such in ComReg document 13/45. These respondents highlight paragraph 3.1 of ComReg document 13/45, which states that *"the USO ensures basic fixed line telephone services are available to end users at an affordable price" [emphasis added].* Operators are of the view that ComReg and Eircom appear to assume *"that the relevant component of universal service is necessarily delivered using Eircom's fixed line network".*

5.54 ALTO, Magnet and UPC disagree with their view of ComReg's interpretation of the Universal Service Directive 2002/22/EC and outline the Directive as transposed into Irish law[50]. Operators are of the view that the *"Directive does not specify service provision through fixed line technology as implied by ComReg and might include other technologies".*

5.55 Vodafone states its belief *"that ComReg has adopted an approach to allowable costs which appears to reward eircom for economically inefficient technology choices which takes little or no account of the fact that eircom's designation of USP effectively mandates it to provide services in the national retail market on which ComReg has separately found it exercises Significant Market Power"*.

5.56 ALTO and other respondents are of the view that *"the cost of Universal Service should be assessed on the basis of efficient provision that extends to use of alternative technologies".* ALTO states that *"given that the bulk of the calculated net cost relates to uneconomic customers in economic areas, there is a high probability that serving those customers using mobile technology might eliminate or very substantially mitigate any net cost to Eircom"*. BT and Vodafone address this issue from an efficiency perspective. BT states that *"the analysis appears to have focused on reviewing the efficiency of what Eircom deployed in 2009 to 2010 rather than what Eircom could have deployed".*

[50] Regulations 3(3) of the Regulations states that *"(A) designated undertaking that provides a connection to the public communications network shall ensure that the connection is capable of supporting-*

a) Voice,
b) Facsimile, and
c) Data communications at data rates that are sufficient to permit functional internet access, having regard to the prevailing technologies used by the majority of subscribers and to technological feasibility."

5.57 Respondents noted efficiency and its measurement in the context of alternative USO service delivery solutions and the efficiency of Eircom's cost base, and suitably their impact on the net cost, was highlighted by BT and Vodafone. BT states that there is *"no evidence or suggestion within the consultation and supporting papers that Eircom used more efficient or alternative access solutions to providing its USP services or whether the costs of a more efficient service were modelled or built into the assessment"*. As a result of this issue, BT is of the view that *"the Eircom claim is likely to be overstated"*.

5.58 Both BT and Vodafone state that a mobile or Fixed Cellular Solution (FCS) solution *"could be significantly cheaper in many instances but there is no evidence it has been factored into the sums claimed".* Referencing paragraph 4.2 of Consultation 13/45, Vodafone states that *"[T]he USO does not require that the USP uses any particular technology in meeting its obligation. Where the USP has made a business decision to use a technology which was more expensive than alternatives available which would also have allowed it to meet the obligation then it should not be compensated for the additional expense voluntarily incurred".*

5.59 Vodafone claims that ComReg did not consider *"whether the USP had available to it cheaper technologies than the one chosen which it could have used to meet all or part of the USO"*. Vodafone continues to outline that eircom deploys a FCS to provide fixed PSTN service and state that *"[T]here is no exploration of the decision thresholds that eircom used in making the decision to use FCS as opposed to copper and whether these thresholds where correctly calibrated against costs. Even where eircom did use FCS there is no exploration of whether it used the lowest cost mobile provider"* and *"where eircom did use FCS there is no exploration of whether it used the lowest cost mobile provider".*

5.60 In addition to the efficiency of the delivery of the solution, Vodafone queries the issue of the cost efficiency of eircom's operational cost base. Vodafone states in its response, as cited also in Consultation 13/45, that since c. 2009, Eircom has been undertaking a cost cutting programme which more recently has involved a substantial reduction in its headcount. This, in the context of Eircom's improved performance throughout the same period with respect to the USO performance targets, provides *"evidence that eircom's operational costs for the period of this funding request were inefficient"*. Vodafone is of the view that ComReg has not adjusted for this.

5.2.5.2 ComReg's view

5.61 ComReg agrees that the obligation to provide access at a fixed location does not have to be provided using a specific technology. However, in the context of Eircom's existing PSTN network and the requirement for access to be at a fixed location in many cases this may be the most efficient solution. Notwithstanding this, ComReg understands Eircom has provided both FCS and FWA solutions where appropriate.

5.62 With respect to BT and Vodafone's views that a mobile or Fixed Cellular Solution (FCS) presents an alternative and possibly more efficient solution than that provided by Eircom via PSTN, ComReg maintains that the efficiency of the solution by Eircom, with respect to access at a fixed location is compliant with the Regulations[51]. It remains ComReg's view that LFI-based efficiency data submitted by Eircom remain appropriate and compliant with D04/11. This adjustment methodology reflects real-life requirements faced by Eircom. In addition to this, ComReg highlights that TERA's assessment of Eircom's calculations, as detailed in 13/45a, shows that Eircom *"make downward adjustments of cost since the average national LFI of eircom is higher than the one recommended by ComReg"*.

5.63 ComReg recognises that there is evidence of alternative technologies being implemented by Eircom where appropriate and cost effective, in the case of new connections.[52] Since Eircom use FCS where it is most economical, it is reasonable to assume that the same principles are applied for uneconomic connections and the USO as Eircom would not have known in advance that a particular customer would be classified as uneconomic. ComReg has drawn on information from Eircom for the calendar years 2009 and 2010, which demonstrates the implementation of alternative solutions, such as FCS. It is ComReg's view that Eircom has sufficiently demonstrated for this application its intent to implement the most cost efficient technologies when appropriate and cost effective.

5.64 It is ComReg's view that as no other operators opted to apply for the status of USP or indeed suggested alternative solutions, it is reasonable for Eircom as the USP to obtain wholesale access or self-supply through its own network.

5.65 Additionally, Eircom was not aware as to whether any net cost would be unfair and whether it would be compensated for the USO. Therefore Eircom had no incentive to put in place solutions that were not cost effective.

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[51] *Regulation 3(1) of the Regulations stipulates "A designated undertaking shall satisfy any reasonable request to provide at a fixed location connection to a public communications network".*

[52] *ComReg is of the view that* in the context of existing connections, it would not be more efficient to replace existing PSTN connections with alternatives.

5.66 With respect to respondents' views in respect of Eircom's efficiency at an operational level, ComReg is satisfied that it was in the interest of Eircom as a commercial entity to minimise costs associated with the provision of USO services.

5.2.6 One-off connection charges

5.2.6.1Summary of Respondents' views

5.67 Magnet suggests in its response that using one-off connection charges *"averaged across 2006-2010"*[53] is not compliant with D04/11. Magnet is of the view that *"a downward adjustment in this is required to reflect the reduced number of avoidable costs in non-economic areas",* owing to the percentage decline in new units or new premises constructed during this period.

5.2.6.2ComReg's view

5.68 ComReg, having re-engaged with its consultant TERA, remains of the view that the reallocation and recalculation of one-off charges over the expected life does not materially impact the direct net cost, as stated in 13/45 and TERA's report, document 13/45a. As the net cost in the area model would only drop by 1%, ComReg considers this immaterial in the context of the direct net cost. This issue is noted in TERA's report, 13/45a, whereby Eircom *"does not allocate all the one-off charges over users' life time. It does not strictly correspond to the decision D04/11 as interpreted by TERA Consultants. However, the impact of this change in allocation method is insignificant with regards to the period considered".*

5.69 ComReg is of the view with regard to the decline of connection charges, as suggested by Magnet, that while retail connections were decreasing, wholesale connections were increasing during 2006-2010, causing to offset the two effects. For ComReg and its consultants to gain assurance surrounding the issue of one-off charging, the provision of Decision 15 of D04/11 was noted, whereby reality checks may be undertaken.

5.70 ComReg also, referring to page 15 of TERA's report, notes that the one-off connection charges and in this instance Reasonable Access Threshold (RAT), as queried by Magnet, refer to revenues. Therefore, in essence any overstatement of these charges serves to increase the net cost. As concluded by TERA in its report 13/45a, *"the simplifying assumption made by eircom does not have a significant effect on the final result".*

[53] Page 15 of ComReg document 13/45a, TERA Consultants (2013*), "Assessment of Eircom's USO funding application"*, 1 February 2013, Annex 1

5.71 In compliance with Decision 15 of D04/11, whereby reality checks may be required to adequately assess an estimate, Eircom was requested to undertake scenario analysis by TERA, with respect to one-off charges. Eircom subsequently ascertained that the impact to the net cost would drop by 1%, should charges be allocated over the correct period, as prescribed by Decision 4 of D04/11. TERA's assessment concluded that this amount was immaterial. ComReg nonetheless would highlight revenue allocation as an area for improvement in future funding applications, ensuring revenue is allotted over the expected life of the customer and methodologies undertaken align with Decision 4 D04/11.

5.2.7 Revenue data and revenue exclusion

5.2.7.1 Summary of Respondents' view

5.72 UPC and Vodafone both query revenue data and revenue exclusion in their respective responses. Vodafone states that owing to the level of redaction *"it is impossible to comment on the detailed assessment carried out by [TERA] under each cost heading"* and *"impossible to properly assess whether the proposed exclusions or inclusions are correctly categorised or whether they might include inappropriate items"*. Vodafone's detailed commentary surrounding revenues includes the following:

- DSL retail;
- Leased lines;
- Freefone;
- Revenue not intrinsic to a particular MDF;
- Retail roaming (VOIP);
- Retail roaming (VPN); and
- Revenue from staff on loan.

5.73 For further detail on Vodafone's commentary surrounding each of these revenue areas, please refer to Vodafone's detailed consultation response.

5.74 In UPC's and Vodafone's view, Eircom should have included costs that are not based on the copper network, for which revenues are not intrinsic to any one MDF or that are not generated on the Eircom's lines, in the net cost calculation.

5.2.7.2ComReg's views

5.75 ComReg remains of the view that the exclusion methodology and assessment adopted by TERA is justified. In ComReg's and its consultants' view, revenues that not are intrinsic to any one MDF are not included as they are not lost even where uneconomic areas are disconnected. Similarly, revenues not generated on eircom lines do not depend on disconnection of areas (for example, mobile calls to directory enquiry services).

5.76 TERA has reconfirmed that Eircom excluded certain revenues from the calculations for a range of reasons including services not being based on the copper network, revenues not being intrinsic to any one MDF, revenues not generated on Eircom lines and unavailability of data and / or of immaterial value. TERA highlighted in its report 13/45a, that only three of the 28 categories including *"interconnect links", "freefone national"* and *"freefone international"* were excluded. As these categories cumulatively constitute only 2% of total revenue. ComReg remains satisfied with the approach taken by TERA.

5.77 Revenues queried by Vodafone and considered by ComReg include the following:

- DSL retail - TERA agrees that satellite rentals and connections that provide broadband services should be included in the model;
- Leased lines - TERA has checked the cost allocation principles and confirms that they are relevant;
- Freefone - TERA confirms that the model takes into account calls from uneconomic customers to Freefone;
- Revenue not intrinsic to a particular MDF - TERA has checked the allocation principles of shared costs and shared revenues and confirms that they are relevant;
- Retail roaming (VOIP) - TERA has checked the cost allocation principles and confirms that they are relevant;
- Retail roaming (VPN) - TERA has checked the allocation principles of shared costs and shared revenues and confirms that they are relevant; and
- Revenue from staff on loan - In principle, the corresponding costs are excluded from the model.

5.2.8 Replacement calls

5.2.8.1 Summary of Respondents' views

5.78 Vodafone and UPC query replacement calls and a suitable replacement call rate[54]. UPC states that replacement call rate assumption used by Eircom, stating that the rate used was *"deemed acceptable"* by ComReg, *"even though the rate used by eircom dates from 1997"*. UPC recognises the commentary surrounding the 1997 date provided by TERA, but however criticise that the rate was used for the purpose of the calculations. UPC emphasises that application of the replacement call rate to the mobile penetration rate by TERA and outline its *"surprise"* with respect to TERA's view, *"given that the mobile penetration rate in Ireland in 1997 was no more than 46%"*. UPC uses this issue to exemplify the perceived lenience of ComReg with respect to the calculation of the net cost in the context of the decisions set out in D04/11.

5.79 Vodafone claims that TERA *"endorsed an approach that seems to assume that if eircom did not have USO then the USO customers would not be provided with fixed connections to the PSTN"*. Vodafone highlights that if Eircom "does not have a USO the end-user demand for PSTN connection is served by someone else. There is no replacement call revenue for eircom as the call revenue attributable to eircom's USO connection will be fully attributable to the alternative provider's connection".

5.2.8.2 ComReg's view

5.80 ComReg is satisfied that TERA has justified that the replacement rate estimated by Eircom and WIK and remains of the view that where replacement rate data is old, the resultant replacement rates estimated by WIK are in line with a more recent benchmark made by TERA. The replacement rate range of ✂ % - ✂ % does not correspond to the Irish 1997 market but the Irish market in 2009, when the penetration rate was equal to 119%[55]. The replacement rate range of ✂ % - ✂ % was not directly taken from the 1997 report but was calculated taking into account the proportion between fixed and mobile calls on the national level.

[54] UPC is "*particularly concerned with regard to the leniency with which ComReg and its consultants treat clearly flawed inputs by eircom in its application*", UPC response to Consultation 13/45

[55] European Commission. Reports on the Implementation of the Telecommunications Regulatory Package

5.81 ComReg reconsulted with TERA, who stated that, in respect of replacement cost assumptions and consistency with international benchmarks, replacement calls correspond to the calls made using the phone of a third party, such as a relative or friend. The Belgian Regulator, BIPT states that *"the calls for which a replacement is possible are those which a user would have to make even if he/she was not connected at home. For such calls, the user could use the phone of a friend, the one at the workplace or a public phone"*[56].

5.82 It remains ComReg's view that disconnected users are those who would not be served on commercial terms by the market. Moreover, in this scenario no universal service obligation is imposed on any operator. In such circumstances, disconnected users have to use a phone in another location or a mobile phone. This approach to replacement calls is in line with ComReg document 11/15, which states that replacement calls correspond to the situation where a customer is disconnected from the universal service provider and uses the telephone of a relative, a friend, one at work, or a mobile phone:

"The concept of replacement calls implies that if this customer was disconnected they would still generate indirect revenue for the USP — as they would use the telephone of, say, a relative which generates revenue for the USP"[57]

5.83 ComReg has considered its view in relation to replacement calls and considers that where the USP has a separate mobile network, acting as a commercial operator, it may consider that mobile revenues may increase as a result of disconnecting uneconomic areas or customers.[58]

5.2.9 Other Related Issues

5.2.9.1 Summary of Respondents' views

5.84 BT queries whether Eircom "*sought to avail of the Wholesale access service provided by 3 Ireland ["3"] as part of the State Aided National Broadband Scheme covering the 30% of the country not reached by commercial broadband",* as BT is of the view that a voice telephony service can be supported over this network. Vodafone is of the view that *"ComReg has adopted an approach to allowable costs which appears to reward eircom for economically inefficient technology choices".* BT finally states that Eircom appears to be developing its copper network through USO funding.

[56] Decision of the BIPT of 17 May 2005 regarding the provisional assessment of the net cost, translation by TERA
[57] Paragraph 3.57 of ComReg document 11/15
[58] ComReg document, 11/42

5.85 UPC states that it is *"not clear from the consultation documents how subsidies from the Department of Family and Social Affairs (DSFA) were considered by ComReg and its consultants, in its assessment of the net cost incurred"* and seek further clarification on the treatment and assessment of these payments. UPC additionally queries the relevance of WIFI costs in the payphone model.

5.86 BT suggests in its response that the *"look and feel"* of Eircom's directory and NDD USO services resemble a *"standalone commercial business".* BT suggests that Eircom benefits from *"industry information for no external cost",* that is sold to marketing companies to ensure compliance with data protection regulations. BT adds that it is *"not aware of any development or significant operational costs in this area and agree with the sentiment expressed by ComReg in paragraph 4.42 that these services should be profitable and contribute to reduce the net burden*"[59].

5.87 BT states that it does not agree with Eircom *"that all payphones with 'negative costs' should be assumed to be uneconomic",* as factors such as poor management, maintenance and cash collection can impact what phones are uneconomic. As such, BT suggests a review of the payphone operations to assess efficiency. In such an assessment, BT suggests criteria such as physical location, usage and records of application by Eircom to remove a payphone should be assessed.

5.2.9.2ComReg's Views

5.88 As noted and expanded upon in paragraph 5.66 ComReg recognises that there is evidence of alternative technologies being implemented by Eircom, particularly FCS and Fixed Wireless Access (FWA) technology where appropriate and cost effective, in the case of new connections.

5.89 In relation to UPC's comment, ComReg notes that Eircom confirmed the inclusion of revenues from the relevant DSP in its revenue calculation, as appropriate during the assessment process. ComReg was satisfied with this confirmation. The revenues derived from relevant customers were included in the same manner as other relevant revenues. As such, this is not an issue that requires further clarification.

5.90 In relation to BT's comments in respect of directories, ComReg notes that the claim for directories 2009-2010 is zero and that the provision of the NDD is no longer a USO.

[59] BT notes ComReg make reference to brand positioning payments but it's not clear what these are and who benefits.

5.91 ComReg is currently undertaking a review of the USO for payphones. For the purpose of the 2009-2010 assessment, ComReg is of the view that the approach taken by Eircom is reasonable. The outcome of the payphones review will lead to a greater understanding of today's needs and Eircom's operations with respect to payphones going forward and this information will be used in future assessments.

5.92 With respect to UPC's query regarding WIFI costs and their inclusion in the payphone model, TERA has detailed its view in sections 1.51 and 1.52 of its report and ComReg is satisfied with this.

5.2.10 Other issues outside the scope of the consultation

5.93 Outside the scope of the specific consultation questions posed by ComReg, respondents provided additional commentary with respect to Eircom's application, ComReg's assessment and high level USO related issues. These issues are summarised in the following paragraphs.

Designation

5.94 Vodafone is of the view that as ComReg has *"'rolled-over' the USP designation on Eircom to 2014"*, a consultation is required to investigate the function of the USP and the services provided in the context of efficiency and relevance.

5.95 Vodafone notes that the National Directory Database (NDD) is no longer part of the USO and is therefore of the view that *"there is a growing case under competition law for ComReg to conduct a public procurement or public invitation to tender for the NDD rather than the supply of the NDD being mandated to Eircom".*

5.96 Eircom notes that it *"never sought or applied for this designation from ComReg, nor did it have any significant say into the scope or duration of the USO designation decided upon by ComReg*".

USF application extensions

5.97 ALTO and its members are of the view that extensions permitted by ComReg, demonstrates the imbalance of the USO consultation process and states that *"(H)aving long and protracted periods of USO funding reviews creates a privative or jaundiced view of the Irish Communications market that should be ended".* UPC adds that the "*unbalanced nature of the current consultation process has been further exacerbated by numerous extensions being granted to eircom on this and other USO funding applications, the latest being the most recent application for the year 2010 – 2011".*

Sharing Mechanism in Ireland

5.98 ALTO, UPC and Magnet query ComReg's intention to commission an expert report and publish a decision on the sharing mechanism at this stage as an unfair burden has not yet been found, adding that this may be an *"inefficient"* use of resources.

5.99 Vodafone claims that in *"determining the net cost of the provision of USO ComReg has failed to take proper account of the fact that eircom would be effectively both a contributor to and beneficiary of any USF".*

Future of the USO

5.100 Magnet states, in the context of the Ministers announcement on broadband rollout plans, *"the concept of the USP is now redundant".*

5.2.11 ComReg's views

Designation

5.101 Following the consultation process, on 29 June 2012, Eircom was re-designated as the Universal Service Provider (USP) for a period of two years (refer to ComReg 12/71, D07/12 for further detail). Eircom's current term as USP lasts until 30 June 2014. ComReg is in the process of a review of the USO for the period post June 2014.

USF application extensions

5.102 As set out in ComReg Information Notice 13/49, Eircom submitted an extension request in respect of its subsequent application for the 2010-2011 period, on 28 March 2013, which was due to be submitted by 31 March 2013. ComReg issued an Information Notice in respect of its receipt of the extension request from Eircom. ComReg considered Eircom's request and in accordance with Decision 33 of D04/11 decided that there was an exceptional reason for acceding to Eircom's extension request. ComReg, cognisant of the fact that the ComReg document 13/45 relates to the first application and assessment undertaken, is of the view that the granting of this extension was within the parameters allowed for under Decision 33 of D04/11. The intention of the extension was to allow Eircom the opportunity to review and incorporate the recommendations, relating to the application, set out in ComReg document 13/45 and associated consultants' reports, in future applications.

5.103 Therefore, ComReg confirmed the granting of an extension to Eircom for the 2010-2011 application from 31 March 2013 to 11 November 2013, a period of six months from 10 May 2013. In line with D04/11 and previous extensions granted, ComReg confirmed that the existing deadline, of 31 March 2014, for both the 2011-2012 and 2012- 2013 applications, as relevant, remain unchanged.

Sharing Mechanism in Ireland

5.104 Given EU case law in this area, ComReg remains of the view that it is more appropriate to finalise and publish the Sharing Mechanism Decision document at a later stage. Based on the responses to the sharing mechanism consultation ("Document 11/77")[60], which will be published in due course, ComReg is currently commissioning an expert report in respect of the most appropriate principles of any mechanism and the issue of sharing of any unfair burden, established in an Irish context.

Future of the USO

5.105 ComReg is currently in the process of its review of the USO in light of the upcoming end to the current designation period. ComReg will consider the current universal service requirements and appropriate ways to meet those requirements. As stated, ComReg will assess each application in its own right, on a case by case basis.

5.106 As set out in ComReg Consultation 13/45, *"In the absence of having established a sharing mechanism previously, it is reasonable to assume, for the purpose of illustration, that if the sharing mechanism is based on all Electronic Communications Revenues, approximately 70%*[61] *of a positive net cost would be provided for by other market participants and 30% by Eircom, the USP. As such, ComReg is of the preliminary view that in the instance an unfair burden is found, the net transfer to Eircom for the 2009-2010 assessment period would be approximately €3.6m (c. 70% of €5.1m)".*

5.3 ComReg's final position – Direct Net Cost

5.107 Having considered the views of respondents, ComReg remains of the view that its assessment of the direct net cost set out in Section 4 of Consultation 13/45 and again in Section 4 of this document and in the accompanying consultants' reports, the direct net cost for 2009-2010 is €7,139,331.

[60] ComReg (2011), "*Consultation on sharing mechanism for any USO Fund: Principles and Methodologies",* October 2011
[61] ComReg quarterly reports for the period 2009-2010, http://www.comreg.ie/publications/publications.583.100023.0.0.p.html

Chapter 6

6 Estimation of intangible benefits

6.1 Overview

6.1 Decision 35[62] of D04/11 requires that the net cost calculation must assess the benefits, including intangible benefits that accrue to the USP, by virtue of being the USP. It provides that at a minimum, ComReg will consider the following benefits:

- Enhanced brand recognition;
- Ubiquity;
- Life-cycle; and
- Marketing.

6.2 The key principles underpinning ComReg's guidance include the following:

- The benefits represent effects on a USP of providing the USO which have not been accounted for in the direct costing methodology;
- To avoid the double counting of any benefits; and
- The benefits are those accruing to the USP, as a consequence of being the designated USP (any benefit arising from the fact that the USP is a large player in the market is to be excluded from the calculations).

With respect to the identification and quantification of the intangible benefit categories listed, ComReg and its consultants assessed the approach and results that formed part of Eircom's application in line with the decisions set out in Decision 36 of D04/11.

[62] Regulation 11 (4)(a)

6.2 Application

6.3 In accordance with the requirement of Decision 31 of D04/11 which prescribes that the *"calculation of the benefits of the USO shall be completed by an external expert, independent of the USP".* Eircom engaged with WIK and Amárach to discharge the requirement for an independent expert to ascertain the estimation of intangible benefits. A summary of Eircom's estimations submitted on 31 May 2012[63] included in its detailed funding application are consistent with the intangible benefits categories included in Decision 35 of D04/11, as set out below.

Intangible benefits (b)	**Section reference**	***Eircom €***	***Adjustment €***	***ComReg €***
Enhanced brand recognition	6.3.1	1,279,842	563,856	1,843,698
Ubiquity	6.3.2	-	15,091	15,091
Marketing	6.3.3	7,896	12,541	20,437
Life-cycle	6.3.4	207,879	(43,319)	164,560
Total intangible benefits		**1,495,617**	**548,169**	**2,043,786**

6.4 Decision 37 of D04/11 states that *"(T)he methodologies to assess the value of the benefits that will actually be used cannot be prescribed in advance of receiving an application for USO funding from the USP*". As such, the assessment of the methodologies adopted by Eircom commenced on receipt of the application. Having regard to Decision 37 of D04/11, Oxera sought *"specific clarifications and explanations"* to ensure an optimum understanding of the application.

6.5 Intangible benefit estimations for each category submitted by Eircom are outlined in paragraph 6.3. Final calculations assessed by ComReg differ in some cases from those originally submitted by Eircom as a result of clarifications and modifications sought by ComReg and its consultants throughout the assessment process. The causes for clarification requirements are discussed throughout this chapter with respect to each intangible benefit category.

[63] http://www.comreg.ie/_fileupload/publications/ComReg1257.pdf

6.3 Assessment

6.6 ComReg engaged Oxera to undertake a detailed assessment of the methodologies and calculations[64] applied by WIK and Amárach, on behalf of Eircom as its' independent experts, to establish the estimate of the intangible benefits generated as a result of the provision of USO services. While D04/11 establishes that costs that are incurred in the provision of USO services, that would be otherwise avoidable, are to be considered in the calculation of the direct net cost, it likewise establishes that benefits, both tangible (i.e. direct) and intangible (i.e. indirect), if positive, are to be deducted from the direct net cost.

6.7 Oxera undertook its assessment and prepared its report, the "*Assessment of WIK's calculation of intangible benefits"* with the objective of achieving the following:

- Developing an understanding of the approaches and methodologies adopted by Eircom and determining their rationale and suitability in calculating the estimation of each intangible benefit category, as listed in paragraph 5.1;
- Evaluating the methodologies adopted in Eircom's application by WIK and the estimates of each intangible benefit category in the context of international precedent, their effectiveness and robust implementation in the overall analysis, while giving due consideration to the requirements set out in Decision 37; and
- Evaluating whether improvements to the methodologies could be incorporated and providing any relevant recommendations for future USO fund applications, in accordance with Decision 37 of D04/11 that provides *"… the receipt of the first USO funding application, ComReg will actively continue to evolve and refine a number of potential methodologies for the purposes of valuing the benefits of the USO[65]".*

[64] Oxera Consulting (2013), *"Assessment of WIK's calculation of intangible benefits",* 1 February 2013
[65] ComReg decision document D04/11

6.3.1 Brand recognition benefits

6.8 Enhanced brand recognition refers to the benefits generated as a result of greater brand recognition, corporate reputation and associated goodwill as a result of the provision of USO services. D04/11 prescribes that it is necessary to assess the level of enhanced brand recognition associated with the USP, as USP status may result in the benefits of more new customers choosing the USP over other authorised operators (OAOs). It may also deter existing customers from switching to competing OAOs. In addition to this ComReg also recognises that customers may be willing to pay a USO-related premium as a direct result of brand recognition.

6.9 For the evaluation of brand recognition, WIK considered two approaches in establishing an accurate estimation; a cost-based approach and a commercial benefit approach. For the purpose of the assessment, the latter approach was adopted, whereby the USO-induced brand benefit derived by Eircom as the USP, is considered in the context of more loyal customers as a directed result of Eircom's USP status. ComReg suggested five possible methodologies in D04/11 that may be adopted in establishing the value of enhanced brand recognition that was enjoyed by the USP (in isolation or as a combination), these include:

- The use of valuation multiples implicit in the USP's transaction price;
- Identify and capitalise cash flows generated by brand recognition, corporate reputation and goodwill;
- Use the depreciated replacement cost;
- Carry out primary research/ survey data; and/or
- Undertake regression techniques.

6.10 The methodology adopted by WIK ascertained the difference between the benefit derived from two scenarios as follows:

- Eircom's actual profit, whereby Eircom is the USP and a portion of customers are willing to pay a USO-related premium; and
- The counterfactual scenario, whereby Eircom is no longer the USP provider and as a consequence does not receive any USO-related premium.

6.11 While Oxera is of the view that the general conceptual approach adopted is reasonable, Oxera highlighted that *"the specific theoretical model developed by WIK to estimate Eircom's profit in the counterfactual scenario and the USO-induced brand benefit has counterintuitive predictions, which raises questions about the validity of WIK's assumptions and the applicability of the model."*

6.12 Oxera found a formula error with respect to the calculation of the ‘willingness to pay premium’ using Amárach’s customer survey data. The required adjustment led to an increase in the ‘willingness to pay’ premium and the brand recognition estimate.

6.13 During the assessment, Oxera considered the consistency of the survey questions posed by Amárach in order to estimate the USO-related premium. One question, used to distinguish between subscribers who are willing to pay a USO-related premium and those who are not, asked customers whether they are more or less likely to switch away from Eircom as the USP provider. A second question asked *“whether the different features of the USO make customers feel more positive or negative about Eircom”*, underpins the estimation of the USO-related premium and is discussed in greater detail in Oxera’s report. This question was *“based on the difference in the average trigger price increase”* between the two subscriber groups and was intended to establish the *“emotional brand effect”* and the willingness to pay a USO-related premium. Oxera argue *“that both questions should have been used to identify the two groups of subscribers and to estimate the USO-related premium”.* Section 2.3.2 of Oxera’s report provides further detail.

6.14 Based on the in-depth analysis provided by Oxera and outlined in its report, ComReg has determined that the approach adopted by WIK is broadly appropriate. However, cognisant of Decision 37 of D04/11, Oxera provided recommendations which serve to inform a more effective practical interpretation of the requirements of D04/11. Oxera noted that although it considered the general conceptual approach adopted by WIK as broadly *“reasonable”* and *“sound”,* their assessment highlights a number of shortcomings in the context of the theoretical model and the empirical research used to populate the assumptions of the model. Oxera’s report queried the appropriateness of the theoretical approach applied by WIK and its application to the estimation of the counterfactual scenario. Separately, Oxera also queried the reliability of survey data owing to the small sample size used to estimate key parameters of the USO-related premium and the consistency of the questions (as per paragraph 6.10) included in the survey questionnaire. To ensure a full understanding, Oxera provided a step-by-step approach to assessing the shortcomings of the approach adopted in section 2.3 of its report. Oxera outlined that *“the model has a counterintuitive prediction that the benefit of the enhanced brand recognition is independent of the number of subscribers who are willing to pay a USO-related premium”.* In addition to this Oxera highlighted that the theoretical model is contrary to the supporting discussion provided by WIK in relation to the methodology.

6.15 In order to test the approach adopted, Oxera further investigated the *“magnitude of the enhanced brand value predicted by WIK’s model and how sensitive the model is to alternative assumptions”.* As a result of this analysis documented in section 2.3.1 of its report, Oxera found *“some comfort regarding the magnitude of the predicted benefit of the enhanced brand value”*, but also highlighted the *“wide range of potential outcomes that can result from small changes to the assumptions”.*

6.16 In the context of enhanced brand recognition, the theoretical model and supporting primary data, Oxera made the following recommendations:

- Certain aspects of the model should be modified to mitigate the risk of counterintuitive predictions and ensure a robust estimate of key parameters of the empirical estimate (λ);
- Primary research survey sample size – Oxera advise larger samples for the purpose of future applications to ensure increased robustness of results;
- Primary research survey questions – Oxera advise consistent survey questions should be applied to each subscriber group; and
- Primary research survey results presentation – Oxera advise that the presentation and discussion of results could benefit from greater clarity to ensure optimum verification of results.

6.17 ComReg, cognisant of Decision 37 of D04/11, is in agreement with the recommendations put forward by Oxera as a means to refining the approach to calculating enhanced brand recognitions for future applications. As stated, for the purpose of the 2009-2010 USO fund application and based on advice provided by Oxera, ComReg considered an upward adjustment of €563,856 to be appropriate.

6.3.2 Ubiquity benefits

6.18 In line with D04/11, ComReg is of the view ubiquity benefits may accrue to Eircom as a result of the following:

- Customers having moved from uneconomic to economic areas, remaining with Eircom;
- Eircom’s services can be marketed more effectively to business customers as a result of being able to serve their requirements nationally; and
- The USP economically benefiting from the overall sector as a result of positive network externalities arising from universal connectivity.

6.19 The approach adopted by WIK in establishing the ubiquity estimation is based on the migration flow of customers from uneconomic areas to economic areas and their likelihood to remain with Eircom as a customer in an economic area in the context of competing OAOs. WIK applied this approach by establishing the number of assumptions detailed by Oxera in section 3.2.2 of its report and summarised below. WIK recalculated the estimate incorporating the following key assumption changes, so as to ensure accordance with D04/11:

- Update of Eircom’s market share among subscribers who move from uneconomic to economic areas from ✂ which is based on data on Eircom's current market share in uneconomic areas;
- Update of Eircom's market share in economic areas from ✂ based on the area model; and
- The number of Eircom fixed line subscribers that moved from uneconomic to economic areas and the average revenue per new subscriber, as per the Area model.

6.20 Ubiquity benefits potentially enjoyed by a designated USP provider are those derived from additional profits enjoyed by a USP which are generated from retaining a proportion of customers who move from uneconomic areas to economic areas. This is in contrast to those who move from uneconomic to economic areas and who choose to switch to a competing OAO.

6.21 Having reviewed the ubiquity benefit, in conjunction with the assessment of the methodology and calculation of ubiquity benefits completed by Oxera, ComReg was of the view that the approach and estimation is reasonable. However, ComReg, cognisant of Decision 37 of D04/11 and giving consideration to the advice of Oxera, was of the view that improvements in the approach should be made. As such, ComReg recommends the following for future applications:

- Additional justification of the assumptions used in the calculation of ubiquity; and
- The inclusion of network externalities in the approach.

6.3.3 Marketing benefits

6.22 ComReg outlines in D04/11, that marketing benefits derived through the provision of USO services result from the access to customer information acquired by consequence of the USP designation and the ability of the USP to advertise its services on uneconomic payphones at no additional cost. To summarise, D04/11 outlines the following areas in respect of marketing benefits:

- Commercial advantage owing to access to customer data and potential benefit of not, as a result, having to undertake market research;

- Commercial benefit of potentially selling customer data to third parties. While the USP in Ireland may not sell information owing to data protection laws, it may use the information for more targeted promotions, and as such may increase profitability of both uneconomic and uneconomic customers; and

- Potential savings as a result of advertising in economic areas through the use of public payphone and WIFI hotspots.

6.23 WIK was of the view that the benefits associated with customer data should not be included in the calculation of the marketing benefits, as it is *"implicitly included in the net cost of the USO".* As such, the marketing benefit calculated is based on the advertising advantage gained by Eircom by its ability to advertise on uneconomic payphones. In accordance with D04/11, WIK assessed the number of total payphones and their value in terms of advertising capability and then ascertained which of these USO payphones were uneconomic. Assumptions used to ascertain this were derived from the payphone model, which is discussed in section 4.7 of this paper. Having ascertained the number of USO payphones with advertising capability, WIK apportioned total third party advertising revenue across these payphones to establish the marketing benefit.

6.24 Although Oxera broadly agreed with WIK's approach, its report highlights that the benefit *"should, in principle, be based on how much it would have cost Eircom to advertise itself elsewhere in the same area as those uneconomic payphones are located, rather than advertising free of charge in uneconomic payphones".* Oxera recommended that the independent consultant should, in future applications, investigate assumptions that enable the calculation of the benefit using the approach set out in Oxera's report. Oxera also noted that it is unclear whether the benefit (i.e. savings in advertising costs) derived from the WIFI hotspots is included in the marketing benefit estimation. For the purpose of this year's assessment, the impact is not considered material; however ComReg advises that consideration should be given to WIFI hotspots and marketing benefits in future assessments.

6.3.4 Life-cycle benefits

6.25 Potential life-cycle benefits that may be enjoyed by Eircom over time, as the USP, include subscribers who may have been uneconomic but who may become profitable to Eircom owing to changes in respect to usage of Eircom's services. As such, as summarised by Oxera, *"it may be beneficial for the USP to provide unprofitable services to (these) customers in the short term in order to reap future benefits when they become economic",* as long as these customers remain customers of the USP.

6.26 As outlined in D04/11, "*ComReg is of the view that "uneconomic" customers (included in the net cost calculation) would not be otherwise served by a commercial operator, they are likely to represent those customers that are never likely to become positive (i.e. profitable) in all states of the world and therefore, their value is likely to be insignificant. Consequently, ComReg reasoned the life-cycle benefits calculation could be excluded from the intangible benefits calculation*". In tandem with this however, D04/11 *"considers that it remains appropriate that life-cycle benefits are acknowledged as an intangible benefit, the fact that their benefit is in part included in the net cost calculation (i.e. the commercial operator decision to continue serving loss-making customers) and not separately calculated as an intangible benefit is irrelevant".* As a consequence, an overlap with the direct net cost assessment may occur as customers who may become profitable in the future are no longer considered an avoidable cost (as a commercial operator is likely to continue serving these customers now to retain their future profit profile) and as such the attributable direct revenue from these former uneconomic customers should not be reflected in the direct net cost.

6.27 In order to estimate the life-cycle benefit derived by a USP, D04/11 advises that the USP establishes the level of uneconomic customers likely to become economic customers and the consideration and relationship between two key metrics, the age profile of customers and household telephone expenditure trends. Oxera undertook in-depth analysis of the approach adopted by WIK and have detailed its assessment in section 4.4.2 of its report. Oxera outlined that in order to calculate this benefit *'information needs to be obtained on which customers are currently uneconomic and may become profitable in the future'*. It should be noted that WIK explained that it would not be practical to make all the data requested available through conventional database tools, which would have allowed Oxera to trace the final estimate of the life-cycle benefit.

6.28 An adjustment to the mark-up to revenue was made during the assessment, ✂. The cause of this adjustment was a modelling error which miscalculated the number of years.

6.29 ComReg was of the view that the theoretical approach to the estimation of life-cycle benefit is adequate and considers that the approach, with respect to the overlap with the direct net cost, is appropriate. Oxera however highlighted that the lifetime of customers and not the lifetime of the considered investment should be adopted in establishing the assessment to ascertain a more accurate estimate in future application. With respect to the assumptions adopted, and ensuring no inaccuracies with the overlap with the direct net cost, as highlighted in paragraph 4.53, Oxera recommended that *"further justification"* is required with respect to the mark-up to revenues assumption with specific consideration to *"distribution of telecoms expenditure and demographic changes in economic areas"*. Similarly ComReg was of the view that an increased level of detailed information is required for future applications.

Table 11: Compliance with Decisions 31, 35, 36 and 37 of D04/11

D04/11 Decision	ComReg's Assessment
31	ComReg was satisfied that Eircom's engagement with independent experts for the purpose of the development of suitable methodologies and the preparation of the intangible benefits estimate and has ensured that independent experts have completed the necessary calculations.
35	ComReg was satisfied that Eircom's estimations assessed the relevant benefits, including intangible benefits, to the USP.
36	Based on the analysis of both TERA and Oxera, ComReg was satisfied that there was no evidence of double counting and benefits accruing as a result of Eircom's USP status were only considered.
37	As discussed in paragraph 6.7, ComReg engaged with Oxera to review the estimate prepared by WIK. ComReg, cognisant of allowances in Decision 37, requested Oxera not only to review the estimate but provide recommendations to ensure the proper evolution of the methodologies used. Furthermore, as set out in D04/11, ComReg reserved its right with respect to implementation of alternative methodologies and as such has adjusted the estimates provided by WIK. Reasoning to support the justification of these adjustments is discussed throughout this chapter and detailed in Oxera's report.

6.4 ComReg's view as per Consultation 13/45

6.30 Oxera concluded that the application was made appropriately and broadly in accordance with D04/11. There have been a series of clarifications and subsequent adjustments throughout the assessment process, as detailed throughout this chapter. ComReg was of the preliminary view that clarifications and certain adjustments during the assessment of any application may be unavoidable and in fact may be necessary to ensure there are no inaccuracies or misinterpretations. ComReg was of the preliminary view that the recommendations do not have a material impact in respect of the 2009-2010 application and furthermore the data submitted by Eircom is acceptable. With respect to Decision 37 of D04/11, the flexibility allowable for the purpose of refining the approach allows for the identification of where improvements can be made. Having reviewed the approach adopted by WIK in the context of the decision document and Oxera's analysis, ComReg was of the preliminary view that the estimate is reasonable. ComReg was of the preliminary view that the intangible benefits estimation requires an upward adjustment of €548,169, therefore giving an adjusted total intangible benefits' estimation of €2,043,876 post assessment, as follows:

Intangible benefits (b)	**Section reference**	***Eircom €***	***Adjustment €***	***ComReg €***
Enhanced brand recognition	6.3.1	1,279,842	563,856	1,843,698
Ubiquity	6.3.2	-	15,091	15,091
Marketing	6.3.3	7,896	12,541	20,437
Life-cycle	6.3.4	207,879	(43,319)	164,560
Total Intangible benefits		**1,495,617**	**548,169**	**2,043,786**

Chapter 7

7 Intangible Benefits - Consultation issues

7.1 ComReg assessed the intangible benefits component of Eircom's application for funding for the period 2009-2010 in accordance with Chapter 5 of Consultation 13/45 and also detailed in Chapter 6 of this document.

7.2 ComReg remains of the view that Eircom's application was fit for purpose, while giving due consideration to the fact that it was the first USF application and assessment of its kind. A summary of ComReg's preliminary view with respect to each intangible benefit post-assessment, is set out below:

- Enhanced brand recognition;
- Ubiquity;
- Life-cycle; and
- Marketing.

Intangible benefits	***ComReg €***
Enhanced brand recognition	1,843,698
Ubiquity	15,091
Marketing	20,437
Life-cycle	164,560
Total Intangible benefits	**2,043,786**

7.3 ComReg requested interested parties' view on the following;

Consultation Question 3
Following ComReg's assessment, detailed in Chapter 5, do you agree with ComReg's preliminary view that the intangible benefits estimate for 2009-2010 is €2,043,786? Please provide reasoning to support your view.

7.1 Summary of respondents' views

7.4 ALTO, UPC, Telefónica and Magnet state in their responses that they are unable to agree or disagree with ComReg's estimation of intangible benefits, while Vodafone and Telefónica disagree with the estimation of €2,043,786. ALTO calls into question the credibility of the entire Eircom application for 2009-2010.

7.5 Magnet states that it does not agree with the estimation of intangible benefits and states that it is of the view that *"the direct costs should be reduced to reflect reduced costs of one off connections in non economic areas"* and that *"the estimations outlined in Question 4 "should in fact be less than that indicated".*

7.6 Eircom states that it *"agrees with ComReg's preliminary view that the intangible benefits estimate for 2009/10 is €2,043,786"*. With respect to ComReg's proposed adjustments, Eircom is of the view that these are reasonable, that they do not have a material impact in respect of the 2009-2010 application and data originally submitted by Eircom was acceptable. Eircom state that the recommendations[66] for future applications on a prima facie basis *"appear reasonable*".

7.1.1 Brand recognition benefits

7.1.1.1Summary of Respondents' views

7.7 ALTO, BT and UPC express concern and a degree of criticism surrounding the calculation and estimation of brand recognition benefits and call into question the whether the application was fit for purpose. ALTO and Vodafone highlight the four areas of concern outlined by Oxera its report and findings. BT states that Oxera's conclusions, although raising *"significant concerns"*, do not appear to *"offer a solution in the review",* where the estimation constitutes *"some 90%" of total intangible benefits*". Vodafone and UPC also share this view. Vodafone states that shortcomings in the intangible benefits' category prove *"most material"*, the indication is that the "*WIK report is not suitable to be used as an input to the USO funding application"* and is not capable of being adjudicated".

7.8 ALTO also reiterates its claim that there is insufficient information available to assess *"the cumulative impact of these deficiencies"* with respect to enhanced brand recognitions in the Eircom application. BT is of the view that further work is required with respect to this benefit.

[66] Recommendations include those discussed in paragraphs 5.16, 5.21, 5.24 and 5.29 of Consultation 13/45

7.1.1.2ComReg's views

7.9 ComReg notes ALTO's comments in respect to enhanced brand recognition benefits and a lack of information. In response to this, ComReg refers to section 5.2.4 which considers the issues of transparency and confidentiality. As outlined previously, ComReg is satisfied that its consultants have undertaken a sufficiently rigorous assessment and ensured that that impact of any information deficiencies, as a result of methodology testing is not material.

7.10 In respect to the overall criticism of data and the methodology applied in arriving at the estimate, ComReg considers it necessary to highlight that Eircom and WIK's estimation of enhanced brand recognition is very much in line with international precedent, as outlined by Oxera in its report ComReg 13/45b. In fact, Eircom and WIK's estimate, as a proportion of total revenue from fixed-line services, is the lowest among the precedents considered in Oxera's report.

7.11 In respect of the errors found in the formulas applied by WIK, Oxera notes in its report that there is a difference between the figures in WIK's final report and its spreadsheet. ComReg's consultants are assured that this however this does not necessarily indicate that there was an error in the calculation. There is a very minor discrepancy between the two figures of DSP subscribers, the detail of which is not provided in ComReg 13/45 or Oxera's report owing to confidentially. With regard to Oxera's view of the model creating counterintuitive predictions; ComReg is confident that its consultation investigated the matter sufficiently by creating four alternative models with similar set-ups to WIK's model. ComReg's consultants reiterate that the *"prediction of WIK's model lies approximately in the middle of the range of Oxera's alternative specifications which indicates that WIK's model appears to lead to a reasonable estimate in terms of its magnitude".* With respect to the issues surrounding the survey sample size, ComReg recognises its inadequacy from which to draw robust conclusions. However, as highlighted by Oxera, *"there is a question of proportionality in terms of re-running the survey for this application, and as such, Oxera recommends that for the next application the survey should be undertaken so as to ensure that results are based on larger sample sizes".*

7.12 As such, ComReg is satisfied with the methodology and estimation of enhanced brand recognition in the context of the current application and in the context of the recommendations provided by Oxera for future assessments.

7.1.2 Marketing Benefits

7.1.2.1 Summary of Respondents' views

7.13 ALTO is of the view that the calculation of the marketing benefit is "narrow in scope and as a result understates the level of benefit considerably". ALTO and UPC question why the estimation does not include improved targeted marketing and all Eircom products, including broadband, bundles, home security and mobile and not just uneconomic payphones, as highlighted by BT. BT suggest other ways through which marketing benefits could be generated, such as vehicle advertising and Eircom directories.

7.14 In both ALTO's and BT's responses, the issue of the "*value of commercial information"* is highlighted. Both organisations reference paragraph 5.23 of Consultation 13/45, and stress their respective concerns should Eircom, as the USP, be availing of commercial information through the USO, that this information should be shared with industry.

7.15 BT highlighted, with reference to paragraph 5.25 of Consultation 13/45 and in the context of wholesale services, that there is a *"high probability of the line staying with Eircom as most other fixed providers in non-urban areas use Eircom wholesale services".* BT is of the view that a line would be most likely to leave Eircom when a customer moves to a mobile service.

7.1.2.2 ComReg's views

7.16 ComReg and its consultants are of the view that there are complexities involved in ascertaining where marketing benefits arise from commercial information. This is primarily owing to difficulty in assessing whether the benefit *"is due to the USO rather than just the size of the operator, and/or that the value of it could be already accounted for in determining the net costs of its services".* As outlined in Consultation 13/45, ComReg is of the view that there is an associated risk of double counting the benefit.

7.17 With respect to other factors through which Eircom may derive benefits, ComReg is of the view that such potential benefits are not only immaterial in the context of the positive net cost but also very difficult to quantify. Echoing the view of Oxera who state that *"benefits, such as directories and vehicles, it may be difficult to avoid double-counting with the brand enhancement benefits".* It should also be noted that these benefits are not typically included USP calculations and applications in other jurisdictions.

7.2 ComReg's final position- Intangible Benefits

7.18 Having considered the views of respondents, ComReg remains of the view that the intangible benefits estimate for 2009-2010 as set out in Consultation 13/45 and in Chapter 6 is €2,043,786.

Chapter 8

8 Estimation of the positive net cost

8.1 Consultation issue

8.1 The table below summarises ComReg's assessment of the estimation of the direct net cost, intangible benefits and the subsequent positive net cost:

Positive net cost	*ComReg €*
Direct net cost	7,139,331
Total Intangible benefits	2,043,786
Positive net cost	**5,095,545**

8.2 ComReg's fourth consultation question asked interested parties the following and was fundamentally based on the outcome of Consultation questions 2 and 3:

Consultation Question 4

Following ComReg's assessment, detailed in Chapters 4 and 5, given ComReg's preliminary view that the direct net cost is €7,139,331 and that the intangible benefits are €2,043,786; do you agree with ComReg's preliminary view that the positive net cost for 2009-2010 is €5,095,545?

Please provide reasoning to support your view.

8.2 Summary of respondents' views

8.3 Vodafone states that it *"does not agree that ComReg has used the correct methodology to assess the net direct cost to eircom of providing Universal Service"* and adds that *"this cost is too high and that positive net cost is overstated by some considerable degree"*. BT and ALTO state that they are is unable to ascertain whether the values included in the consultation question are correct, owing to a lack of financial information. Telefónica and UPC refer to their response to Questions 2 and 3 with respect to its view on Question 4.

8.4 Eircom disagrees with ComReg and its preliminary view of a positive net of €5,095,545, owing its comments set out with respect to consultants' costs.

8.3 ComReg's assessment of responses

8.5 The issues raised by respondents have been considered by ComReg in the relevant chapters of this paper. With specific regard to the issues raised in paragraphs 8.3 and 8.4, ComReg would direct the reader to Chapters 5 and 7.

8.4 ComReg's final position- Positive Net Cost

8.6 Having considered the views of respondents, ComReg remains of the view that the direct net cost is €7,139,331 and that the intangible benefits amount to €2,043,786. As such, ComReg is of the view that the positive net cost for 2009-2010 is €5,095,545.

Chapter 9

9 Determination of an unfair burden

9.1 Overview

9.1 In accordance with Regulation 11 of the Regulations, ComReg is required to assess whether a positive net cost of the USO represents an unfair burden on the USP, and consequently whether a sharing mechanism should be implemented to compensate the USP.

9.2 The concept of an 'unfair burden' is not defined in the Directive[67] or the Regulations. EU case law[68] confirms that the Directive gives NRAs' discretion in determining what constitutes an unfair burden. As such ComReg will determine if the positive net cost of providing the USO represents an unfair burden on the USP on a case by case basis.

9.3 D04/11 sets out the conditions and parameters to be considered in the determination of an unfair burden. An unfair burden assessment is only conducted once a positive net cost of providing the USO has been established. Consistent with the EU case law, and the legislative framework, ComReg is of the view that a positive net cost does not automatically mean an unfair burden nor does it automatically give rise to the need for USO funding.

9.4 Once ComReg establishes that there is a positive net cost to the USO, ComReg must subsequently establish whether the net cost represents an unfair burden on the USP before a sharing mechanism can be implemented. This section details the steps that ComReg took to establish its preliminary view as to whether the positive net cost of Eircom providing the USO in the 2009-2010 period created an unfair burden.

[67] 2002/22/EC
[68] Commission v Belgium, paragraph 44 and 50, Case C -222/08

9.5 ComReg commissioned Oxera to provide practical advice on the implementation of a structured assessment of the process. Oxera has provided a methodology in the form of three cumulative tests, to identify the existence of an unfair burden, based on the guidance and decisions set out in D04/11 and then analysed Eircom's application for the 2009/10 period, according to this methodology. ComReg considered Oxera's views in the context of international precedent and the unique market characteristics of the industry in Ireland. Oxera's paper *'Does the universal service obligation represent an unfair burden for Eircom*?'[69] considered the following key areas:

- ComReg's guidance on the determination of an unfair burden;
- A standard methodology to assess whether the positive net cost represents an unfair burden on the USP or not, consistent with ComReg's guidance;
- The application of this methodology to Eircom's application for the 2009/10 period; and
- International precedent of the determination of an unfair burden.

9.2 Application

9.6 The summary table below provides a high level overview of Eircom's application and the outcome of ComReg's assessment.

Net cost (after intangible benefits) / Positive net cost (c)	*Eircom €*	*ComReg €*
Direct net cost	7,720,836	7,139,331
Total intangible benefits	(1,495,617)	(2,043,786)
Net cost (after intangible benefits) / Positive net cost	**6,225,219**[70]	**5,095,545**

9.7 The determination of whether the proposed net cost is an unfair burden is discussed throughout this chapter in the context of both Eircom's application for €6,225,219 and positive net cost following ComReg's assessment of €5,095,545. It is apparent throughout this chapter, that ComReg's adjustments to Eircom's application relating to the positive net cost do not impact the determination of an unfair burden.

[69] Oxera (2013), "*Does the universal service obligation represent an unfair burden for Eircom?",* 1 February 2013
[70] The actual sum is €6,225,220

9.8 Decision 38 of D04/11 states that for an unfair burden to be determined, the three cumulative conditions set out below must be met:

i. There must be a verifiable and verified direct net cost;

ii. The benefits of the USO must not outweigh the net cost (i.e. there is a positive net cost).

iii. This positive net cost is (a) material compared to administrative costs of a sharing mechanism, and (b) causes a significant competitive disadvantage for a USP.

9.9 For the application covering the 2009-2010 period, ComReg was of the preliminary view that the first two criteria included in Decision 38 of D04/11 (paragraph 9.7) were met, as outlined:

- Having undertaken its assessment ComReg proposed an adjusted direct net cost and an adjusted intangible benefits;
- As set out in paragraph 5.1, ComReg was of the preliminary view that the benefits of the USO do not outweigh the direct net cost and, as such, that the assessment has demonstrated the existence of a positive net cost of €5.1m;

9.10 Given this assessment, ComReg subsequently moved to the final component of the assessment as described in subparagraph (iii) of paragraph 9.8.

9.3 Administrative test

9.11 The assessment of whether the positive net cost is material compared to the administrative costs of a sharing mechanism is based on the guidelines for the administrative test in Decision 39 of D04/11, which states that *"If the positive net cost is relatively small, ComReg will determine, on the basis of audited costs of the USO, whether USO financing is or is not justified, taking into account the administrative costs of establishing and operating a sharing mechanism (compared to the positive net cost of the USO) and taking into account whether these costs are disproportionate to any net transfers to a USP."*

9.12 As outlined by Oxera *"If the positive net cost of the USO is relatively small, ComReg will assess whether USO financing is justified depending on whether the cost of establishing a sharing mechanism would be disproportionate to the net transfers of the USP".*[71] The objective of this test was to assess whether the costs of implementing a sharing mechanism are below the net revenue that would be collected by the USP from the other market players in the event that a sharing mechanism was implemented.

9.13 This administrative test involved a two step process, the estimation of the administrative costs of establishing the sharing mechanism and secondly, the identification of the net transfer to the USP. ComReg was of the preliminary view that the proposed positive net cost is material compared to the reasonable administrative costs of a potential sharing mechanism as set out in Regulation 12(2) of the Regulations.

9.3.1 Estimate of the administrative costs

9.14 Oxera provided an indicative range for the administrative costs involved in the establishment of a sharing mechanism of no more than €300,000 to €400,000. ComReg agrees with Oxera's approach and the administrative cost estimation.

9.3.2 Net Transfer to the USP

9.15 For the purpose of illustration, Oxera made reference to precedent in Italy in discussing potential net transfers to Eircom should an unfair burden be determined and state that *"the USP is often the former monopoly provider, a sharing mechanism set up in this way may lead to the majority of the compensation being contributed by the USP itself."*

9.16 In the absence of having established a sharing mechanism previously, it is reasonable to assume, for the purpose of illustration, that if the sharing mechanism is based on all Electronic Communications Revenues, approximately 70%[72] of a positive net cost would be provided for by other market participants and 30% by Eircom, the USP. As such, ComReg was of the preliminary view that in the instance an unfair burden is found, the net transfer to Eircom for the 2009-2010 assessment period would be approximately €3.6m (c. 70% of €5.1m).

[71] Oxera (2013), *"Does the universal service obligation represent an unfair burden for Eircom?"*, 1 February 2013
[72] ComReg quarterly reports for the period 2009-2010, http://www.comreg.ie/publications/publications.583.100023.0.0.p.html

9.3.3 Assessment of administrative costs

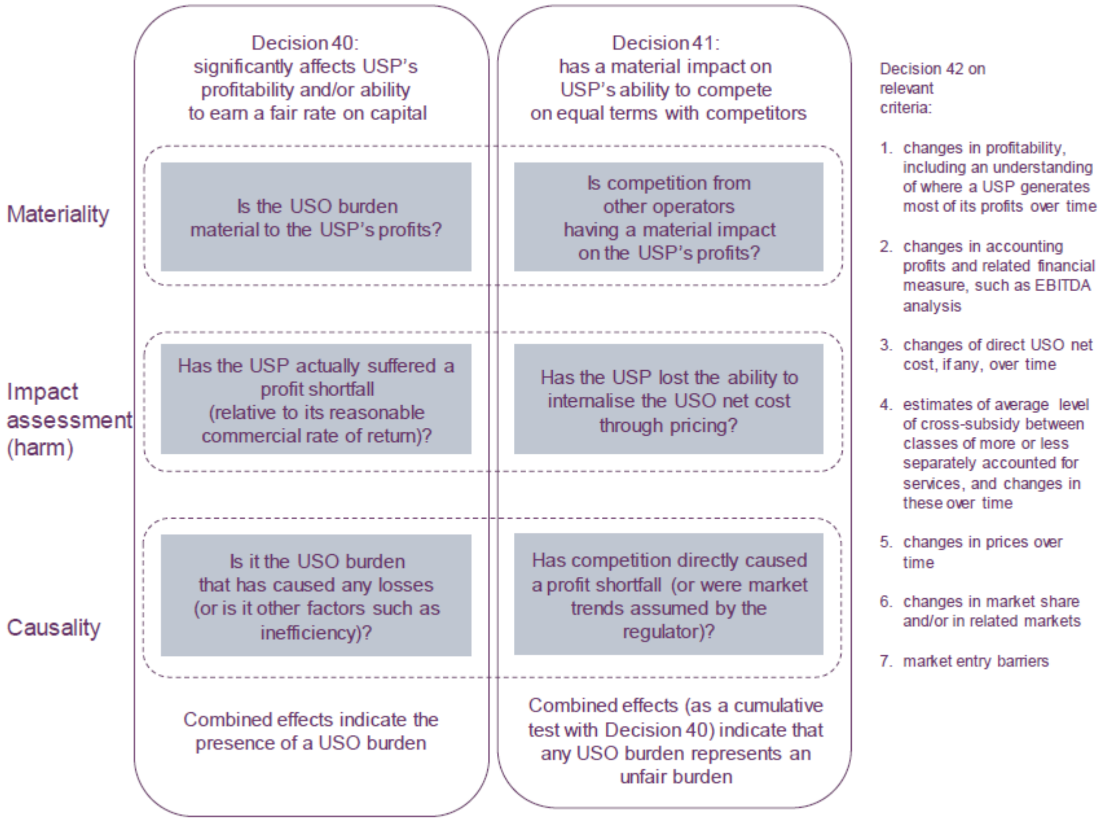
9.17 Using the analysis undertaken by Oxera together with ComReg's own view, ComReg concluded that the potential costs associated with establishing an appropriate sharing mechanism would not be disproportionate to any potential net transfers to a USP.

9.18 Since the assessment proposed a positive net cost, ComReg was of the view that the net transfer to the USP would most likely exceed the administrative costs of the sharing mechanism, and therefore, ComReg subsequently undertook the next step of the assessment process, namely assessing the extent to which the positive net cost creates an unfair burden on the USP.

9.4 Unfair burden assessment

9.19 D04/11 prescribes three cumulative tests to be undertaken when determining the existence of an unfair burden. These tests are summarised in paragraphs 9.20 to 9.24 below. Oxera's report provided detail on the principles and functions of each test and stresses that *"while each of these tests can be assessed objectively, there may not be a single outcome from applying them all in practice, and it will be important to assess their outcomes on a case-by-case basis"*. The methodology with respect to the assessment is outlined in Figure 2.

Figure 2: Overview of Decision 40, 41 and 42 of D04/11



Source: Oxera

9.20 Decisions 40, 41 and 42 of D04/11 provide guidance to ComReg as to how to approach the unfair burden assessment. Oxera prepared the overarching approach in the context of Decision 40 through to Decision 42 of D04/11, which is summarised by Oxera in section 3.1 of its report. Oxera advised on three areas that need to be addressed (see Figure 2) to fulfil Decisions 40 and 41 of the assessment. These areas include:

- Materiality;
- Impact; and
- Causality.

9.21 Each assessment area listed above is considered on a dynamic basis. As such, it was ComReg's view that a cumulative view of all three areas is taken when determining whether in fact the positive net cost represents an unfair burden, which is in accordance with D04/11.

9.22 Consistent with the requirements of Decision 40 of D04/11 which states that "(*I)f the positive net cost is not relatively small, ComReg will assess whether or not this net cost significantly affects a USP's profitability and/or ability to earn a fair rate of return on its capital employed*", section 9.4.1 considers whether the positive net cost significantly affects the Eircom's profitability or ability to earn a fair return on capital.

9.23 All three areas with respect to Decision 40 were assessed by ComReg prior to proceeding to the same steps under Decision 41.

9.24 Decision 42 provides a list of criteria by which ComReg should evaluate with respect to the profitability test (Decision 40 of D04/11) and the competitive test (Decision 41 of D04/11), these are discussed in section 9.4.2. These criteria are as follows:

i. "Changes in profitability, including an understanding of where a USP generates most of its profits over time;

ii. Changes in accounting profits and related financial measures e.g. earnings before interest, tax, depreciation and amortisation ("EBITDA") analysis.

iii. Changes in direct USO net cost, if any, over time.

iv. Estimates of average level of cross-subsidy between classes of more or less separately accounted for services, and changes in these over time.

v. Changes in prices over time.

vi. Changes in market share and/or changes in related markets.

vii. Market entry barriers."

9.4.1 Decision 40 of D04/11: Does the positive net cost significantly affect Eircom's profitability or ability to earn a fair return on capital?

9.25 In assessing whether the overarching conditions of Decision 40 of D04/11 are met, as outlined in Figure 2, ComReg considered the three test areas: materiality, causality and impact.

9.26 ComReg first considered the level of the proposed positive net cost relative to Eircom's profitability metrics and its ability to earn a fair rate of return on its capital employed. Oxera stated that one way to *"evaluate the impact of the net cost on the USP's profitability is to determine how the profit of the USP compares to a range of reasonable profitability benchmarks with and without compensation of the net cost".*

9.27 In order to fully consider the impact of compensation for the positive net cost of the USO with respect to Eircom's ability to earn a fair rate of return, it was necessary to ascertain the most appropriate profitability measurement for the purpose of the assessment. ComReg was of the view that the most suitable metric against which to assess profitability levels, based on advice provided by Oxera, is the Return on Capital Employed (ROCE). Oxera identified that an operating profit[73] measured as ROCE within a WACC range of 7% – 11%, drawing on ComReg's prior determination of Eircom's cost of capital[74] as being most suitable for the assessment.

9.28 As a starting point, to broadly evaluate the potential impact of the positive net cost on the USP's profitability, Oxera prepared a range of hypothetical scenarios to determine how the profit of the USP compares to a range of reasonable profitability benchmarks with and without compensation of the positive net cost. Figure 3 sets out four illustrative scenarios, whereby the USP's ROCE without compensation spans across the range of reasonable profitability levels, discussed in paragraph 6.29.

Figure 3: Compensation – Impact on ROCE

Scenario	USP's ROCE without compensation (%)	USP's ROCE with compensation (%)	Is the USP able to earn a fair rate of return without compensation?
1	15	15.4	Yes
2	10	10.4	Yes
3	6.8	7.2	No
4	3	3.4	No

Note: The net cost of 0.4% of the gross turnover is intended to be illustrative only and is not based on actual data.
Source: Oxera.

[73] Pre-tax and pre-financing operating profit
[74] ComReg, *"Eircom's Cost of Capital",* http://www.comreg.ie/_fileupload/publications/PR220508.pdf, May 2008

9.29 Oxera applied a notional compensation of 0.4% of capital employed to show the potential impact on the USP and how compensation would impact Eircom's ability to earn a fair rate of return. The outcome of each scenario is not definitive but serves to provide an initial indication of the USP's performance. This step of the process must be assessed in the context of the subsequent tests discussed throughout this section. Oxera summarised the potential hypothetical outcomes for the USP as the following:

- Scenario 1: In this scenario the ROCE is above the upper range of a reasonable rate of return, compared with the upper range of Eircom's cost of capital (as discussed in paragraph 9.27). As such, it is therefore unlikely that the positive net cost is threatening the ability to earn a reasonable rate of return, however further analysis would have to be undertaken to ensure an adequate investigation into materiality and causality.

- Scenario 2: In this scenario the pre-compensation ROCE is below the point estimate of Eircom's cost of capital (10.21%). Compensation of the positive net cost brings the ROCE above the 10.21% benchmark. In this case the positive net cost does not appear to significantly threaten the ability of Eircom to earn a fair rate of return, however further objective analysis and regulatory judgement would be required to investigate further, on a case by case basis.

- Scenario 3: This scenario strongly indicates that the net cost may reduce Eircom's ability to earn a fair rate of return. However as per scenario 2 further objective analysis and regulatory judgement would have to be applied to assess the nature of the positive net cost in terms of impact, materiality and causality.

- Scenario 4: In this scenario the ROCE pre-compensation is either at or below the lower end of the range of values for Eircom's cost of capital. In this case, the positive net cost may reduce Eircom's ability to earn a fair rate of return, but in order to gain a further understanding, materiality and causality tests must undertaken.

9.4.1.1 Assessment as to whether the positive net cost significantly impacted Eircom's profit

9.30 In accordance with the relevant criteria set out by Decision 42 of D04/11 and in order to gain an understanding of Eircom's performance with respect to the potential significant impact of the positive net cost, the following key factors are considered in the following paragraphs:

- Gaining an understanding of the performance of the different business areas and ascertaining the level of cross-subsidy between business area;

- Gaining an understanding of the changes in profitability throughout the period before, during and after the application period.

9.31 The actual performance of business areas relevant to the USO have been assessed by ComReg. These include the core USO business[75], the fixed-line business[76] and the Group level business[77]. It was ComReg's view, particularly in the context of criteria (iv) of Decision 42 of D04/11, that the USO business and fixed line business are the most relevant to the analysis. ComReg was also of the view that the intangible benefits arising from the provision of USO services predominantly benefit the fixed line business, thus reinforcing the relevance of the assessment of the results set out in Figure 4 and Figure 5.

Figure 4: Profitability within Eircom's regulatory accounts

Level of aggregation	Turnover (€m)	Mean capital employed (€m)	ROCE, 2011–12 (%)
USO business	994	1,374	14
Fixed-line business	1,609	1,515	22
Group level	1,981	1,556	19

Note: All figures reported are for 2012. USO business is proxied by wholesale regulated and retail PSTN and ISDN Access. Fixed-line business includes both regulated and unregulated parts of wholesale and retail businesses. Group level includes Meteor, but excludes other subsidiaries. Exceptional items are excluded from the analysis of returns.
Source: eircom (2012), 'Historical cost separated accounts for the year ended 30 June 2012'.

Source: Oxera

9.32 ComReg was of the view that assessing the impact of the positive net cost would be best served by the regulated accounts. Oxera identified the regulated business to be *"best proxied by Eircom's fixed-line segment, which includes access (rental and connections), voice and data traffic, data communications, and interconnect services".*[78] This view is reinforced by ComReg's requirement for Eircom to maintain separated accounts at the market level. The regulatory accounts[79] serve to provide a higher level of detail of information than that derived from the statutory financial statements, to reflect the performance of parts of the notified operator's business accurately.

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[75] USO business - includes regulated wholesale components of Eircom's business that operate the USO network, and the related USO retail business.

[76] Fixed-line business - integrated fixed-line business, including wholesale and retail, and business and residential, including data communications and interconnect services. Mobile services are excluded.

[77] Group level – All or substantially all activities, undertaken by the Eircom Group, both regulated and unregulated, mobile and retail. In principle, it would exclude any businesses that are completely unrelated to the telecoms business, but at present the size of such businesses as a share of total Eircom revenue is very small.

[78] ComReg (2010), "*Response to Consultation Document No. 09/75 and Final Direction and Decision: Accounting Separation and Cost Accounting Review of Eircom Limited",* 10/67, 31 August 2010

[79] Data has been extracted from the audited separated accounts and additional financial statements of Eircom Limited for the year the relevant years. The audit report issued by PWC was addressed to

9.33 As depicted in Figure 5, the ROCE in the fixed line business is above the profit benchmark range and has remained stable from 2006 to 2012. The performance of the regulated business was broadly in line with that of the overall fixed line business throughout the 2009-2010 application period. Operating profits from 2006 to 2012 for both the regulated business and USO business operations are significant and as Oxera stated "*show that Eircom has met and generally exceeded ComReg's assumptions for profitability across the areas that are subject to price control regulation, and, in particular that it has managed to retain significant profitability across the retail markets*".

Figure 5: Return on capital employed for the fixed-line business

	2006	2007	2008	2009	2010	2011	2012
Revenues (€)	2,362	2,960	2,249	2,119	1,906	1,823	1,609
Operating profit (€)	267	264	320	245	305	388	338
Mean capital employed (€)	1,358	1,286	1,278	1,266	1,242	1,484	1,515
Return on capital employed	**20%**	**21%**	**25%**	**19%**	**25%**	**26%**	**22%**

Note: Operating profit is calculated as revenues less operating costs including transfer charges from wholesale and exceptional cost items. Wholesale revenues include both regulated and unregulated revenues. Meteor, other subsidiaries and other businesses are excluded.
Source: eircom's HCA separated accounts 2006–11, available at www.eircom.ie, including the impact of restatements. Oxera has also reviewed the CCA accounts, which indicate a comparable conclusion.

Source: Oxera

9.34 To conclude this step of the assessment process, it was clear that the results depicted in Figure 5 clearly demonstrated Eircom's ability to earn a fair rate of return without compensation. With the ROCE for the fixed line business ranging from 19% to 26% from 2007 to 2012, it was significantly in excess of the pointed estimate of 10.21% and the upper end of the range of 11.08%. Reflective of this, Oxera stated that *"the regulatory accounts (therefore) appear to give a clearer indication that Eircom has been consistently profitable, at the level of the business that has the USO, since 2006."*[80] This objective analysis was considered in tandem with the assessment of the materiality and causality of the positive net cost.

Eircom Limited and ComReg in order to meet the requirements of the reporting requirements and shall not be relied upon by any other person for any other purposes. A copy of the published elements of the Separated Accounts including the auditor's report is available from Eircom Limited's website.
[80] Oxera (2013), '*Does the universal service obligation represent an unfair burden for Eircom?*', 1 February 2013

9.35 D04/11 states that it is not appropriate to consider wider business activities impacting the ROCE at Group level, such as goodwill impairment, leveraging and debt in the assessment. This view aligns with the observations made by Oxera with respect to the eircom ltd accounts as filed with the Companies Registration Office (CRO) and the eircom group level accounts[81], *"to the extent that this financial performance is a result of significant borrowing requirements or wider business activities, it would follow from D04/11 that this would not be relevant to the determination of an unfair burden".*

9.4.1.2 Is the positive net cost material to Eircom's business performance?

9.36 ComReg, using the analysis undertaken by Oxera as shown in Figure 6, assessed the potential impact of the positive net cost in absolute money values and approximate threshold values.

Figure 6: Threshold analysis

Level of aggregation	Revenue threshold	Profitability threshold (as % of allowed return)	Profitability threshold (as % of actual return)
USO business	€6–€11m	€7–€14m	€10–€20m
Fixed-line business	€9–€18m	€8–€15m	€19–€39m
Group level	€11–€22m	€8–€17m	€18–€35m

Note: All figures reported are for 2011 (the first year under which the current definition of the regulatory accounts is available). USO business is proxied by wholesale regulated and retail PSTN & ISDN Access. Fixed-line business includes both regulated and unregulated parts of wholesale and retail businesses. Group level includes Meteor, but excludes other subsidiaries.
Source: Oxera analysis, based on eircom (2011), 'Historical cost separated accounts for the year ended 30 June 2011', July.

Source: Oxera

9.37 The materiality threshold analysis set out in Figure 6, serves to broadly ascertain in absolute money terms when a positive net cost may have a material impact on the USP. Threshold values, which serve as materiality signals, are calculated based on a range of 5 - 10% of profitability (%) or 0.5 - 1.0% in revenue terms (€'s). In other words, a net cost that was greater than 5 - 10% of profits would be material.

[81] Filed under BCM Ireland Finance Limited

9.38 Oxera considered the materiality range in the context of Eircom's regulatory accounts for each business area; the USO business, the fixed line business and the Group level business.[82] This analysis was considered in tandem with Eircom's ability to earn a fair rate of return.

9.39 Taking a high level view and broad view of all business areas in the context of this analysis, ComReg was of the preliminary view that a positive net cost of the USO which is within a threshold range of €6m to €22m would signal a material impact on the USP, based on the levels of aggregation of revenue at each business level. Considering the fixed-line business in isolation, the materiality range of €9m to €18m has been ascertained, from a revenue perspective and €8m to €15m from a profitability perspective. Where the positive net cost is close to or within this range, materiality would need to be assessed on a case-by-case basis alongside other tests included in paragraph 9.20. With a proposed positive net cost of €5.1m for the 2009-2010 period, this falls below the lower end of the materiality range and therefore no further investigation would be required.

9.4.1.3 Can a shortfall in profitability be linked to the positive net cost?

9.40 As part of the assessment, ComReg recognises the need to investigate the third test area, causality.

9.41 As such, ComReg considered the importance of considering efficiency when assessing the potential impact of the net cost on the profitability of Eircom as the USP and the consistency of efficiency levels of the USO business.

9.42 ComReg gave significant attention to the issue of efficiency and was of the preliminary view that recent decisions within Eircom to implement a cost reduction programme provide a signal that the historical financial performance (2006-11) reflects inefficient costs of operation within the Group. Such inefficiencies in the context of this assessment suggest that the ROCE range of 20% to 26% may then in turn be understated, as a ROCE value, based on efficient operation of the USO business, would be even higher.

9.43 For the purpose of future determinations it is important to note that the determination of an unfair burden is not solely reliant on a shortfall of profits. Therefore should there be evidence of a shortfall of profits, further analysis as to the cause of the shortfall would have to be undertaken.

[82] Eircom's 'fixed-line' business includes Eircom's integrated fixed-line business, including wholesale and retail, and business and residential, including data communications and interconnect services. The 'fixed-line' business does not include mobile services. Eircom's 'group level' business includes all or substantially all activities, undertaken by the Eircom Group, regulated and unregulated, mobile and retail.

9.4.1.4 Preliminary conclusion

9.44 Analysing Eircom's performance, ComReg was of the view that the proposed positive net cost of the USO for 2009-2010 did not impact significantly nor prove material to Eircom. Based on the objective analysis undertaken throughout this chapter, ComReg's preliminary conclusion was that the proposed positive net cost of the USO did not have a material impact on the USP's profitability and ability to earn a fair rate of return for the 2009-2010 period.

9.45 Formulation of ComReg's preliminary view with respect to Decision 40 of D04/11 primarily owed to the fact that Eircom earned a consistent and reasonable rate of return across all business areas, in particular the fixed line business. Oxera's report clearly stated that *"analysis of the USP's profitability does not indicate that, with respect to Eircom's 2009–10 application, the first part of this test (i.e., a significant impact on the USP's profitability) is met. In the absence of a shortfall in profitability, it is in practice impractical to test the causes of the shortfall and in particular whether this results in an inability to compete on equal terms"*[83]. ComReg's preliminary view was that the proposed positive net cost falls below the lower end of the materiality range.

9.46 ComReg was satisfied with the analysis undertaken in the context of D04/11 by Oxera and was of the preliminary view that given the results of the analysis undertaken with respect to the effect on the USP's profitability or ability to earn a fair return on capital and the assessment of the positive net cost with respect to threshold values, there was no unfair burden for Eircom.

9.47 Given the conclusion that the positive net cost of the USO in the 2009-2010 period was not material to the profitability of Eircom, as discussed in section 9.4, ComReg concluded that a competitive distortion test, as defined in Decision 41 of D04/11 was not required for the 2009-2010 assessment.

[83] Oxera (2013), *'Does the universal service obligation represent an unfair burden for Eircom?'*, 1 February 2013

9.4.2 Decision 41 of D04/11: Does the positive net cost affect Eircom's ability to compete on equal terms with competitors?

9.48 Although it was not necessary for the 2009-2010 application and draft determination under D04/11 to consider Decision 41 of D04/11 for the reasons outlined in section 9.4.1.4 of this chapter, ComReg considered it beneficial to provide an outline of subsequent steps in the determination process, for the purpose of providing context for future applications, as relevant. Should the proposed positive net cost have passed the tests discussed, whereby the positive net cost proved to have a material impact on the USP and causality indicated that the USO business may be a root cause of the impact rendering it *"unable to earn a return consistent with the range identified (in section 3.2), and unable to cross-subsidise the USO",* ComReg's assessment would progress to Decision 41 of D04/11.

9.49 To provide a practical interpretation for future assessments, as relevant, Decision 41 of D04/11 states that "*(I)f the positive net cost significantly affects a USP's profitability, ComReg will assess whether or not such a net cost materially impacts a USP's ability to compete on equal terms with competitors going forward".* Oxera provided a practical interpretation of Decision 41 of D04/11 for future assessments.

9.50 In subsequent years, should this step in the determination process be required, ComReg would assess, from both a static and dynamic perspective, the relevant criteria set out in Decision 42 of D04/11. This would serve to inform the assessment of relevant changes in the historical market share of the USP and further information on its key competitors by forming a view of whether *"competition is having a negative impact on the USP's revenue, or whether other factors, such as a decline in the overall market or the USP's lack of efficiency, could be responsible".*[84] Like Decision 40, the relevant criteria, upon which the test outlined in Decision 41 of D04/11 would be based, are set out in paragraph 9.24.

9.51 It is worth noting that with respect to the 2009-2010 application and this step of the process[85], if it were found that competition had caused a positive net cost and yet no material impact profitability was found, ComReg's preliminary view is that this would not imply an unfair burden.

[84] 84 Oxera (2013), *"Does the universal service obligation represent an unfair burden for Eircom",* 1 February 2013
[85] Decision 41 of D04/11

9.5 ComReg's preliminary view

9.52 Based on the analysis undertaken by Oxera with respect to Eircom's financial performance[86], ComReg was of the preliminary view that the positive net cost did not materially impact the profitability of Eircom for the period 2009-2010 for the reasons discussed throughout this chapter, irrespective of whether the positive net cost of either Eircom's application of €6,225,219 or ComReg's estimation of €5,095,545 was assumed. As such, ComReg was of the preliminary view that the positive net cost does not represent an unfair burden on Eircom. This conclusion would mean that a sharing mechanism would not be implemented for the positive net cost of the USO for 2009-2010 financial year.

[86] Oxera (2012), *"Does the universal service obligation represent an unfair burden for Eircom",* 1 February 2013

Chapter 10

10 Determination of an unfair burden - Consultation issues

10.1 Having ascertained that there was a positive net cost, ComReg assessed, in accordance with the Regulations and D04/11, whether the positive net cost represented an unfair burden. This is set out in Chapter 6 of Consultation 13/45 and also in Chapter 9 of this document.

10.2 ComReg's fifth consultation question asked respondents the following:

Consultation Question 4
Following ComReg's assessment, detailed in Chapter 6, do you agree with ComReg's preliminary view that a positive net cost of €6,225,219 or €5,095,545 for 2009-2010 is not an unfair burden on Eircom? Please provide reasoning to support your view.

10.1.1 The Methodology

10.1.1.1 Summary of Respondents' views

10.3 ALTO, Telefónica and UPC are in agreement with ComReg with respect to paragraph 6.3 of Consultation 13/45, which states the following; *"Consistent with the EU case law, and the legislative framework, ComReg is of the view that a positive net cost does not automatically mean an unfair burden nor does it automatically give rise to the need for USO funding".* ALTO and UPC proceed to highlight the requirements of Decision 38 of D04/11[87] and ComReg's preliminary view in paragraph 6.9[88].

[87] "*Decision 38 of D04/11 states that for an unfair burden to be determined, the three cumulative conditions set out below must be met:*

i. There must be a verifiable and verified direct net cost;

ii. The benefits of the USO must not outweigh the net cost (i.e. there is a positive net cost).

10.4 Magnet states that it *"agrees with ComReg's assessment that it is not an unfair burden on Eircom to provide the USO service"* and that the reasoning provided by ComReg *"is sufficient support to Magnet's view"*. Magnet adds that the data set out in Consultation 13/45 *"should be verified in greater depth rather than complicity accepting eircom's approach and figures".*

10.5 Eircom, referencing the 2002 Directive on Universal Service, as amended in 2009 ("USO Directive")[89] suggests that ComReg's *"starting point is wrong"*. Eircom disagrees with ComReg's preliminary view that an amount, (which Eircom considers "a strictly avoidable cost") *"in excess of €5m is not material",* and is of the view that *"to bear such a charge of its own for the benefit of its competitors*" is unjust.

10.6 Eircom states that it recognises that the USP derives benefits as a result of its status as USP, however through the intangible benefits calculation it is of the view that these benefits[90] are deducted from the direct net cost, as ComReg has validated through its assessment. Eircom states that *"the remaining positive net cost, clearly, needs to be borne by all operators, not just one of them".* Eircom continues its argument by drawing reference to the financing of other public services and states that *"(T)he need to provide public goods imposes a burden on the population through the imposition of taxes*". In this context Eircom notes that it *"never sought or applied for this designation from ComReg, nor did it have any significant say into the scope or duration of the USO designation decided upon by ComReg*".

iii. *This positive net cost is (a) material compared to administrative costs of a sharing mechanism, and (b) causes a significant competitive disadvantage for a USP".*

[88] Paragraph 6.9 of Consultation 13/45 states that *"For the application covering the 2009-2010 period, ComReg is of the preliminary view that the first two criteria included in Decision 38 of D04/11 (paragraph 6.7) are met......"*

[89] Recital 18 of the 2002 Directive on Universal Service (as amended in 2009) states that "*where necessary, establish mechanisms for financing the net cost of universal service obligations in cases where it is demonstrated that the obligations can only be provided at a loss or at a net cost which falls outside normal commercial standards."*

[90] Such as enhanced brand recognition, ubiquity, marketing and life-cycle benefits

10.7 Eircom concludes this point by stating that *"eircom is obliged by ComReg to incur massive costs by virtue of being the USP"* with other operators being able to *"leverage off these investments to sustain business cases and make substantial profits as a direct result"* enables other operators, in effect, to enjoy a *"free ride"* at eircom's expense. Eircom claims that the basis on which ComReg and its consultant Oxera have determined that there is no unfair burden *"as it has been able to get a return above WACC…disregards the principle that regulators should strive to create an environment where operators have an incentive to gain additional profits under fair competition"*[91]. Eircom states that this is not consistent with Recital 18[92] of the Directive.

10.1.1.2 ComReg's views

10.8 ComReg has considered and provided responses to ALTO, UPC and Magnet's views in respect of data deficiencies, verifiable inputs and the credibility of Eircom's application. ComReg maintains that the information provided by Eircom and the methodologies implemented, as well as those implemented by ComReg's assessment are both adequate and in line with the requirements of D04/11.

10.9 In addition, ComReg does not agree with respondents that infer that the positive net cost does not constitute a "*verifiable net cost*"[93]. Giving consideration to the effort made on Eircom's part to clarify queries and provide additional information where required, the AUPs undertaken by PwC and the detailed assessment undertaken by ComReg and its independent consultants, ComReg maintains the view that the positive net cost is indeed verified and in line with D04/11. ComReg, to ensure transparency and recognition of the principles, included recommendations for future applications. ComReg's approach in this context is to optimise the application and assessment process where possible.

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[91] Eircom claims in its response to Consultation 13/45 that *Vodafone has made a "ROCE significantly above WACC (and higher than eircom's) without it having to share part of the burden"*.

[92] Recital 18 of the Universal Service Directive 2002 states that "*where necessary, establish mechanisms for financing the net cost of universal service obligations in cases where it is demonstrated that the obligations can only be provided at a loss or at a net cost which falls outside normal commercial standards."*

[93] Decision 38 of D04/11

10.10 It remains ComReg's view, which is consistent with the EU case law[94], that a positive net cost does not automatically mean that the burden of a net cost is unfair, or that it automatically gives rise to the need for USO funding. As set out in paragraph 5.27 of D04/11, ComReg maintains its view, as stated in D04/11 that *"The impact of a USO can, in principle, undermine the profitability of a USP or endanger its financial viability. It is relevant and necessary, therefore, to take into account whether or not a positive net cost significantly affects a USP's profitability and/or ability to earn a fair rate of return on its capital employed in the prevailing market circumstances. This analysis would take account of a USP's ability to bear a positive net cost (i.e. a USP's ability to fund a USO today through cross-subsidy revenues)."* Giving this due consideration in the context of the analysis undertaken by Oxera, which is discussed and justified further in the following paragraphs, ComReg maintains its view that the positive net cost did not significantly affect Eircom's profitability and as such, ComReg maintains that Eircom had the ability to bear the positive net cost, particularly through cross-subsidisation of other business areas.

10.11 Similarly, ComReg has considered Eircom's views which, in this context, encompass the interplay between a positive net cost and the determination of an unfair burden, being the non-commercial nature of USO activities and the perception of a *"free ride"* for operators, as a result of Eircom's provision of the USO. ComReg does not agree with this view. The basis of the calculation of the net cost of the provision of USO relies on avoidable revenues and costs and the ability to make and receive calls. The 'free ride' other operators benefit from, that Eircom refers to, in essence is the avoidable net cost incurred in providing the universal services that Eircom could have avoided had it not been the USP. In this instance, the avoidable positive net cost is €5.1m. In this instance for the application 2009-2010, and in line with D04/11, ComReg has determined that it is not an unfair burden for Eircom to bear alone.

10.12 ComReg is of the view that it has an obligation to comply with the Regulations with respect to designation, amongst other USO regulatory requirements.

10.13 Giving consideration to Eircom's comments in paragraph 10.6 of this Chapter, ComReg considers that Eircom's view conflicts with the requirements of D04/11. In essence, Eircom's statement of the positive net cost as a tax argument essentially would remove the condition around a significant impact of a positive net cost on profitability. Eircom's view implies there is no such thing as an "unfair" burden as any positive net of the USO must be automatically unfair to the USP, which is not in accordance with D04/11 or the Regulations.

[94] Commission v Belgium, paragraph 42, Case C-222/08

10.1.2 ComReg and Oxera's approach

10.1.2.1 Summary of Respondents' views

10.14 Eircom states that the methodology adopted by ComReg and its consultant in assessing whether a positive net cost is an unfair burden is *"least likely, among the methodologies considered, to lead to the establishment of an unfair burden"* and as a result states that ComReg's assessment is *"not objective and is unfair"*.

10.15 Eircom claims in its response that there are seven *"hurdles"* or *"ever-increasing and subjective tests",* comprising the methodology developed by Oxera and adopted by ComReg[95]. Eircom states that this approach is unlike the approach adopted by other NRAs.[96] Eircom suggests that this approach simply measures *"the magnitude of its unfairness"*, which it states is not a provision in the Directive.

10.16 Eircom states in the concluding section of its response to consultation that it *"fundamentally disagrees with Oxera's approach to determining the existence of an unfair burden"*, referring in particular to the structure and application of the tests. Eircom's view with respect to these tests is set out in the following paragraphs.

10.17 In the context of the methodology adopted by ComReg, Eircom claims that *"ComReg has completely disregarded eircom's current condition, including the existing cost of servicing the debt".* Eircom refers to the European Court of Justice and the Base Case[97], and notes provision to consider an operators own characteristics and its economic and financial situation[98].

10.18 Referring to the issue of taxation, and in particular the taxation of revenues, Eircom calculates the equivalent for other major operators, remarking that Eircom, from a revenue perspective, is not the *"largest telecommunications operator in the country".* To substantiate its argument, Eircom references operators in different industries, including those in the technology sector.

[95] Detail of Eircom's interpretation of Oxera's methodology, adopted by ComReg, can be found in Eircom's detailed response

[96] Which in Eircom's view, is simply the assessment of whether the costs of the USO exceed the benefits, which the result being greater than a specific threshold.

[97] *Base & Others v Ministerraad*

[98] Which includes *"its declining profitability in the face of increased competition and regulation*", as stated by Eircom in it's response to consultation.

10.1.2.2 ComReg's views

10.19 Eircom stated that the approach taken by Oxera makes it unlikely an unfair burden will ever be found. ComReg does not agree with Eircom's view for numerous reasons which are addressed throughout this section.

10.20 There are numerous variables that will change over time including the manner in which Eircom delivers the USO, the delivery of other business areas using USO assets and the scale of the net cost incurred. The extent of the variables involved and also the case by case assessment approach serves to reinforce that the unfair burden assessment methodology seeks to assess each application and where appropriate, the positive net cost, objectively, for each application. The dynamic nature of the tests reflect the case by case approach on which the assessment is based and such an approach will be taken to ensure that each assessment considers the net cost and the impact on the USP individually for each financial period.

10.21 Eircom states that the approach Oxera has taken, which has been adopted by ComReg, only measures the *"magnitude of unfairness"*, as per previous commentary. ComReg is of the view that such an approach would not be consistent with D04/11 or the Regulations. ComReg is obliged to assess a net cost and where a positive net cost is ascertained, it is then in turn obliged to assess whether in fact the positive net cost represents an unfair burden.

10.22 ComReg considers that Eircom's view, with respect to the relevance of its financial situation and the assessment of an unfair burden, is inconsistent with the requirements of D04/11 and the Regulations. ComReg notes Eircom's submission with respect to the *Base & Others v Ministerraad* which considers the USP's economic and financial position as factors which should be taken into account in ascertaining whether a positive net cost represents an unfair burden or not. In response to this ComReg refers to D04/11 and remains of the view that it is not *"reasonable or appropriate to take account of the USP's level of indebtedness"*, as outlined in D04/11.

10.23 ComReg stated in D04/11 that the impact of a USO can, in principle, undermine the profitability of a USP or endanger its financial viability. It is relevant and necessary, therefore, to take into account whether or not a positive net cost significantly affects a USP's profitability and/or ability to earn a fair rate of return on its capital employed in the prevailing market circumstances.

10.24 ComReg's view with respect to the USP's financial position and level of indebtedness was considered in detail in Consultation 11/15 and D04/11. ComReg believes that it would not be reasonable or appropriate to take account of the USP's level of indebtedness. The decision in *Base & Others v Ministerraad* expressly refers to the USP's financial position as a characteristic to take account of in relation to an unfair burden. Giving consideration to the Base Case, ComReg maintains its view that Eircom *"is already allowed a sufficient rate of return on its investments. Some account should be taken of incentives already given to the USP through other regulatory measures e.g. setting the WACC and regulatory pricing measures*[99]*".* Similarly, ComReg remains of the view that the *"capital structure is a financing decision based on a company's own commercial interests, and therefore, independent of regulatory intervention".* ComReg concludes that it is *"not appropriate to take account of the implications of a company's commercial financial strategy, including its level of indebtedness, in examining the question of an unfair burden"*[100]*.*As such considerations would have already been captured through the methodology used which are fundamentally consistent with the Base Case.

10.25 ComReg's approach is to complement a profitability assessment with a competitive distortions assessment, if appropriate, in accordance with D04/11. ComReg notes Eircom's view that: "*a snapshot of its profitability today will tell ComReg nothing about whether self funding the USO is sustainable into the future*". Profitability can indicate a USP's ability to bear a USO in the short term. Profitability analysis may be complemented by a competitive distortions assessment, as appropriate. For the purpose of the assessment of the 2009-2010 application, it was not required to undertake a competitive distortions test.

10.26 D04/11 specifies the steps and considers the numerous reasons a net cost may have arisen. ComReg also notes that giving consideration to the level of indebtedness is not consistent with efficiency, which considers efficient capital structure, as reflected in the WACC. The WACC compensates for efficient or a target level of debt not "current" levels of indebtedness whilst also taking into *"account of the impact of financial volatility on eircom's cost of capital,* as stated in Consultation 11/15[101].

[99] ComReg (2011), 11/15, Paragraph 5.36, "*Response to Consultation and Draft Decision: Costing of universal service obligations: Principles and Methodologies"*

[100] Ibid.

[101] ComReg (2011), 11/15, Paragraph 5.36, "*Response to Consultation and Draft Decision: Costing of universal service obligations: Principles and Methodologies"*

10.27 ComReg has considered Eircom's comments with respect to its view that it *"fundamentally disagrees with Oxera's approach to determining the existence of an unfair burden"*, referring in particular to the structure and application of the tests. In response to Eircom's comments as to the approaches of other NRAs, ComReg would note that other NRAs predominantly have not published the methodologies to the extent to which ComReg has. As such, it is difficult to measure the degree to which ComReg has taken a diverging approach. The common thread is of course the Directive, which stipulates that NRAs have a broad discretion as to how an unfair burden is determined. In fact a definition of an 'unfair burden' is not provided by the Directive and the transposition of the Directive into Irish Law provides no further detail in this regard. As such, D04/11 provides the guidance on which an application is assessed. ComReg has conducted its assessment in line with D04/11.

10.1.3 Profitability Assessment

10.1.3.1 Summary of Respondents' views

10.28 Eircom claims that the methodology adopted by ComReg and Oxera means that it is *"impossible for any positive net cost to be found to be an unfair burden"* and consequentially *"has a detrimental effect on today's value of the company"*.

10.29 Vodafone is of the view that the "profitability" test used by ComReg is not the appropriate test to be used in connection with a USP which has also been designated as the SMP on the national market for Retail Fixed Narrowband Access. Vodafone states that *"The very essence of such a designation is that the SMP operator is capable of acting independently of the market. In this instance the USP has the ability to recover the costs of the USO from the market and so the USO cannot be an undue burden".*

10.30 Vodafone claims that the first issue ComReg should query is *"could the USP recover the costs of Universal Service provision and not whether it did actually recover this cost?".* Vodafone claims ComReg needs to looks at how Eircom conducts its business in the context of *"inefficiency, poor business planning or execution or a deliberate commercial decision".*

10.31 Eircom states that although the "*building blocks of Oxera's profitability assessment are what would be expected for the regulated part of the business"*, when comparing Eircom's fixed line business ROCE to its regulated WACC, it queries the variables and assumptions used by Oxera in its calculations. Assumptions and variables queried by Eircom include the following:

- Business definition;
- Measure of Mean Capital Employed (MCE) and;

- Weighted average cost of capital (WACC)

Business definition

10.32 With respect to Oxera's methodology and reasoning in the identification of the scope of the relevant business definition through which to assess profitability, Eircom is of the view that the fixed-line business *"is not the correct definition of the business"*[102]. Eircom's argues Oxera's approach primarily for the following reasons:

- Eircom claims that a regulator could not expect an operator to fund a net cost, arising from the provision of USO services, through cross subsidisation with a profitable but unrelated business;

- The sharing of cost elements between the USO and non-USO businesses, causing separate businesses to be intrinsically linked. Eircom states that it *"seems counter-intuitive to then group all the separate markets together when making a regulatory decision on the basis that they share costs";* and

- Eircom claims that benefits derived from non-USO services to customers in uneconomic areas have been calculated into the net cost.

10.33 Eircom argues that that USO business is the correct definition. To support this view Eircom claims that it should be able to retain profits generated from non-USO business areas, as other operators do, and should not have to cross-subsidise. Eircom claims that adjusting the scope[103] of the relevant business to the USO business causes the outcome of the profitability test to change.

10.34 Eircom states that the profitability results calculated by Oxera and used by ComReg in its assessment *"should be based on metrics calculated for that period"*.

10.35 Eircom claims there is an element of double accounting in the approach adopted. Eircom states that ComReg *"explicitly directed eircom that only costs which would actually be avoided by eircom if it did not have a USO, should be included in the calculation of the net cost of the USO"*. Given that the net cost has been deducted from revenues earned by Eircom during the assessment period, Eircom claims that double counting arises as USO revenues also contribute to Eircom's actual profits and henceforth its ROCE.

[102] As summarised by Eircom, the rationale for this approach taken by Oxera, *"is that whilst the additional services will incur costs that are unrelated to the USO network, nevertheless there will be cost elements that are shared between the USO and non-USO businesses"*
[103] "Eircom refers to the "*Revenues, operating costs and MCE"*

Asset valuation

10.36 Eircom queries the basis for the mean capital employed (MCE), in the context of the profitability test. Eircom states the *"fact that the net costs of the USO were calculated on an HCA basis does not have any relevance for the basis used to calculate the MCE"*. Eircom claims that it is relevant to *"calculate the fair value for acquiring assets as the basis for determining the MCE"* and by doing this, *"will a firm be able to truly understand if its current activities are profitable".*

10.37 Eircom states that *"if Oxera had used a fair valuation for the capital employed in eircom's business, the level of MCE would have been much higher".*

WACC

10.38 Eircom argues that the WACC of 10.21% set by ComReg in 2007 and adopted by Oxera for the purpose of its assessment does not reflect market conditions for the period under assessment, outlining the impact of events arising the global financial crisis. It is Eircom's view that *"any return above 10.21% was not necessarily a fair return on investment".*

10.39 Eircom refers to the Dow Jones Industrial Averages (DJI) from 2007 to 2013, drawing particular attention to its volatility during the period of 2009-2010 states that the view of the capital markets at this time portrays *"an increased perception of risk among investors, leading to a need for greater returns on their investments"*. With respect to Ireland, Eircom also notes the performance to the stock market and Irish bond yields in the consequence of austerity measures and a subsequent bail-out. Eircom outlines downward trend from 2007, when the WACC of 10.21% was set by ComReg, and relative to the Irish Stock Exchange Index, reiterating the attitude of equity and bond holders to risk. Eircom is of the view that this attitude to risk would have caused Eircom to *"fund its operations, including the USO, with a higher cost of capital during 2009/10".*

10.40 Eircom proposes that an adjustment to the risk free rate and beta and a recalculation is required to reflect any possible impact on the cost of capital and as such, a revised WACC. Eircom states that adjustments to the risk free rate are required to reflect the *"increased yields of the Irish sovereign debt and its effects on the cost of debt of Irish companies".* Adjustments to the beta were referenced to Damodaran's beta for telecommunications services. Further detail outlining adjustments made suggested by Eircom are set out in detail in its consultation response. Eircom includes that its debt is *"considerably more expensive than market rates".*

10.41 Further to this, Eircom states that the cost of capital for Irish operators was above 10.21% and as such, *"it is incorrect to assume that a company that had a return on capital above 10.21% in 2009/10 necessarily made a fair return on its investment"*. Eircom argues that although an ex-ante regulatory WACC is in line with international practice, the analysis undertaken for the purpose of determining an unfair burden is done on an ex-post analysis basis and *"ComReg can therefore use existing historical information from the relevant periods".*

10.1.3.2 ComReg's Views

10.42 Subsequent to receiving Eircom's response, ComReg engaged with Oxera with respect to certain issues raised by Eircom in its response. Annex 1 contains Oxera's further analysis in respect of certain areas. These areas principally include discussion surrounding the appropriate definition of business, the application of materiality and the suitability of the WACC. ComReg points out that Oxera's report only addresses limited aspects requested by ComReg in respect of items raised by Eircom.

10.43 In respect of Vodafone's comments, ComReg is of the view that whether Eircom is an SMP operator or not, as well as its status as USP, is not relevant in this context. For the period 2009-2010, Eircom, as the USP, submitted an application for funding related to the net cost arising from the provision of the USO. ComReg, in accordance with the Regulations, has assessed the net cost and determined that it does not constitute an unfair burden. It is ComReg's view that the designation of a USP and the identification of SMP are two entirely different issues that are determined on the basis of fundamentally different criteria and for different purposes. Eircom was designated with SMP and as such is subject to cost orientation for SMP services. ComReg recognises that a level of cross-subsidisation is partly limited owing to the regulatory obligations regarding price increases. However, ComReg also recognises that Eircom has generated profits significantly in excess of the WACC in the relevant business area, the fixed line business. ComReg notes that there is a level of cross-subsidisation, but does not see the relevance of this point in the context of Eircom's high level of ROCE.

10.44 ComReg and Oxera have considered Eircom's comments and provide the following response in respect of each area. Eircom states that the "*building blocks of Oxera's profitability assessment are what would be expected for the regulated part of the business*".

Business definition

10.45 In order to provide further granularity of the approach taken by Oxera with respect to the identification of an appropriate business definition, ComReg re-consulted with Oxera to provide further detail and justification to further inform stakeholders of its methodology in assessing an unfair burden, in accordance with D04/11.

10.46 Eircom claims that the fixed-line business *"is not the correct definition of the business"*[104] and that a regulator could not expect an operator to fund a net cost, arising from the provision of USO services, through the cross subsidisation with a profitable but unrelated business. ComReg in response to this maintains its view and additionally draws on the further analysis undertaken by Oxera[105]. Where Eircom perceives Oxera's definition broader than that of the USO business or the cross-subsidisation of the USO with more profitable areas of business, ComReg and Oxera maintain that the rationale in its approach is formed on the basis that business activities which rely on the use of USO assets in a given year prevails. Where strictly non-USO business areas utilise USO assets, using the copper access network as an example, profitability within these areas rely on USO assets, therefore contributing to the profitability of the business which uses the assets, in respect of which an unfair burden is assessed. The alternative approach, as proposed by Eircom, could result in other operators contributing towards the funding of the network of assets used to provide the USO, in circumstances where the net benefits to Eircom from that network outweigh the costs of building and operating the network. Consistent with Oxera's view, it is ComReg's view that this would be inconsistent with the intentions of the Directive and the Regulations.

10.47 In its report Oxera has provided granular detail on the approach it took for the purpose of the consultation document and also took the opportunity to evaluate and ensure its methodology was robust. On this basis, referencing document 13/45a and 14/03a, Oxera maintains that this approach, which is in essence the measurement of the fixed-line business and not that solely of the USO business, more accurately reflects revenues and profits derived from USO assets. As such the outcome of the profitability test has not changed and Oxera's further assessment has only strengthened its original position.

[104] As summarised by Eircom the rationale for this approach taken by Oxera, *"is that whilst the additional services will incur costs that are unrelated to the USO network, nevertheless there will be cost elements that are shared between the USO and non-USO businesses"*

[105] Oxera (2013), *"Review of eircom's response to ComReg's consultation on the 'Assessment of Eircom's Universal Service Fund Application for 2009-2010'", 28 October 2013*

10.48 ComReg is of the view that the approach taken by Oxera is reflective of the reality of Eircom's business. It recognises that the use of USO assets or the profits generated outside the scope of the USO through the use of these assets may change over time and as such, its approach will be reviewed on a case by case basis for each application. To further discuss the issue of the evolution of services, ComReg notes Oxera's reference to new technologies. In the case of a potential increase of migration to NGA, the cross business use of USO assets may begin to decline.

10.49 Eircom states that the profitability results calculated by Oxera and used by ComReg in its assessment *"should be based on metrics calculated for that period"*. Owing to the lack of sufficiently granular financial information for the 2009-2010 period, Oxera relied on 2011-2012 financial results from the Regulatory accounts. Oxera justify the reasoning for this approach in 14/03b and ComReg is satisfied with this justification.

10.50 ComReg is of the view that Eircom's position regarding double counting suggests that any positive net cost automatically implies an unfair burden on Eircom. Consistent with the Directive, Regulations and case law[106], ComReg does not accept this view and maintains that in order to determine an unfair burden on Eircom, it is obliged to undertake an assessment, as has been set out in D04/11. Following such an assessment, Eircom would only be compensated for a positive net cost through a sharing mechanism which would be implemented if an unfair burden was found.

Asset Valuation

10.51 Eircom's proposed approach with respect to current cost accounting means that Eircom could potentially earn a return above ComReg's allowed return, yet would still be claiming this to be a significant shortfall in profitability. ComReg does not hold current cost accounts for Eircom for the access network and relies on the robustness of the regulatory accounts. As such, ComReg has used Eircom's regulatory accounts to form a view on profitability based on historical costs.

[106] *Base & Others v Ministerraad*

10.52 Eircom's argument is generally inconsistent with ComReg's approach within D04/11. The analysis undertaken in respect of profitability for the purpose of determining an unfair burden focuses on what ROCE Eircom actually earned. Current cost accounting (CCA) is more relevant to a forward looking price control exercise, however ComReg is of the view that it is not relevant when looking backwards to assess historic profitability. It is also worth noting that the regulatory accounts are broadly consistent with the statutory accounts (with the exception of certain accounting policies) and that these are in turn are what financial markets and lenders rely on when assessing Eircom's financial condition.

10.53 Additionally, with respect to cost recovery, the investment in USO assets represents a long-term investment for the purpose of providing services over the medium-term. It is ComReg's view that it would not be appropriate to identify an unfair burden based on short-term fluctuations in market value for investment in the USO assets. The assessment should be linked to whether Eircom can expect to recover the cost of investment in assets over the life cycle of the assets. As such, an assessment based on actual investment by Eircom in USO assets, and the WACC, is generally more consistent with ensuring cost recovery by Eircom. This approach would also be consistent with ensuring that Eircom does not suffer an unfair burden from investment in relevant USO assets and assists ComReg in determining whether or not an unfair burden exists. It would also be more consistent with ensuring an unfair burden cannot occur solely as a result of Eircom making holding gains in the value of its USO network, which could be counter-intuitive and contrary to the intentions of the framework.

10.54 ComReg's view is the approach taken remains appropriate and is in accordance with D04/11.

Weighted average cost of capital (WACC)

10.55 Eircom argues that ComReg is not correct to base the assessment of profitability, as part of the unfair burden, on the basis of the WACC applied within the current charge control. The WACC, Eircom argues is a regulatory tool, imposed by ComReg and developed for *ex ante* regulation (such as an input into wholesale pricing decisions as it sets out what the reasonable rate of return is) and is not appropriate for this *ex post* assessment.

10.56 ComReg has considered the views of Eircom and sought further detailed advice from its consultant, Oxera, to review its preliminary view set out in light of Eircom's response to Consultation 13/45. A WACC of 10.21% was used in the profitability analysis, as required by D04/11. Eircom queried the appropriateness of this WACC in the context of changes in the economic environment since the establishment of this WACC by ComReg in 2008[107].

10.57 Economically, the use of the WACC for the purpose of the profitability assessment is an appropriate approach to adopt as the WACC is reflected in all regulated prices and therefore enables Eircom to receive a reasonable rate of return.

10.58 Eircom states that a WACC of 10.21% is not consistent with market conditions prevalent for the 2009-2010 application and assessment period; and that *"any return above 10.21% was not necessarily a fair return on investment".* As discussed Eircom draws reference to the volatility of the Dow Jones Industrial Averages (DJI) and Irish bond yields during the 2007 to 2013 period in the context of the shareholders' perception of risk and austerity measures. As stated. Eircom is of the view that this attitude to risk would have caused Eircom to *"fund its operations, including the USO, with a higher cost of capital during 2009/10"*. Eircom claims that an adjustment to the risk fee rate and beta is required to recognise the fact that Eircom's cost of debt was in excess of market rates.

10.59 In order to address some of the issues raised by Eircom, ComReg reengaged with Oxera. Document 14/03a sets out Oxera's detailed response and conclusion on this matter. Oxera, in response to Eircom's views, states that there appear to have been shortcomings in Eircom's estimates for the risk free rate and asset beta.

10.60 Oxera's analysis of the issue shows that the 2008 WACC, set by ComReg and applied to the profitability test in Consultation 13/45 remains appropriate. The analysis includes the following points:

- Using its own analysis, Eircom states that the risk free rate has increased from 4.75% in 2008 to 8.2% in 2011/12;Eircom's reference to Irish Government bond yields is not an effective representation of risk free investment, and cannot be assumed to be directly reflected into a higher WACC;

[107] ComReg, *"Eircom's Cost of Capital",* http://www.comreg.ie/_fileupload/publications/PR220508.pdf, May 2008

- Oxera's review notes the approach taken by the Commission for Energy Regulation (CER) in 2012 when setting the cost of capital for Bord Gáis and specifically the use of a crisis premium to reflect the sharp increase in Irish Government bond yields within the WACC calculation. Within this approach a crisis premium was applied using the *"spread of yields of bonds by Irish regulated utilities";*

- Using its analysis based on estimates sourced from the website of Prof Damodaran of New York University, Eircom states that the asset beta has increased from 0.57 to 0.78 in 2009/2011 and 0.59 in 2011/12;

- Oxera states that although Damodaran's website is a relevant data source, it queries assumptions made by Eircom in its asset beta estimates including; comparable estimates biased toward US based companies while the European asset beta is 0.44, significantly less that a US beta of 0.91;

- Oxera also notes that Eircom draws on comparables in the Telecommunications industry. Oxera's review of the data within the Damodaran source evidence indicates that 'Telecommunications Utility' is a more suitable comparator, as it appears to include incumbent companies operating in the fixed-line markets, therefore more comparable to Eircom's profile. The asset beta for these companies is generally lower. Drawing on Damodaran's analysis, Oxera therefore considers that maintaining the asset beta of 0.57 is most appropriate and could be considered *"optimistic"*;

- In respect of Eircom's comments on the volatility of the debt markets and investors' perceptions of risk, in the case of both equity and debt, ComReg has considered Eircom's claims that it needed to yield greater returns in the context of the greater cost of debt and equity. Oxera however, notes that although this may or may not be true, it does not impact the asset beta, as this *"measures the company's business risk relative to that of the market, rather than the riskiness of the market itself"*; and

10.61 Table 4.4 of Oxera's report sets out a summary of its analysis which demonstrates that ComReg is correct in maintaining its view that the 2008 WACC of 10.21% remains appropriate for the purpose of its application to the profitability test, as required by D04/11, in the assessment and determination of no unfair burden for Eircom.

10.62 Eircom argues that although a regulatory WACC for ex-ante is in line with international practice, the analysis undertaken for the purpose of determining an unfair burden is done on an ex-post analysis basis and "ComReg can therefore use existing historical information from the relevant periods". Oxera notes that this could be the case should actual costs have been very different from ComReg's assumption, and could be part of a future assessment, but does not consider that this is relevant for the assessment of the 2009-2010 application.

10.1.4 Materiality

10.1.4.1 Summary of Respondents' Views

10.63 D04/11 states that ComReg will *"assess whether or not this net cost significantly affects a USP's profitability"*[108], which in Consultation 13/45 assesses the materiality of the positive net cost. It is Eircom's view that it is *"not obviously clear how one can assess whether the effect of a net cost is significant or not"*. Eircom is of the view that *"the concept of a net cost being immaterial is simply anachronistic".* Eircom queries the definitions and precedents identified by Oxera and adopted by ComReg, with respect to the practices of the following:

- Ofwat;
- Ofcom;
- Ofgem;
- International Federation of Accountants; and
- Australian Accounting Standards Board.

10.64 Eircom is of the view that the precedents and practices associated with the above and discussed in Consultation 13/45 and Oxera's document 13/45c are *"convoluted"* and not relevant to the USO. Eircom claims that instead these methodologies *"deal with what level of profits or revenue needs to be reported, the circumstances for a contract being reopened or whether a reporting error needs to be corrected"* and do not support Oxera's approach. Eircom refers to Oxera's view that there appears to be few regulators who have used the concept of materiality in the context of a positive net cost and argues that its approach to materiality is *"neither necessary nor appropriate for the purpose of the Universal Service Directive and Regulations"*.

[108] Paragraph 5.16, D04/11

10.65 Eircom notes that Oxera references ANACOM's decision with respect to materiality and argues that ANACOM's precedent is most relevant when setting a materiality threshold, noting that ANACOM drew on the €4m threshold set by ARCEP in relation to administrative costs associated with the administering of the USO Fund in the event of an unfair burden. Eircom claims with respect to a positive net cost, the materiality level is *"significantly lower",* particularly so in the context of higher subscriber numbers and revenues.

10.1.4.2 ComReg's Views

10.66 As stipulated by Decision 40 of D04/11, for there to be a determination of an unfair burden the impact of the positive net cost on a USP's profitability should be 'significant' or 'material' in order for it to be an unfair burden. In order to gain assurance around the concept of materiality, in the absence of a particular definition of materiality, Oxera drew on relevant precedents[109] in the context of the assessment and determination of an unfair burden and Eircom's own business. Eircom argued in its response that the precedents applied by Oxera were not relevant. To support its view, Eircom suggests two alternative approaches to assessing the materiality of the net cost.

10.67 Oxera's subsequent analysis in response to Eircom's assertions underpins ComReg's view that the precedents used and the materiality levels established by Oxera, as implemented in the assessment, of whether the positive net cost represents an unfair burden or not, remain appropriate. ComReg's rationale is discussed in the following points:

- Eircom's queries surrounding the appropriateness of the Royal Mail example, as detailed by Oxera in Document 14/03a, are not relevant. As stated by Oxera, the established 1% materiality threshold is not inaccurate but was in fact a regulatory decision, which went through the Postcomm/Ofcom consultation and decision process;

- Eircom states that ARCEP set a materiality threshold of €4m. Oxera argue that this however is not a relevant threshold in terms of the assessment of the impact on profitability. The threshold in this instance is in fact implemented by ARCEP to assess the cost of implementing a sharing mechanism, similar to the administrative costs test set out in Consultation 13/45 as prescribed to Decision 39 of D04/11;

[109] Through which Oxera concluded 5-10% of profitability or 0.5-1.0% of revenues were appropriate measurements for materiality or significance.

- The approach taken by the Portuguese regulator, ANACOM, which was referenced by Oxera in its report, ComReg document 13/45c, is not considered a relevant precedent by Oxera. ANACOM's approach in respect of materiality differs from that the approach required by D04/11. Similar to the purpose of the threshold in the case of ARCEP, ANACOM use the threshold to assess the administrative cost involved in setting up a USF and not for the purpose of assessing a positive cost as to whether it is an unfair burden or not. There is also little information available documenting how in fact ANACOM arrived at its decision with respect to a burden.

- The precedents adopted by Oxera, as detailed in its report (13/45c) are more relevant for the purpose of the assessment of the determination of an unfair burden, in accordance with ComReg's framework which is based on D04/11. They are in fact relevant to the assessment of Eircom as an entity itself in terms of assessing the impact of the positive net cost on profitability and whether this in turn represents a material or significant impact in the context of the investor and investment decisions, as prescribed by D04/11.

10.68 Oxera states in its report that *"in the context of revenue within the relevant business definition of well over €1 billion, a change in profitability of this level would be unlikely to impact an investment decision*". ComReg, having considered the further analysis completed by Oxera, remains of the view that the materiality thresholds (both revenue and profitability orientated) assessing the significance of the impact of the positive net cost on Eircom's business are appropriate.

10.69 Based on experience and widely accepted accounting practice, Oxera's view is that a threshold range of 5-10% for profitability *"is broadly consistent with that which would be considered by accountants and market participants as material in the context of understanding reports provided to financial markets".* Oxera is of the view that applying a profitability threshold provides an *"appropriate additional check in addition to the revenue range, although the latter is more common in a regulatory environment due to the complex incentives that can arise from using profit-based materiality measures".*

10.70 ComReg is of the view that an outcome of the materiality assessment in the determination of an unfair burden assessment is not a sole factor and is analysed in the context of other tests which include impact and causality tests. In accordance with D04/11 it is only one element of the assessment process.

10.71 ComReg has considered the issue of materiality in the context of the appropriateness of a materiality range and also the value attached to the range. In the context of the profitability threshold tests and the values attached to the threshold (5-10%), it is ComReg's view that a positive net cost that represents at a minimum the lower end of the range of 5%, would signal that a net cost is material and the next part of the test, as set out in D04/11, the impact on competitiveness, would have to be undertaken. However, for the purpose of this year's assessment the net cost is c.3% of profits for the fixed line business and therefore does not reach the lower part of the threshold and as such is not material. As such, in accordance with D04/11, future assessments will continue to include an assessment of the materiality of a positive net cost in the context of the impact and causality assessments.

10.1.5 Further Analysis

10.1.5.1 Summary of Respondents' views

10.72 Eircom queries ComReg's preliminary view that the positive net cost did not pass the administrative, profitability and materiality test, the determination process did not proceed to Decision 41 of D04/11[110] to assess whether the positive net cost impacts Eircom and its ability to compete on equal terms with its competitors. It is Eircom's view that this approach *"totally ignores the profitability implications of the loss of lines, and thus of revenue market share in the fixed line business*" and that this is "*inconsistent with the requirement under the Universal Service Regulations (as clarified by the CJEU in the Base case) that account is taken of the market share of the USP".* Eircom disagrees with this approach stating that it distorts the outcome of ComReg's analysis and causes ComReg to reach *"economically incorrect conclusions".* Eircom states that where Oxera outlines that the relevant assessment period proved *"supra-competitive"* for Eircom, its market share with respect to the fixed line market and revenues generated, declined.

10.73 Eircom claims that, owing to the decline of its market share in the fixed line market, its ability to cross-subsidise the positive net cost was undermined and notes that fixed lines lost are mostly those that are most profitable and more typical of urban areas rather than rural areas. Eircom outlines in such a scenario, it would be normal practice to reduce prices, however owing to the obligation, Eircom is required to maintain prices, as such *"preventing eircom from taking those actions that a prudent business would normally take"*. Eircom insisted that the positive net cost of providing USO services is consequentially causing a *"substantial impact on eircom's competitiveness"* and as such on its profitability.

[110] Decision 41 of D04/11 serves to assess whether a positive net cost impact Eircom's ability to compete on equal terms with competitors going forward.

10.1.5.2 ComReg's views

10.74 Decision 41 of D04/11 states *that "(I)f the positive net cost significantly affects a USP's profitability, ComReg will assess whether or not such a net cost materially impacts a USP's ability to compete on equal terms with competitors going forward"*. Oxera provided a practical interpretation of Decision 41 of D04/11 for future assessments in 13/45. Eircom's view, with respect to forward-looking profitability, that a different conclusion could be concluded is not consistence with ComReg's approach as set out in D04/11, whereby historic profitability is the relevant consideration.

10.75 In the context of further analysis with respect to competition, ComReg remains of the view that given the outcome of analysis in relation to profitability, it is unnecessary to undertake the competitive analysis test, as outlined in D04/11. Owing to the extent to which Eircom maintained a level of return in considerable excess of the WACC, ComReg maintains that there is no requirement for this test to be undertaken for the 2009-2010 assessment, Oxera's report, ComReg document 13/45c, nonetheless provides an explanation of the practical interpretation of D04/11 for future assessments, as relevant,

10.2 ComReg's final position- unfair burden

10.76 In accordance with the analysis set out in Chapter 9 and having considered the views of respondents and having considered the further analysis, ComReg remains of the view that a positive net cost of €5,095,545 for 2009-2010 is not an unfair burden on Eircom.

Chapter 11

11 Adherence to D04/11

11.1 All Decisions regarding Eircom's adherence to each requirement of D04/11 are listed below, including those that have not been specifically highlighted throughout Chapters 4, 5 and 6.

D04/11 Decision	ComReg's Assessment
1	Based on the assessment and review undertaken by TERA, ComReg was satisfied that Eircom's funding application adequately satisfied the criteria set out in Decision 1.
2	Based on the assessment and review undertaken by TERA, ComReg was satisfied that Eircom's funding application adequately satisfied the criteria set out in Decision 2.
3	ComReg was satisfied with the calculation of USO revenues on the basis that Eircom has adequately included direct and indirect revenues that it would forego as a result of ceasing to provide services to USO services to uneconomic customers.
4 & 5	ComReg was satisfied that the revenue scope for direct revenue incorporated by Eircom corresponds to the definitions set out in Decisions 4 and 5.
6	ComReg was satisfied that the revenue scope for direct revenue incorporated by Eircom corresponds to the definition set out in Decision 6. In addition to this, based on TERA's detailed analysis and findings, ComReg considered the principles and methodology of Eircom's approach to replacement calls to be appropriate.
7	ComReg was satisfied that given the lack of certain data Eircom altered its approach where appropriate. ComReg however recommends the provision of all available data in future applications. To substantiate the assessment of Eircom's adherence to the requirements of this decision, ComReg refers to comments included in paragraphs 4.12 - 4.17 of this document.
8	ComReg was satisfied that Eircom's funding application has been prepared on an avoidable cost basis, reflecting the costs incurred in the provision of the USO which a commercial operator would not ordinarily have provided, considering both OPEX and CAPEX for the 2009-2010 period.
9	ComReg was broadly satisfied that Eircom has adopted the appropriate methodologies in the preparation of cost and efficiency estimates.

10	ComReg was satisfied that Eircom met the requirements of Decision 10, by excluding customers who were originally considered “uneconomic” and have now become profitable.
11	ComReg was satisfied that Eircom met the requirements of Decision 11, by identifying uneconomic areas at an MDF level.
12	Based on the assessment and review undertaken by TERA respectively, ComReg was satisfied with the depreciation method applied by Eircom.
13	ComReg was broadly satisfied that Eircom met the requirements of this Decision. As there was a lack of information which was beyond the control of Eircom, Eircom appropriately applied a probability approach, as per the below, in order to identify customers. Given the complexity of the task to identify each uneconomic customer by its number, the probabilistic approach was considered reasonable.
14	For the purpose of the customer model, ComReg was satisfied that Eircom has adhered to the requirements of Decision 12 and Decision 14 with respect to the use of probability analysis in the identification and allocation of uneconomic customers in uneconomic areas.
15	Decision 15 of D04/11 prescribes that “(D)uring the course of ComReg’s assessment of a USO funding application, a number of sample “reality” checks will be undertaken". ComReg was satisfied that any deviations from D04/11 were acceptable and that the application was fit for purpose, giving particular consideration to this Decision.
16	Having discussed minor issues with Eircom and having rectified these in the calculation of the net cost, ComReg was satisfied with the adjusted estimation of €93,906.
17	ComReg was satisfied with the approach, assumptions and calculations applied by Eircom in arriving at the directories avoidable cost estimate, with the exception of a necessary adjustment with respect to the NDD, as detailed in paragraph 4.42.
18	ComReg was satisfied with the approach, assumptions and calculations applied by Eircom in arriving at the disabled services avoidable cost estimate.
19	ComReg was satisfied that Eircom’s USO funding application was consistent and in accordance with D04/11. Notwithstanding, adjustments and cognisant of Decision 20 of D04/11, ComReg was of the view that Eircom’s application satisfied this decision. ComReg however was of the view that recommendations on methodological and data provision improvements discussed throughout this document must be incorporated into any future USO fund applications.
20	ComReg was satisfied that Eircom’s USO funding application was fit for purpose.
21	ComReg was satisfied that Eircom's USO funding application was based on annual information which coincided with the 2009 - 2010 financial year, with the

	exception of consultant's fees.
22	ComReg was satisfied that an independent declaration, signed off by the Board of Directors of Eircom, accompanying the application, was provided. Similarly ComReg was satisfied that an AUPs engagement, approved by ComReg was undertaken by PwC to satisfy the requirement.
23	ComReg was satisfied that Eircom's application was supported by calculations in software which was reasonably capable of proper access and review. However using the calculation of lifecycle benefits as an example, Eircom and its consultants must ensure all calculations can be fully validated in a comprehensive format in future assessments.
24	ComReg was satisfied that Eircom's application and supporting models were adequately transparent and sought to fulfil the requirement of Decision 24; in terms of the specific requirements of the application including the format of each USO services and relevant calculations and also in terms of general modelling best practice.
25	ComReg was satisfied that Eircom's application identified uneconomic customers appropriately and adequately considered the approaches to their identification as advised by ComReg.
26	ComReg considered the issues of transparency and confidentiality of certain information in the context of the Regulations 11(7) of the Regulations, its Confidentiality Guidelines and international precedent with respect to the USO.
27	ComReg was of the view that sufficient information on economic payphones was provided by Eircom, particularly in respect of their location and proximity to other payphones operated by Eircom.
28	ComReg was satisfied that Eircom's application and financial models were adequately supported by comprehensive documentation.
29	ComReg was satisfied that data sampling was required when certain data could not be sourced, and that the requirement to do so was reasonably justified by Eircom.
30	ComReg was satisfied that Eircom's application was in accordance with ComReg Decision No. D07/10.
31	ComReg was satisfied that Eircom's engagement with independent experts for the purpose of the development of suitable methodologies and the preparation of the intangible benefits estimate and has ensured that independent experts have completed the necessary calculations.
32	ComReg was satisfied that Eircom's application met the submission requirements with respect to timing. Where an extension was sought, ComReg was of the view that this was sought on reasonable grounds and in a manner that adhered to Decision 32.

33	ComReg has no comment with respect to this Decision, as it is not relevant to this year's assessment.
34	ComReg has no comment with respect to this Decision, as it is not relevant to this year's assessment.
35	ComReg was satisfied that Eircom's estimations assessed the relevant benefits, including intangible benefits, to the USP.
36	Based on the analysis of both TERA and Oxera, ComReg was satisfied that there was no evidence of double counting and benefits accruing as a result of Eircom's USP status were only considered.
37	As discussed in paragraph 6.7, ComReg engaged with Oxera to review the estimate prepared by WIK. ComReg, cognisant of allowances in Decision 37, requested Oxera not only to review the estimate but provide recommendations to ensure the proper evolution of the methodologies used. Furthermore, as set out in D04/11, ComReg reserved its right with respect to implementation of alternative methodologies and as such has adjusted the estimates provided by WIK. Reasoning to support the justification of these adjustments is discussed throughout this chapter and detailed in Oxera's report.
38	Refer to Chapter 9 and 10 – "Determination of an unfair burden"
39	Refer to Chapter 9 and 10 – "Determination of an unfair burden"
40	Refer to Chapter 9 and 10 – "Determination of an unfair burden"
41	Refer to Chapter 9 and 10 – "Determination of an unfair burden"
42	Refer to Chapter 9 and 10 – "Determination of an unfair burden"

Chapter 12

12 Decision

12.1 Statutory Powers

12.2 This Determination is hereby issued by the Commission for Communications Regulation ("ComReg"):

i. Pursuant to Regulation 11 of the European Communities (Electronic Communications Networks and Services) (Universal Service and end users' rights) Regulations 2011 ("the Regulations"),

ii. Pursuant to the principles and methodologies set out in ComReg Document D04/11 Report on Consultation and Decision on the Costing of Universal Service Obligations: Principles and Methodologies ("D04/11"),

iii. Having regard to the Commission's functions and objectives under sections 10 and 12 respectively of the Communications Regulation Acts 2002 – 2011,

iv. Having regard to the analysis and reasoning set out in ComReg Document No. 13/45,

v. Having regard to the submissions received and set out in ComReg Document No. 13/45,

vi. Having regard to the analysis and reasoning set out in ComReg Document No. 14/03 and

vii. Having, where relevant, complied with Policy Directions made by the Minister for Communications, Energy, and Natural Resources.

12.3 Determination

12.4 Following the assessment of the application received from Eircom Limited ("Eircom") on 31 May 2012 pursuant to Regulation 11(1) of the Regulations, ComReg has determined, in accordance with Regulation 11(3) of the Regulations and D04/11, that for the year 2009-2010 there was a positive net cost comprising the following figures:

USO Service **Direct net cost (a)**	***ComReg €***
Uneconomic Areas	545,796
Uneconomic Customers	6,454,978
Directories	-
Payphone	93,906
Services for disabled end users	44,651
Consultancy fees	-
Direct net cost	**7,139,331**

Intangible benefits (b)	***ComReg €***
Enhanced brand recognition	1,843,698
Ubiquity	15,091
Marketing	20,437
Life-cycle	164,560
Total intangible benefits	**2,043,786**

Net cost (after intangible benefits)	*ComReg €*
Direct net cost	7,139,331
Total intangible benefits	(2,043,786)
Net cost (after intangible benefits) / Positive net cost	**5,095,545**

12.5 Pursuant to the determination of the positive net cost and in accordance with Regulation 11(4) of the Regulations and D04/11 ComReg has determined that for the year 2009-2010, the positive net cost does not represent an unfair burden on Eircom.

Chapter 13

13 RIA

13.1 A RIA is a structured approach to the development of policy, and analyses the impact of regulatory options on different stakeholders. ComReg's approach to RIA is set out in the Guidelines published in August 2007.[111] In conducting the RIA, ComReg takes account of the RIA Guidelines[112] issued by the Department of An Taoiseach in June 2009 and adopted under the Government‟s Better Regulation programme.

13.2 Section 13(1) of the Communications Regulation Act 2002, as amended, requires ComReg to comply with certain Ministerial Policy Directions. Policy Direction 6 of February 2003 requires that before deciding to impose regulatory obligations on undertakings ComReg must conduct a RIA in accordance with European and International best practice, and otherwise in accordance with measures that may be adopted under the Government's Better Regulation programme. In conducting the RIA, ComReg also has regard to the fact that regulation by way of issuing decisions, for example imposing obligations or specifying requirements, can be quite different to regulation that arises by the enactment of primary or secondary legislation.

13.3 ComReg's published RIA Guidelines (Doc 07/56a), in accordance with a policy direction to ComReg, state that ComReg will conduct a RIA in any process that may result in the imposition of a regulatory obligation, or the amendment of an existing obligation to a significant degree, or which may otherwise significantly impact on any relevant market or any stakeholders or consumers. However, the Guidelines also note that in certain instances it may not be appropriate to conduct a RIA and, in particular, that a RIA is only considered mandatory or necessary in advance of a decision that could result in the imposition of an actual regulatory measure or obligation, and that where ComReg is merely charged with implementing a statutory obligation then it will assess each case individually and will determine whether a RIA is necessary and justified.

[111] ComReg Document 07/56 & 07/56a

[112] See revised RIA guidelines, ―*How to conduct a Regulatory Impact Analysis‗ dated June 2009*‖, http://www.betterregulation.ie/eng/Publications/Revised_RIA_Guidelines.pdf

13.4 In this Response to Consultation and Determination, ComReg considers that it is not exercising its discretion by imposing a discretionary regulatory obligation but is acting under a statutory obligation imposed on it by Regulation 11 of the Regulations which requires that, upon receipt of an application from the USP, ComReg shall determine whether a positive net cost has been incurred and if so, whether this positive net cost represents an unfair burden for the USP. As such, ComReg has no discretion as to whether or not such an assessment is undertaken, if an application for a USF has been received. Therefore, a RIA is not being undertaken for this determination.

Annex: 1 14/03s - Submissions to Consultation 13/45

Annex: 2 14/03a - Oxera: Review of eircom's response to ComReg's consultation on the 'Assessment of Eircom's Universal Service Fund Application for 2009-2010'