



Commission for
Communications Regulation

Assessment of Eircom's Universal Service Fund Application for 2009-2010 Submissions to Consultation 13/45

NON-CONFIDENTIAL

Submissions to Consultation

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**An Coimisiún um Rialáil Cumarsáide
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alto

alternative operators in the communications market

**Response to Consultation - Draft Decision on the Assessment
of Eircom's Universal Service Fund Application for 2009-2010
Ref: 13/45**

Submission By ALTO

Date: July 5th 2013

ALTO is pleased to respond to Consultation – Draft Decision on the Assessment of Eircom’s Universal Service Fund Application for 2009-2010 Ref: 13/45

Preliminary Comments

ALTO welcomes the consultation and ComReg’s conclusion being that “*the positive net cost does not represent an unfair burden on Eircom*” as set out at page 68 of the ComReg Consultation paper.

ALTO has consistently maintained this position and will continue to highlight areas for concern to the market as a whole.

ALTO members wish to raise a number of concerns in respect of the ComReg Consultation and the ancillary/supporting documentation referable thereto:

1. Transparency:

ALTO members are concerned that throughout the various documentation published by ComReg and its agents, a perception arises that a disproportionate approach to “*commercially sensitive information*” may have been taken or allowed.

2. Discussion/Information gaps:

ALTO members are concerned that gaps emerge relation to key components of the net cost calculation. We particularly emphasise the calculation of uneconomic customers.

3. Divergence of Approaches:

ALTO members are concerned at the scale of divergence by Eircom from ComReg methodology as specified by in ComReg in document/decision reference 04/11, should be fully addressed in any further outputs.

4. Flexibility of approach taken by ComReg:

ALTO members are concerned that an overly flexibly or tending to be permissive stance taken by ComReg to the level of Eircom divergence from ComReg document/decision 04/11, should be addressed in any further outputs.

5. Verification of Eircom inputs to the net cost calculation:

ALTO members are concerned about the process and verification undertaken by ComReg to the various inputs in the net cost calculation. This relates directly to point 1, above and should be properly addressed in any further output from ComReg.

6. ComReg and its agents approach and methodology in dealing with unverified Eircom inputs related to the net cost calculation:

ALTO members are again concerned about the process and verification thereof. Again, this relates directly to point 1, above and should be properly addressed in any further output from ComReg.

It is ALTO's view that the combined effect of the above items may result in systemic flaws, if certain assumptions and assertions are left unverified and unavailable to the market for review.

ALTO would prefer a regime and process whereby any unsubstantiated figure or input is simply rejected until such justification or defence can be proffered to validate the impugned input/s.

Further, ALTO expresses serious concerns on the approach taken by ComReg to the extent that it will allow Eircom simply “*fix issues in future applications*”. ALTO believes that this approach is seriously, if not fundamentally flawed and the current application should fail *in limine* for lacking clarity and merit.

The market, and indeed ComReg, deserves better treatment than to be told to assume certain matters that are simply left period-upon-period for a decision to be taken *ex ante* and those matters can be “*fixed*” at a later time.

ALTO submits 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. Anything less must simply be rejected in its entirety.

ALTO believes, as will be apparent from the above listing 1 – 6, that this USO Consultation process has not been sufficiently transparent. The obvious and varied lack of detail on many key elements relating directly to the net cost calculation are such that ALTO members are simply unable to properly, and moreover cogently, evaluate ComReg’s draft decisions.

ALTO members remark that it is obvious that the continual permitted extensions to the USO processes, stemming from the applicant operator, exemplify the imbalanced nature of this and future USO consultation processes. This is evident on a simple review of ComReg Reference 13/49 and its accompanying documentation.

ALTO firmly believes 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. That finding being that Eircom has met the first condition for determination of an unfair burden in its application for 2009 - 2010, namely that: *“There must be a verifiable and verified direct net cost”*.

ALTO members have numerous concerns relating to a plethora of issues not specifically addressed by the questions posed by ComReg in the within consultation document.

Finally, ALTO suggests that USO remains an unwanted hangover that should simply be dispatched on terms and conditions properly consulted upon by ComReg. Having long and protracted periods of USO funding reviews creates a privative or jaundiced view of the Irish Communications market that should be ended. This is over and above the almost permanent search for information by CFOs of ALTO member companies on any future conditions for paying into a USO fund – which is the correct and responsible approach in the circumstances.

Regulations applicable to the current application

ALTO members submit that while ComReg has determined that there has been no unfair burden within the current consultation and related to USO, its members are firmly of the view that the requirements of S.I. 308 of 2003, and in particular the *‘Costings of universal service obligations’* and the performance criteria associated thereto have not been complied with.

ALTO notes that in 2008, ComReg found Eircom to be in breach of its obligations in respect of USO and we refer in particular to ComReg document reference 08/37 and the publications ancillary thereto.

ALTO queries whether, in light of the various publications and clear findings by ComReg, applications for USO funding are appropriate until clarification on service

performance and determinants has been fully investigated and presented to the industry in a transparent fashion.

Interpretation of the Universal Service Directive:

It is ALTO's view that Eircom, ComReg and their various consultants (in this instances: Oxera and TERA) appear to assume that the relevant component of universal service is necessarily delivered using Eircom's fixed line network.

At paragraph 3.1 of ComReg 13/45, ComReg states that:

"the USO ensures basic fixed line telephone services are available to end users at an affordable price" (emphasis added).

ALTO disagrees with this interpretation of the Universal Service Directive 2002/22/EC.

The Directive as transposed into Irish law states;

"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."*¹

As such, the Directive does not specify service provision through fixed line technology as implied by ComReg and might include other technologies.

¹ S.I. No. 337 of 2011, section 3.

ComReg's assumed and as yet unjustified provision of universal service through fixed line technology carries throughout the consultation.

For example *Figure 1: Overview of the net cost calculation and unfair burden assessment methodology*² this seems to imply that ComReg reviewed only the historic cost of the copper network model in assessing the cost of the universal service provision.

ALTO believes this is not correct, as the cost of Universal Service should be assessed on the basis of efficient provision that extends to use of alternative technologies.

Unfortunately, ALTO is not in a position to quantify the impact of this incorrect approach, given the lack of detail provided in the ComReg consultation documents.

However, 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.

ALTO believes that these omissions and deficiencies in ComReg's methodology, and in Eircom's approach in its application, need to be properly and thoroughly addressed.

ComReg's intention to commission an expert report and publish a decision on the sharing mechanism, even though as yet there is no unfair burden or need for sharing:

Paragraph 2.10 states that: *"ComReg is 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")⁹, which will be published in due course, ComReg is commissioning an*

² P. 19 ComReg 13/45.

expert report in respect of the most appropriate principles of any mechanism established in an Irish context”.

ALTO believes that this is potentially a wasteful and inefficient use of ComReg and industry resources given that ComReg’s initial assessment of Eircom’s first application for funding (2009 – 2010) concludes that there is no unfair burden and therefore no need for a sharing mechanism now. Please also note our remarks on previous compliance with own obligations and relevant ComReg findings associated therewith.

Additionally, ALTO members believe, that based on European precedent, the level of any potential net cost will fall drastically over time. Trends experienced by ALTO members in Europe clearly show significant declines in net cost amounts from the initial assessment over subsequent years, as unjustified costs are simply removed.

Response to Consultation Questions:

Q. 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.

A. 1. ALTO members agree with ComReg's preliminary view that consultancy costs incurred in respect of any application do not form part of the direct net cost. Those costs could not have been directly incurred as a result of the provision of USO services and although not stated, were unlikely to have been incurred in the funding period under review i.e., 2009 – 2010. Additionally, it is ALTO's view that expenditure undertaken by Eircom was entirely discretionary and should be clearly excluded under the heading of inefficiencies in any case.

Eircom unilaterally chose to hire three different mainstream consultancy firms costing €881,915³ which is the second highest item of Eircom's request for USP funding. The figure for consultancy is higher than the combined cost claimed for uneconomic areas, payphones and service for disabled end users.

ALTO submits that this is wholly disproportionate and unreasonable.

Q. 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.

A. 2. ALTO submits that in general, increases to the net cost calculation should be

³ clause 4.51

excluded if their inclusion is not properly validated. Any decreases to the net cost calculation, should be included, if not displayed clearly as validly excluded. The onus is on Eircom as the applicant to make the case for either in a robust and verifiable manner.

Unfortunately, given the scale of unverified inputs used by Eircom in the net cost calculation and the lack of detail provided by ComReg in the consultation documents, ALTO is not in a position to agree or disagree with ComReg's calculation of the direct net cost for 2009 – 2010 of €7,139,331.

Q. 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.

A. 3. ALTO is not in a position to agree or disagree with ComReg's calculation of the intangible benefits for 2009 – 2010 of €2,043,786.

ALTO members are particularly concerned with the degree of criticism of Eircom's approach to the calculation of "*Brand recognition benefits*", again the level is such that it calls in to question the credibility of the entire Eircom application for 2009 – 2010.

Clear criticisms include:

- Errors in formula used.
- Concerns on questions posed by Amarach in order to estimate the USO related premium.

- Concerns on the survey sample size used.
- Counterintuitive model predictions used by WIK.

Unfortunately, ALTO does not have sufficient information to understand the cumulative impact of these deficiencies in the Eircom application and would request ComReg to clarify.

ALTO is also concerned that Eircom's approach to the calculation of marketing benefits is very narrow in scope and as a result understates the level of benefit considerably. For example, ALTO would question why the following benefits do not appear to be included:

- Improved targeted marketing and uptake of all Eircom products (broadband, bundles, home security, mobile) as a result of access to customer information acquired by consequence of the USP designation.

ALTO submits that with direct reference to paragraph 5.23 members are seriously concerned that Eircom may be availing of commercial information through the USO that should reasonably be shared with the industry.

ALTO members therefore consider ComReg should investigate whether Eircom Retail are taking an unreasonable and discriminatory commercial benefit from the availability of USO information. ALTO's view is it would be more appropriate this information is made available to competitors.

Q. 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.

A. 4. ALTO refers ComReg to responses 2 and 3 above. ALTO submits that the lack of available information in this consultation is regrettably limiting.

Q. 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.

A. 5. ALTO agrees with ComReg’s statement in paragraph 6.3 that:

“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.”

However ComReg goes on to state in paragraph 6.8 that:

“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.”*

ComReg further states in paragraph 6.9 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**.....”* (emphasis added).

ALTO rejects ComReg’s preliminary view that the first two criteria have been met.

ALTO members believe that it is evident throughout the consultation documents published by ComReg that there are significant deficiencies in the data provided to ComReg in the Eircom application.

ALTO members submit that the scale of these deficiencies is such that the credibility of Eircom’s application is significantly undermined and it is clear that the first of the criteria stated above has not been met, namely that *“there must be a verifiable and verified direct net cost”*.

ALTO makes reference, in particular, to the calculation of *“Uneconomic Customers”* which make up €6,454,978 of the net cost calculation is wholly inadequate in terms of transparency and verifiability, and would be unlikely to withstand more rigorous scrutiny as would certainly be the case should funding ever be deemed appropriate for future applications.

Certain ALTO members are submitting direct responses to ComReg and ALTO has not addressed specific concerns within this response.

ALTO
5th July 2013



BT Communications Ireland Ltd [“BT”] Response to: ComReg’s Consultation and Draft Determination on the Assessment of Eircom’s Universal Fund Application for 2009-2010

Issue 1r1 – 9th July 2013
Non-Confidential Version

Introduction

BT welcomes the opportunity to comment on ComReg’s assessment of Eircom’s first application for Universal Service Provider (USP) funding to cover the period 2009 to 2010.

We welcome ComReg’s provisional outcome that no charge should apply to the industry and we appreciate the detailed and considerable work that ComReg and its consultants have carried out in assessing this complex issue. We agree with most of ComReg’s analysis and conclusion however we would like to raise the following important issues arising from the analysis both for this and future reviews.

Key concerns

Scope and Efficiency – The focus of the analysis has been to review the Eircom Universal Service Fund Application to ensure it is reasonable and compliant with the Regulations¹ and in particular ComReg Decision D04/11. ComReg acknowledge in paragraph 4.2 a key part of the investigation is to determine whether the services have been provided efficiently.

With the principle of efficiency in mind, 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. For example there were two alternative access technologies available to Eircom during the period under study and there is no evidence these were considered in the review.

1. Eircom had deployed Fixed Cellular Service (FCS) services for some customers and it’s not evident from the study whether these were deployed for uneconomic lines. We note the FCS service would have been compliant with the USO

¹ Statutory Instrument SI 308 2003

regulation and our understanding is it would have been a more efficient solution in many instances to very long copper lines with the associated deployment of telephone poles etc.

2. There is also no evidence 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. We know that '3' offered wholesale access services and believe a voice telephony service could be supported over this network in many instances alongside the internet access service it was designed for.

The consultation and associated reports do not highlight that Eircom attempted or have used available and cheaper alternatives for meeting their USP obligations suggesting the analysis does not fully address whether the deployed solution is the most efficient. It appears Eircom have simply continued to grow its own copper network through the USO funding thereby adding value to Eircom rather than using other resources available in the market

Failure to meet USO targets – We consider that the Eircom application for funding for the provision of economic lines does not align with either Regulation 11.1 of SI 308 2003 or ComReg Decision D02/08 given the reported failure of Eircom to meet its USO targets as discussed in ComReg Information Note10/80. We therefore consider the uneconomic lines part of the Eircom funding claim should be rejected by ComReg. Further detail to our position is provided in our response to question 11.4.

Redaction/non provision of information – We consider key pieces of information are not supplied or unreasonably redacted in the documents which prevent us from conducting an informed financial analysis of whether the outcome is reasonable. We note questions 11.2, 11.3, 11.4 and 11.5 ask whether we consider the financial sums quoted are correct, however the information necessary to make this judgement is not supplied.

We consider the absence of information such as the number of customers availing of the USO (non-commercial services) and the probability formulae to estimate the ball-park costs is unreasonably preventing us giving intelligent consideration of whether the analysis is correct. We have provided a judgement of the UK Court of Appeal to support our view. We don't need all the data, but we do need more than is supplied.

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, at paragraph 108, stated as follows:

"It is common ground that, whether or not consultation of interested parties and the public is a legal requirement, if it is embarked upon it must be carried out properly. To be proper, consultation must be undertaken at a time when proposals are still at a formative stage; it must include sufficient reasons for particular proposals and allow those consulted to give intelligent consideration and an intelligent response; adequate time must be given for this purpose; and the product of consultation must be conscientiously taken into account when the ultimate decision is taken...". [emphasis added]

Consistency of detail - The majority of Eircom's claim is for uneconomic customers (circa 6.3 Million Euro compared to the total costs of circa 7.72 Million Euro) and due to the unavailability of data² this key cost is merely estimated from a probability formula yet neither the formula nor the input figures are provided. With reference to the report on non-tangible benefits Oxera do provide numerous mathematical workings and formulae yet the same is not provided for the assessment of costs. We believe that the probability formula for calculating the cost of uneconomic customers should be based on public domain industry experience hence ComReg should encourage views on whether it is correct.

Variance - On a number of occasions Tera highlight in its assessment of the Eircom USO funding application document that the information provided by Eircom was either not available or estimated using a different approach to that expected. We note Tera evaluated the information provided and considered a 1% or 2% variance acceptable. There were a number of similar instances of this and we are concerned that, in the aggregate, these add up to a significant percentage. We consider ComReg should review and explicitly state the net impact of the variances.

Wider review urgently required (2014) – We acknowledge this consultation is primarily to review the 2009-2010 USO funding application; however there is no evidence available that ComReg plans to align the USP functions with evolving and more efficient or State funded access solutions. ComReg has 'rolled-over' the USP designation on Eircom to 2014 and we would ask ComReg to urgently commence a public consultation on the function of the USP and the services provided to ensure it remains both relevant and efficient. For example the advent of 3G and 4G mobile technologies provide for more opportunity for commercial supply or to develop specific fixed access solutions using technologies such as mobile etc.

Post the 2011 transposition of the new European Communities Electronic Communications Framework and Directives we note the National Directory Database (NDD) is no longer part of the USO. We therefore consider 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.

Response to the detailed questions

11.1 —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.

Answer – We agree with ComReg's preliminary view that the consultancy costs incurred in respect of any application do not form part of the direct net cost for the following reasons:

1. We agree with ComReg that Decision D04/11 only allows costs to be claimed for the portion of the costs (both capital and operational expenditure) for the given financial year that can be directly attributed to the USP service.

² Reference Paragraph 4.38 of the consultation 13/45

2. Without prejudice to our view in 1 above the consultants work will largely inform future applications and the benefit will be spread over future claims should Eircom decide to make such claims.
3. Again without prejudice to our view in 1 above, Eircom chose to hire consultancy firms costing €881,915 (ref. clause 4.51) which is the second highest item of Eircom's request for USP funding. The figure for consultancy is higher than the combined cost claimed for uneconomic areas, payphones and service for disabled end users. This is disproportionate and unreasonable.

11.2 —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.

We do not agree with the preliminary view that the direct net cost for 2009 to 2010 is €7,139,331 for the following reasons:

1. Availability of information – As stated above, ComReg has redacted or not supplied sufficient information to enable us to provide an informed answer to whether the specific financial value is correct or not. Our answer is therefore focused on whether the correct process and inputs have been considered.
2. Choice of solution – 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. We believe from experience the Fixed Cellular Services (FCS) was a viable option. It is our understanding that this solution could be significantly cheaper in many instances but there is no evidence it has been factored into the sums claimed.
3. National broadband Scheme - '3' were awarded the State Aid National Broadband Scheme in 2008 to provide broadband services in the 30% of the nation not already covered by broadband. This service could support IP voice in those areas as the service was specified for 1Mbit/s broadband. We are aware that '3' offered a wholesale agreement to use their access solution. It's not clear whether Eircom sought to use this access facility to reach customers in what would be a significant part of rural Ireland where many uneconomic lines are located. Were these State Funded facilities used by Eircom to meet its USP obligations and if not, why not? We consider this solution should be built into an efficient USP model.

Conclusion – Whilst it appears the study has attempted to apply its analysis to what has been put before it, there is no evidence the review considered more efficient alternatives to reduce costs. We therefore consider the Eircom claim is likely to be overstated.

11.3 —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.

We are unable to determine whether the specific values are correct given the lack of financial information available however we would offer the following comments:

1. Oxera view on Intangible benefits – We note clause 7.1 last paragraph of the Oxera’s conclusions on Enhanced brand recognition raises significant concerns about Eircom’s (WIK’s) empirical estimation of the benefit of enhanced brand recognition but does not appear to offer a solution in the review, We note this aspect makes up some 90% of the intangible benefit and consider further work is needed on this part of the review.
2. Marketing – we note Oxera have addressed the issue of marketing through uneconomic phone boxes, however we would consider the marketing benefit to be wider as follows:
 - a. Telephone directories are heavily branded Eircom and detail Eircom services. These were distributed to every house in the land.
 - b. Advertising on vehicles – Eircom vans were branded with Eircom Retail products and in rural areas in particular Eircom will gain marketing benefit through its physical presence (vans) installing and maintaining uneconomic lines.
3. Value of commercial information: With reference to paragraph 5.23 we would be concerned if Eircom is availing of commercial information through the USO that should reasonably be shared with the industry. We therefore consider ComReg should investigate whether Eircom Retail are taking an unreasonable and discriminatory commercial benefit from the availability of USO information. Our view is it would be more appropriate for this information to be made available to competitors.

Wholesale Services - With reference to paragraph 5.25 our view is there is a high probability of the line staying with Eircom as most other fixed providers in non-urban areas use Eircom wholesale services. The only time a line would be lost is where the customer moves to a mobile service.

11.4 —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

We are unable to determine whether the specific values are correct given the lack of financial information available however we would offer the following comments:

1. Failure to meet USO targets – Regulation 11.1 of SI 308 2003 states:

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.”

ComReg Information Note 10/80 dated 1 October 2010 States:

“In accordance with ComReg D02/08, the failure by eircom to achieve any of the targets constitutes non-compliance”.

Regulation 11.1 of SI 308 2003 is clear that the funding is for meeting the obligations concerned (it does not address attempting to meet those obligations) and ComReg are also clear as to the targets that must be met to be compliant with meeting those obligations. In this respect we note that ComReg Information Note 10/80 records for the period 2009-2010 that Eircom failed to achieve certain key provision targets and all the fault repair targets.

Pursuant to Regulation 11.1 of SI 308 2003 and ComReg Decision D02/08 ComReg should therefore reject Eircom’s claims for costs regarding uneconomic customers due to its failure to meet mandated USO targets. We therefore consider the uneconomic lines part of the Eircom Funding claim should be rejected by ComReg.

2. Directories – The look and feel of Eircom’s directory and NDD operation is that of a standalone commercial business where Eircom obtains the industry information for no external cost and sells it on to marketing companies for them to be compliant with data protection opt out rules and separately to directory enquiry businesses. We are 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.

We note ComReg make reference to brand positioning payments but it’s not clear what these are and who benefits.

3. Payphones – We don’t agree with Eircom that all payphones with ‘negative costs’ should be assumed to be uneconomic. Our view is poor management, for example not maintaining payphones in a working order, not collecting cash in a timely way etc., could undermine the viability of economic payphones. We would suggest that a review of the operations and availability of payphones should also be assessed to ensure they are being run efficiently. The review appears too simplistic to determine whether the operation is efficient. We believe several criteria should be used to determine uneconomic payphones such as the physical location, usage and whether Eircom has applied for the phone to be removed.

11.5 —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.

We agree the industry should not be required to bear the burden of the USO for 2009 to 2010 and would like to make the following comments to support our view:

1. Eircom failed to meet its targets for the supply of USO services for uneconomic lines as we have detailed in 11.4.
2. We consider there is insufficient financial information provided (omitted or redacted) for us to accurately value the claim. Our analysis is thus limited to evaluating the processes.
3. There is insufficient evidence that Eircom sought to avail of more efficient access to meet its USP obligations, such as using Fixed Cellular solutions or NBS. If such services have been deployed there is no evidence they have been costed within the claim. Our perception and view is the claim should be a lot smaller.
4. Paragraph 6.42 of the consultation highlights that since 2009 Eircom has conducted cost reduction programs which strongly suggest inefficiencies existing in Eircom in 2009-2010. We therefore consider the level of Eircom charges were higher than that of an efficient operator, making the claim overstated.
5. As regards whether the burden is unreasonable on Eircom we offer the following:
 - a. The pricing of Eircom's wholesale and retail voice services were not cost orientated in 2009 to 2010 as the wholesale price was set by retail minus price control. Eircom maintained a high percentage of retail and wholesale lines in 2009-2010 as access competition was poorly developed at that time. We considered this allowed Eircom pricing freedom to decide whether or not to recover USO costs at that time through its retail and wholesale pricing – hence USO burden was not an issue.
 - b. ✂

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eircom Group

Response to ComReg Consultation Paper:

**Consultation and Draft Determination on the Assessment of
eircom's Universal Service Fund Application for 2009/10**

ComReg Document 13/45

Non-Confidential

5th July 2013

eircom Group response to ComReg 13/45

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Executive Summary

eircom welcomes ComReg's acknowledgement that the provision of universal services represented a positive net cost for eircom in 2009/10.

We disagree with ComReg's preliminary view that consultancy costs do not form part of the direct net cost. As we set out in our response to question 1 these costs had to be incurred solely for the purpose of meeting the requirements of Decision 04/11. Recovery of these costs is permitted by the Regulations as they are costs that would have been avoided had there been no Universal Service Obligation (USO).

The 2009/10 positive net cost is therefore €5,977,460 in contrast to ComReg's preliminary view of €5,095,545.

eircom does not accept ComReg's preliminary view that a positive net cost in the region of €5.1m or €6m is not an unfair burden. In the context of eircom's own characteristics, including the quality of its network, its economic and financial situation and its market share, such a sum manifestly amounts to an unfair burden and it is punitive to require eircom to bear it on its own.

ComReg is plainly wrong in its conclusion that an amount in excess of €5 million is not an unfair burden and shows that it has approached the matter in such a restrictive way as to make it highly unlikely that any net cost would ever be considered to represent an unfair burden. It is eircom's submission that ComReg's approach as such is unlawful and contrary to EU law. EU law, including in particular the Universal Service Directive, gives a clear right to the universal service provider to have the burden of supporting the universal service shared. The discretion granted to the Member States in deciding how to assess whether a burden is unfair is not properly exercised where it leads to a finding that in a competitive market context, where cost savings and making marginal gains are considered the norm, a net cost amounting to 5-10% of profits is not "unfair".

The concept of an unfair burden of the costs of the USO, however well intentioned when conceived as part of the EC's USO directive, has been interpreted in a very restrictive way by ComReg and Ofera. ComReg's starting premise that an incumbent operator has sufficient market power to cross-subsidise the provision of USO is the wrong place to start. The competitive nature of the markets has transformed since the 2002 USO Directive and it is unreasonable to expect eircom to shoulder the burden of USO alone. ComReg's objective is "*fair competition and a level playing field*". However ComReg seems to be perfectly happy to allow Vodafone to make a ROCE significantly above WACC (and higher than eircom's) without it having to share part of the burden. This is despite the definitive benefits that other operators get from eircom having the USO obligation; e.g. through their customers calling the uneconomic fixed-line customers. Conversely, any benefits that eircom gets from its customers calling the USO customers have already been internalised and used in accordance with ComReg's rules to reduce the positive net cost as part of eircom's calculation of the net costs of the USO.

eircom is of the view that ComReg's approach to causality is wrong. The question is whether a net positive cost constitutes an unfair burden; it is not whether that unfair burden is directly linked to the USO. Such an interpretation is not consistent with the purpose of the Universal Service Directive nor with the test set out by the European Court of Justice in the *Base* case.

eircom has also very significant concerns in relation to Oxera's assessment whether the net positive cost of USO is an unfair burden on the basis of separate profitability and materiality tests as part of the review of the 2009/10 funding application. The succession of tests is unnecessary and out of line with international best practice. In addition, having reviewed Oxera's methodology in detail we have further concluded that even if such tests were necessary or appropriate, which they are not, they have been applied in the wrong way. The following changes would need to be made to Oxera's profitability assessment to make it robust and in line with international best practice:

- Where profitability is assessed to determine whether a net cost is unfair, it must be determined in respect of the USO business, not the entirety of the fixed line business;
- The correct basis for the Mean Capital Employed is the economic value, proxied by the replacement costs of assets, as opposed to the historical costs;
- eircom's profitability needs to be compared to its actual cost of debt from 2009/10, as opposed to the ex-ante WACC calculated in 2007/08.

These changes would lead to eircom's ROCE falling to 3% under a fair value or 3% under a replacement value, that is, significantly lower than the actual WACC of 8%. It is clear that there is no reasonable evidence to support ComReg's proposition that there are super-normal profits to subsidise the USO costs.

There is no appropriate precedent for Oxera's materiality assessment. Oxera seeks to rely on 'precedents' of materiality used by a variety of institutions outside the telecoms industry. None of these precedents are relevant to these USO circumstances. They instead 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. The precedents chosen do not act to give support for Oxera's presumption that eircom would consider a 5-10% tax on its profits to be immaterial.

When Communications Regulators have set up USO materiality thresholds in the past, they have ended up with far lower numbers than Oxera have used. For example, in France the materiality threshold is €0.2 USO Cost per line and in Portugal it is €1.0 USO cost per line. This is in stark contrast to ComReg's proposal that eircom must bear at least 8% USO cost per line before this might even start to be considered material. We therefore conclude that ComReg's preliminary view that a cost of between €5m and €6m is not 'material' to be wrong. The proposed thresholds cannot be justified.

It is eircom's submission that a net positive cost that is material relative to administration costs and relative to international benchmarks, as is clearly the case here when compared to Portugal and France is an unfair burden. A funding mechanism must be established that so that burden can be shared with Industry, in accordance with the requirements of the Universal Service Directive and Regulations.

Response to Consultation

Q.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.

eircom does not agree that the consultancy costs incurred in respect of preparing applications should be excluded from the direct net cost.

These costs were incurred in order to comply with the requirements of Decision D04/11. Specifically Decision 22 of D04/11 requires that "*An independent declaration shall be signed off by the Board of Directors of the [Universal Service Provider] 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 [Universal Service Obligation] USO funding application.*" In addition, Decision 31 of D04/11 requires that "*calculation of the benefits of the USO shall be completed by an external expert, independent of the USP.*"

The legislative framework establishes that "*In undertaking a calculation exercise, the net cost of universal service obligations is to be calculated as the difference between the net cost for a designated undertaking of operating with the universal service obligations and operating without the universal service obligations.*"¹ eircom 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. As such the consultancy costs are solely and directly attributable to eircom's USO designation. The Regulations require that "*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*"². The consultancy costs clearly fall into the category of avoidable costs if there had been no USO.

The Regulations also establish that the onus for conducting independent verification sits with ComReg. "*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.*"³ It is unfair that ComReg should seek to place the financial burden of its responsibilities solely on the USP.

We cannot reconcile the three reasons ComReg offers⁴ to support its preliminary view with the relevant legislation. Taking each in turn:

¹European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) Regulations 2011 (SI 337 or 2011), Schedule 2, Part A

²European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) Regulations 2011 (SI 337 or 2011), Schedule 2, Part A

³European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) Regulations 2011 (SI 337 or 2011), Regulation 11 (7)

⁴See paragraph 4.52, ComReg 13/45

First, *“ComReg is 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 considers that this is reinforced in Part B of 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”.*

eircom, as USP, has effectively been obliged to provide services to the State to support Government objectives relating to social inclusion. The consultancy costs have been incurred solely to satisfy the requirements of D04/11. The hurdles that have been set in front of eircom to seek compensation for the provision of these services are non-commercial conditions. ComReg has incorrectly interpreted the Directive.

We also struggle to understand how ComReg considers that its preliminary view is supported by international precedent. For example in France the net cost of USO includes the calculation and audit costs *“...This includes the cost of fund management by the Caisse des Dépôts, the costs of regulatory audits required to calculate the net cost and production turnover relevant for the assessment of contributions, costs the preparation of statements and in payment by the operators, the cost of calculating the net cost of universal service by the Authority and the management of social tariff reduction device.”*⁵

ComReg’s second point is that *“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) and which could have been avoided without the USO, which are included in the net cost calculation”*

This point is very similar to the first and the clear flaw in ComReg’s reasoning is, as noted above, the consultancy costs could have been avoided without the USO. As such they are 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. 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.

ComReg’s third point is *“that the cost of making such an application is a commercial cost that carries a risk, should a positive net cost constitute an unfair burden or not.”*

Universal Service is not a commercial activity and as such this observation is not relevant. In a normal commercial arrangement for the procurement of services, the costs of administering the contractual terms would be built into the compensation model. It is not normal commercial practice to expect a supplier to provide a service at a loss when incremental administrative costs are incurred due to requirements specified in the terms of the commercial relationship.

⁵“Il convient de comparer cette somme au coût de mise en œuvre du mécanisme de financement. Celui-ci comprend les frais de gestion du fonds par la Caisse des dépôts, les coûts des audits réglementaires nécessaires au calcul du coût net et à la production des chiffres d’affaires pertinents en vue de l’évaluation des contributions, les coûts liés à l’élaboration des déclarations et des mises en paiement par les opérateurs, les coûts liés au calcul du coût net du service universel par l’Autorité et à la gestion du dispositif de réduction sociale tarifaire. Ce coût total de mise en œuvre est d’un montant inférieur à 4 millions d’euros, dont la majorité est imputable au dispositif de réduction sociale tarifaire”.P13, http://www.arcep.fr/uploads/tx_gsavis/12-0484.pdf

Q.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.

We do not agree with ComReg's preliminary view that the direct net cost for 2009/10 is €7,139,331. As explained above the legitimately incurred consultancy costs €881,915 must also be included, bringing the total to €8,021,246.

eircom has reviewed the other proposed adjustments to the direct net cost calculations and considers them to be reasonable. We agree with ComReg's view⁶ that *"these adjustments do not have a material impact in respect of the 2009-2010 application and that the data originally submitted by Eircom was acceptable."*

We have also reviewed the recommendations for future applications. These are set out in ComReg 13/45 at paragraphs 4.14, 4.15, 4.16, 4.17, 4.30, 4.32, and 4.33. Prima facie these appear reasonable suggestions for areas to be explored in future applications.

We note ComReg's comments at paragraph 4.39 regarding the use of a probability analysis to calculate uneconomic customers in economic areas. *"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."* 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. ComReg's consultants recognise and accept this.

Q.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.

eircom agrees with ComReg's preliminary view that the intangible benefits estimate for 2009/10 is €2,043,786.

eircom has reviewed the other proposed adjustments to the intangible benefits calculations and considers them to be reasonable. We agree with ComReg's view⁷ that *"these adjustments do not have a material impact in respect of the 2009-2010 application and that the data originally submitted by Eircom was acceptable."*

We have also reviewed the recommendations for future applications. These are set out in ComReg 13/45 at paragraphs 5.16, 5.21, 5.24 and 5.29. Prima facie these appear reasonable suggestions for areas to be explored in future applications.

⁶Paragraph 2.5, ComReg 13/45

⁷Paragraph 2.5, ComReg 13/45

Q.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.

eircom disagrees. For the reasons outlined above the correct positive net cost is €5,977,460.

Q.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.

eircom does not agree with ComReg's preliminary view. A positive net cost of €5,977,460, or for that matter, €5,095,545 as (incorrectly) suggested by ComReg, is manifestly an unfair burden to impose on a market participant. That is, it is a charge that is manifestly excessive for one operator to bear, taking into account that no benefit whatsoever accrues to the operator concerned as any benefit is included in determining the net positive cost. It is eircom's view that ComReg's conclusion that a net sum in excess of €5 million is not excessive shows that ComReg's approach is fundamentally flawed.

- **ComReg's starting point is wrong: in the presence of a net positive cost, what must be determined is whether to require one operator to bear that cost falls outside normal commercial standards**

The 2002 Directive on Universal Service, as amended in 2009 ('USO Directive') requires that Member States "*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.***"⁸

In this regard, it is clearly wrong to suggest that an amount in excess of €5 million is not material, or is otherwise negligible to the extent that it can be considered to be within normal commercial standards to expect one operator – which derives no benefits whatsoever from it, those having been taken into account – to bear such a charge of its own for the benefit of its competitors. In fact, such an amount, having regard to eircom's circumstances and the size of the market, is clearly punitive if it has to be borne by one operator only.⁹

ComReg is correct in stating that there are additional benefits to being the USO provider such as brand enhancement, ubiquity, marketing, etc. In eircom's case, as has been validated by ComReg, these indirect benefits are still below the costs of the USO, meaning that there is a net cost and a net positive burden. Therefore, eircom is already bearing the share of the burden for which it is compensated by 'indirect benefits'. The remaining positive net cost, clearly, needs to be borne by all operators, not just one of them.

⁸Recital 18, emphasis added.

⁹See in this respect the approach of the French Regulator which compared the positive net cost of the USO in France, in the amount of €12.6 million, to be a scale comparable to the fines imposed by the European Commission or the French Competition Authority for breach by France Telecom of the competition rules. See ARCEP Decision No. 2012-0484.

Universal service is not the only type of burden that can be found in society. The need to provide public goods imposes a burden on the population through the imposition of taxes. However, these burdens are shared by all either based on the capacity to contribute (e.g. income taxes) or based on the benefit that each party receives from the public good (e.g. tolls on roads).

In the case of universal service, similarly, the costs should be borne based on either (i) the differing operators' ability to contribute, or (ii) the extent to which operators benefit from the universal service being provided, or (iii) both. Either way, the answer would be that all operators, not just one of them, should share a positive net cost in excess of €5 million on an equitable basis such as revenue or profit sharing.

In this context it is worth reiterating that the positive net cost figure calculated by eircom and submitted to ComReg is a strictly avoidable cost that is net of any USO-related revenues, indirect benefits, etc. Therefore, the cost is clearly an expense that eircom would not have incurred had it not been designated as the USP by ComReg. It is also very relevant that eircom 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.

With this in mind, the fact that other operators are not sharing a load of more than €5 million is intrinsically unfair. Other operators benefit from the existence of a universal service provider as it provides connectivity to areas and people who would not be served otherwise. These people and areas can call other operators' subscribers and be called by them, thereby increasing the value of the other operators' services. In spite of this, ComReg's principles effectively state that it is fair for them to reap these benefits while the cost is borne by eircom alone. In spite of the fact that eircom is obliged by ComReg to incur massive costs by virtue of being the USP, and that other operators can readily leverage off these investments to sustain business cases, and make substantial profits as a direct result, ComReg, by concluding that the burden of USO provision is not "unfair" to eircom, allows all other operators, in effect, to enjoy a "free ride" at eircom's expense. This is hardly consistent with ComReg's latest Mission Statement which aspires "*to promote competition and provide appropriate protection, for the benefit of all users of communications services*"¹⁰.

- Oxera's unfair burden assessment is inherently unfair

Furthermore, the methodology followed by ComReg for the purpose of assessing whether the positive net cost that it has calculated is an unfair burden is the least likely, among the methodologies considered, to lead to the establishment of an unfair burden. eircom in this respect is of the view that ComReg's assessment is not objective and is unfair.

In particular, the number of hurdles set by Oxera makes it unreasonably unlikely that an unfair burden ever be found to exist – under the approach proposed by Oxera and followed by ComReg, any burden will appear "fair". As such, it is a methodology that is not consistent with the regulatory framework. There are seven distinct hurdles, as follows:

1. Is there a net cost of USO?
2. Does it exceed indirect benefits

¹⁰Ref. ComReg's Annual Report for 2010/11

3. Does the net cost after indirect benefits exceed administration costs?
4. Is eircom's unable to earn a fair rate of return (profitability assessment)?
5. Is the impact of positive net cost 'material'?
6. Is the net cost causing the profit shortfall?
7. Does the net cost affect eircom's ability to compete?

This complex approach, with a succession of ever-increasing and subjective tests, is very different to what has been done by other NRAs when assessing funding applications. Other NRA's have generally assessed whether the costs of the USO exceed the benefits and potentially also whether the net costs exceed a minimal threshold.

By contrast, under ComReg's approach, a single operator can be saddled with an additional cost and which can be considered as "fair", as long as it is not large enough. The existence of thresholds as the ones that have been laid out by Oxera/ComReg do not justify the existence of a burden, they just measure the magnitude of its unfairness. Measuring the magnitude of unfairness is not a condition precedent to sharing the cost of USO between operators that is required, or for that matter, is consistent with, the Universal Service Directive.

Oxera and ComReg reach the conclusion that the USO does not represent an unfair burden on eircom as it has been able to get a return above WACC. This disregards the principle that regulators should strive to create an environment where operators have an incentive to gain additional profits under fair competition. What Oxera and ComReg are implicitly stating is that the profits of the operators in the market should be the same as if a rate of return regulation on all services had been implemented. This is fundamentally incorrect and clearly at odds with the principle set by Recital 18 of the Universal Service Directive that a net cost should be funded when it falls outside normal standard commercial conditions.

Furthermore, in concluding that eircom's operating profits are such that the USO is clearly not an unfair burden, ComReg has completely disregarded eircom's current condition, including the existing cost of servicing the debt. This is entirely inconsistent with the test set by the European Court of Justice which requires that account be had of the operator's "*own characteristics*", including in particular "*its economic and financial situation*". Indebtedness is clearly a very relevant matter to the financial, and economic, situation of a company. A company can still be in a difficult situation despite having positive operating profits if these are not sufficient to service its liabilities. If, in addition to this, an additional burden is placed, the overall situation can only worsen.

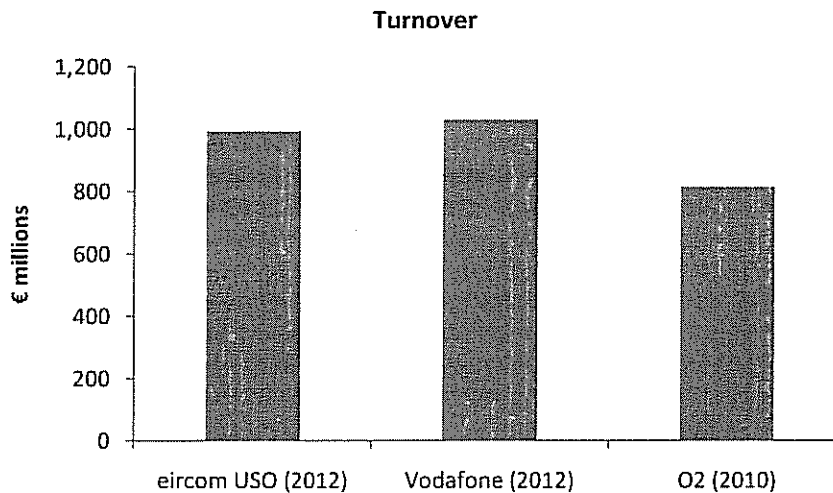
ComReg's approach implies that it is "fair" to impose a tax of 0.5-1% in revenues or 5-10% on operating profits on any company. If this is indeed the case, then the following "taxes" on the Irish telecommunications operators would be considered to be fair¹¹:

¹¹ Source: eircom's Financial statements

Operator	Revenues (millions)	Operating profits (millions)	"Fair tax" (millions)
Vodafone Ireland (2010)	€1,088	€122	€6.1-€12.2
O2 Ireland (2010)	€815	€135	€6.75-€13.5

Under ComReg's interpretation of fairness, this "tax" could be imposed on some but not all operators.

Forcing eircom to fund the positive net cost alone does not reflect the relative situation of other market players. It is not clear that the burden is being placed on the largest telecommunications operator in the country. As the chart below shows, eircom's figures do not dwarf those of other operators in Ireland. As a matter of fact, eircom's USO business is smaller in revenues than Vodafone Ireland.



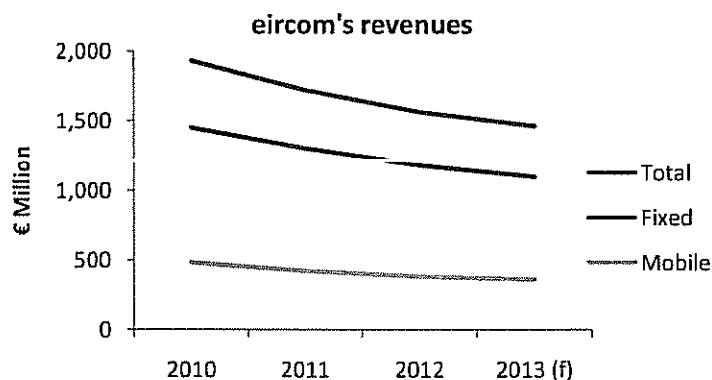
While there could have been a valid argument in the past that there were benefits to being an incumbent, recent market trends show that all these incumbency benefits have disappeared. Therefore, there is no reason why the burden should be borne only by eircom.

The underlying logic of ComReg's "fairness" criteria can also be applied in the context of other companies. For instance, what would be a "fair tax" on companies such as Verizon in the US, BT in the UK, Google or Apple? The results are shown in the table below:

Company	Revenues	Profits	“Fair” tax
BT (year up to March 2013) ¹²	£18bn	£2bn	£100-£200 million
Verizon (2012) ¹³	\$115 bn	\$10 bn	\$500 million to \$1bn
Apple (FY 2012) ¹⁴	\$ 156 bn	\$ 41.7bn	\$2-\$4 billion
Google (FY 2012) ¹⁵	\$ 46 bn	\$ 10 bn	\$ 500 million to \$1bn

We do not believe that ComReg’s notion of a “fair burden” would be regarded as fair by any of the affected companies or by any reasonable observer.

Even accepting that it could ever be found that imposing a multi-million euro burden can ever be fair, which eircom does not, eircom’s ability to bear a burden of €5 million must also be considered in the context of eircom’s specific circumstances and its declining profitability in the face of increased competition and regulation. In particular, over the past few years ComReg has taken a series of decisions that have had a significant impact on eircom’s profitability and viability, including decisions on interconnection charges and wholesale access regulations, Leased Lines, among others. These, coupled with the erosion of profit in the areas where there is significant competition have resulted in a steady decrease in revenues by eircom¹⁶, even in nominal terms.



¹² Source:

http://www.btplc.com/Sharesandperformance/Annualreportandreview/pdf/2013_BT_Annual_Report_Fin_Statement_s.pdf

¹³ Source: http://www22.verizon.com/investor/DocServlet?doc=vz_ar_2012.pdf

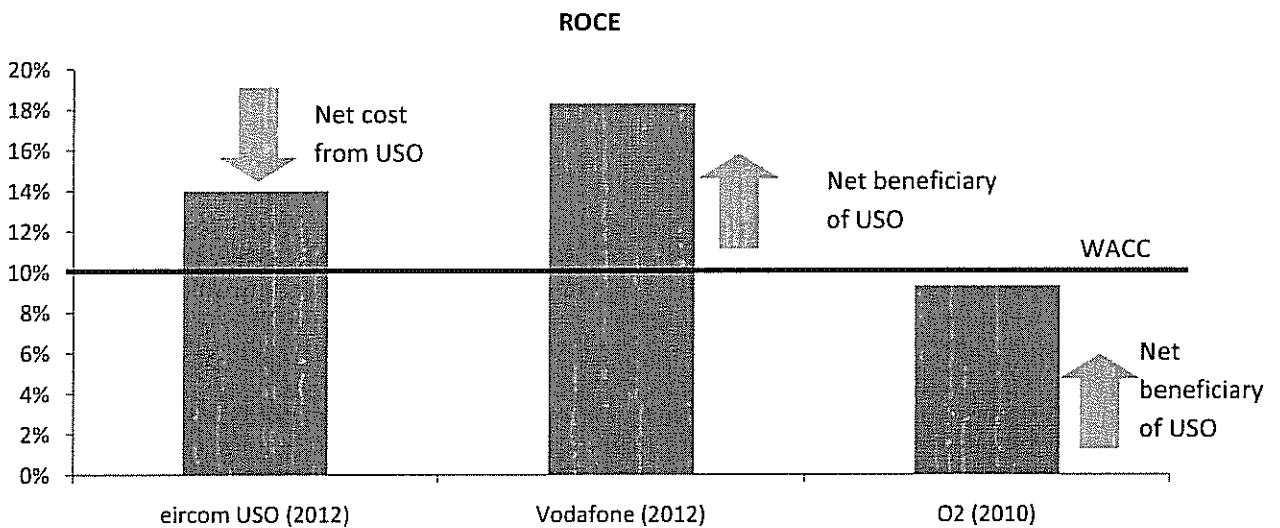
¹⁴ Source: http://files.shareholder.com/downloads/AAPL/2547626250x0x444195/E7A8FE5F-8835-46AB-ACC2-6FA28DFB546D/Three_Yr_Financial_History.pdf

¹⁵ Source: <http://investor.google.com/financial/tables.html>

¹⁶ Source: eircom

In making it impossible for any positive net cost to be found to be an unfair burden, ComReg's proposed decision has a detrimental effect on today's value of the company. Decreasing revenues not only mean that there is increased risk to the viability of the USO. It also implies more subscribers are likely to become uneconomic in the future, thereby increasing the positive net cost. As a result, today's value of the company is affected by the expectation of a cost that will continue to increase with decreasing revenues with which to fund it.

Again, in doing so, ComReg ignores what constitute "normal standard commercial conditions". As the following graph shows, ComReg has allowed Vodafone to make a ROCE significantly above WACC (and higher than eircom's) without it having to share part of the burden. This is despite the definitive benefits that other operators get from eircom having the USO obligation; e.g. through its customers calling the uneconomic fixed-line customers. By contrast, any benefits that eircom gets from its customers calling the USO customers have already been internalised and used to reduce the positive net cost as part of eircom's calculation of the net costs of the USO.



- The profitability assessment is flawed

In order to determine whether the burden is fair or unfair, Oxera's profitability assessment considers whether eircom is able to earn a fair rate of return (test 4). This assesses whether eircom's Return on Capital Employed (ROCE), is greater than its level of WACC, according to the following calculation:

$$(Revenues - Operating Costs) / MCE > WACC$$

Whilst the building blocks of Oxera's profitability assessment are what would be expected for the regulated part of the business, the specific inputs chosen will depend on the assumptions that have been chosen by Oxera. There is an inherent uncertainty in the calculation of profitability and the outcome of this test will depend in the definitions of the variables, in particular:

- Definition of relevant eircom business
- Measure of Mean Capital Employed (MCE)
- WACC figure used as comparison

We consider each of these in turn.

- Definition of relevant eircom business

In order to assess the profitability of eircom's business it is first necessary to define the scope of this business. If, in addition to providing a costly USO service, a universal services provider also owned a highly profitable unrelated business (e.g. Virgin Mobile and Virgin Money), no regulator could expect it to cross-subsidise its USO through these profits. Similarly if it had profitable operations overseas, these would not be deemed relevant. Instead the definition of the business that profits can be cross-subsidised from should be the regulated part of the business.

In table 3.3 of its report, Oxera present a comparison between the profitability assessments for three definitions of eircom's business:

1. The core USO business
2. The Fixed line business
3. The Group level

The USO business is defined as the regulated components of the businesses through which eircom would retain a position of incumbency based on being the USP. It has been proxied by Oxera using the wholesale regulated and retail PSTN and ISDN Access services. The fixed line business comprises of this USO business as well as all the remaining fixed line wholesale and retail services. The Group level also incorporates Meteor, the mobile business.

Despite setting out the legitimacy of each approach, Oxera has chosen the fixed line business to be its preferred definition. The rationale for this approach 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. As a result the separate businesses are intrinsically linked. This also coincidentally gives the highest level of ROCE out of the three alternatives.

We consider that this is not the correct definition of the business. A similar argument could be made for the inclusion of mobile services (or even another completely unrelated service that eircom may choose to offer in the future) as there will be common costs (e.g. IT, billing costs) that are shared between the services. The reason for eircom preparing separated accounts and allocating costs to different services is precisely to allow ComReg to understand the costs and revenues associated with each service. It seems counter-intuitive to then group all the separate markets together when making a regulatory decision on the basis that they share costs. Moreover any benefits flowing from non-USO services (e.g. broadband) to customers in uneconomic areas have already been internalised by eircom within the net costs of the USO.

Instead intuitively the USO business is the correct definition, as this includes only those services which are related to the USO provision. The other business definitions include other unregulated services in competitive markets. Any profits earned by other operators from these services are

retained by them. eircom should be allowed to do the same and cannot be expected to cross-subsidise from these services.

Correcting the definition of eircom's business that is under consideration will change the revenues, operating costs and MCE used; it will have an impact on all aspects of the profitability assessment. In table 3.3, Oxera have provided the ROCE for the three different businesses in 2011-12. The ROCE for the USO business was 14%, eight percentage points below that for the fixed-line business. Making this change will certainly be significant and Oxera needs to update its analysis in full, using this correct definition. We would also remind ComReg that the assessment is in respect of eircom's application for funding in 2009/10 and as such any such assessment should be based on metrics calculated for that period.

As highlighted above ComReg's proposal to base the assessment of "unfair burden" on the ROCE (Return on Capital Employed) of the fixed line business is incorrect and inherently unfair to eircom. Furthermore it is a form of double-counting, the result of which is to penalise eircom by "setting the bar" at an excessively high level, thereby facilitating ComReg in disallowing eircom's application for funding on the basis that the burden of USO on eircom for the year in question is not "unfair".

The element of double-counting arises because, in calculating the positive net cost, 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. ComReg further directed that the overall net cost figure must already have deducted from it all revenues that eircom earned in the year in question by virtue of it being the USP. However, it should be noted that these USO-related revenues contribute directly to the profitability of eircom, and consequently they contribute to eircom's ROCE. The fixed line business ROCE figure is the metric against which ComReg gauges whether or not the USO constitutes an "unfair burden" on eircom. ComReg does this by comparing eircom's fixed line business ROCE to its regulated WACC (Weighted Average Cost of Capital). Insofar as eircom's 2009/10 USO funding application is concerned, ComReg has concluded that the USO does not constitute an unfair burden on eircom in that year, as the ROCE was ~ 20% while WACC was 10.21%¹⁷. However, this ROCE figure should, for a consistent and equitable treatment of all stakeholders, and for the avoidance of double-counting, have been reduced by the removal of all USO-related revenues, which had already been used by eircom to reduce the final positive net cost for 2009/10 submitted to ComReg. We believe that this would have resulted in a significantly reduced ROCE figure against which the WACC would have been compared in order to establish the presence or otherwise of an unfair burden on eircom.

- Measure of MCE

A further change that should be made to the profitability assessment relates to the basis for the MCE. This is the denominator in the profitability equation and acts as the reference point to determine whether profits are low or high. The absolute level of profits is not relevant in this

¹⁷This WACC figure was set by ComReg in Decision D01/08 in May 2008, following a review which was initiated by ComReg in April 2007. This pre-dated the economic collapse of 2008-10, and so the 10.21% figure may not be the appropriate WACC to use in the current "unfair burden" deliberations. This issue is discussed in more detail elsewhere.

assessment, only this in reference to the MCE (i.e. the ROCE). It is therefore critical that the valuation basis for the MCE is correct.

Different valuation approaches can be used for different statutory and regulatory purposes and the application of one approach in one instance does not mean that it is necessarily correct for all other instances. 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 (given that one is not compared to the other).

In profitability assessments, it is relevant to calculate the fair value for acquiring assets as the basis for determining the MCE. Only by using this fair value, will a firm be able to truly understand if its current activities are profitable. This fair valuation then can be compared to the WACC which is calculated for the economic value of an asset. It is accepted best practice to use the current cost of acquiring assets (i.e. the MEA value) as a proxy for this fair value. The UK Competition Commission guidelines for measuring profitability explain clearly that this is the most meaningful measure to use for these assessments:

"Under current accounting standards, most assets are held at historical cost and this may differ substantially from the 'replacement cost' or 'Modern Equivalent Asset value' which the CC considers to be the economically meaningful measure for its purposes in most cases."¹⁸

Despite this guidance and the well-understood economic rationale behind it, in its profitability assessment Oxera have taken the MCE directly from eircom's HCA separated accounts. In its notes to Table 3.2 in the Oxera report, Oxera has pointed to the fact this is not the correct measure to be using through referring to a review it carried out of the CCA accounts. It explains that this review came to a comparable conclusion inferring that, whilst it may be intuitively correct, the move to a CCA measure would have no discernible impact.

Oxera does not make it clear in its Report that the only CCA accounts prepared by eircom are for its core network, and so the comparable conclusion it reaches is understandable given that the CCA valuation of the core network is typically lower than the HCA valuation. What is more relevant is whether the conclusion would still be comparable if the CCA basis was used for the entirety of eircom's USO business (i.e. core and access). Whilst Oxera did not have a full set of CCA accounts to use, we would have expected it to attempt to derive these figures for its calculation, given the clear rationale for using a fair value approach. Indeed in its guidelines for competition investigations, the UK Competition Commission explains that getting a reliable fair value valuation for the capital employed is an indispensable factor before applying this ROCE profitability assessment. *"In situations where capital employed cannot be reliably valued the CC may consider alternative measures, such as the return on sales or other relevant financial ratios."¹⁹*

We believe 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. This would then mean that the ROCE would be lower, impacting on the conclusions drawn on profitability. Analysis previously conducted for

¹⁸ Competition Commission. Guidelines for market investigations. Annex A. paragraph 13 (found at http://www.competition-commission.org.uk/assets/competitioncommission/docs/2012/consultations/market_guidelines_annexes.pdf)

¹⁹ Competition Commission, Guidelines for market investigations, Annex A, paragraph 14

eircom calculated the fair value and cost of replacement for eircom's network assets, across both the core and access networks. This was done for statutory purposes (so the valuation figures will differ from regulatory accounts given the different asset lives). However the proportional uplift from moving from an HCA approach is still broadly indicative of what would be expected for the regulatory accounts.

The results of this calculation are shown in the table below:

Asset Category	HCA (€m)	NBV	Fair Value	
			Valuation (€m)	Uplift (%)
Copper	∞		∞	∞
Duct	∞		∞	∞
Poles	∞		∞	∞
Other assets (including core network)	∞		∞	∞
Total	∞		∞	∞

This shows that the level of MCE would increase significantly if looking at the current costs. Using a "fair value" approach would lead to the MCE being approximately ∞ higher. The ROCE, which calculates profits in proportion to the MCE, would reduce by the same proportion.

This demonstrates explicitly how, as expected, the relationship between HCA and CCA is very different for eircom's core and access networks. The CCA uplift for all parts of the access network is significantly higher than observed for the core network ∞. This further calls into question the relevance of Oxera's review of the CCA accounts for the core network, and the conclusions drawn from that.

Using Oxera's assessment of the USO business as the starting point (i.e. a 14% ROCE based on an HCA valuation in 2011/12), making the necessary change to the MCE valuation would lead to the eircom's ROCE falling to ∞ under a fair value approach, below the level of WACC used in Oxera's calculation.

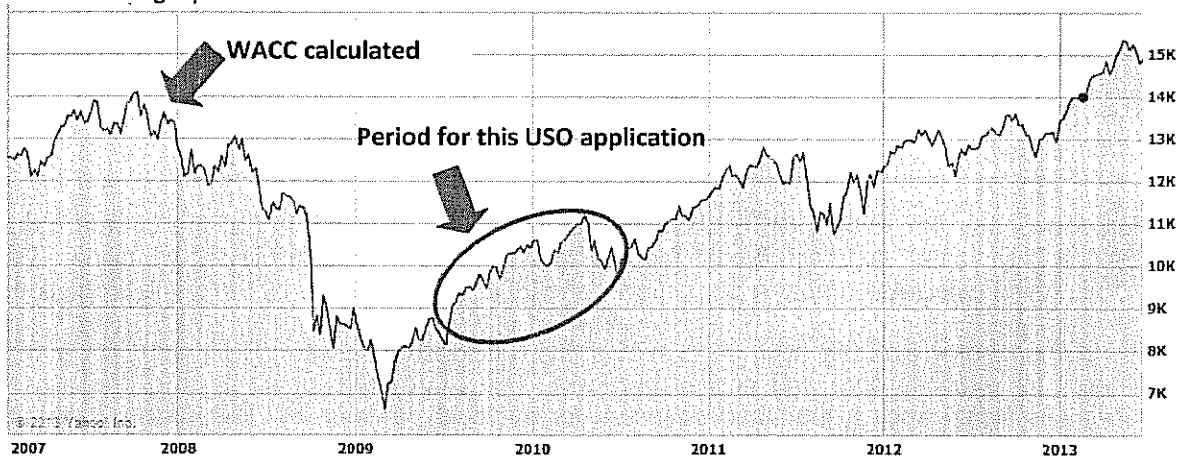
MCE Valuation methodology	Profit (£m)	Mean Capital Employed (£m)	ROCE (2011-12)
HCA valuation	197	1,374	14.3%
"Fair value" valuation	197	∞	∞

- **WACC figure used as a comparison**

In order to determine whether eircom is profitable, Oxera has used as reference ComReg's 2008 cost of capital (WACC) of 10.21%. This WACC was estimated by Oxera in November 2007²⁰.

While this WACC may have reflected correctly the market conditions in late 2007, when the ex-ante assessment was carried out, the events that followed both in global and Irish financial markets meant that the cost of capital changed considerably. These changes, including those during the 2009/2010 period, imply that any return above 10.21% was not necessarily a fair return on investment. These events and their implications on the cost of capital are discussed in the following sections.

In November 2007 the Dow Jones Industrial Average (DJI) had been near its then historical peak value of around 14,000 points. In contrast, between 2009 and 2010 the DJI was just recovering from its lowest point in years - 6,600 points around March 2009. In July 2009 it was just above 8,100 points, closing at the end of June 2010 at just over 9,500 points. The index is shown in the graph below²¹:



This volatility in the capital markets evidences an increased perception of risk among investors, leading to a need for greater returns on their investments, be it equity or debt.

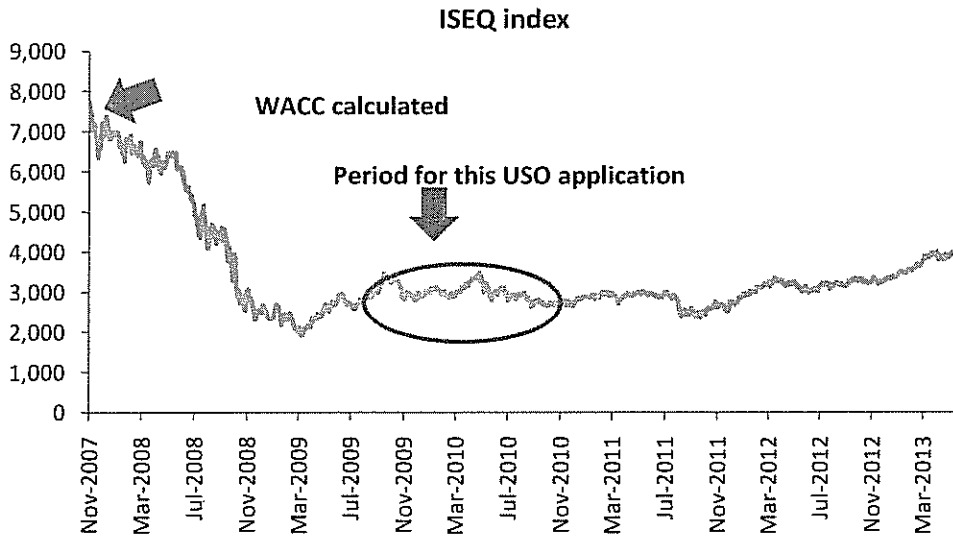
Ireland was one of the countries hardest hit by the fallout of the global financial crisis. Not only did the stock market plunge, but Irish bond yields rose to levels which eventually required the country to request a bailout and impose severe austerity measures.

As the following graphs for the Irish stock market and Irish 10year bonds show, the Irish environment was very different in 2009/10 compared to November 2007. In November 2007 the Irish Stock Exchange Index²² was still around 7,000. By the period between July 2009 and June 2010 it had reached levels of around 2,500 points, which were still a slight recovery from the historical lows in April 2009 when the index dipped below 2,000 points.

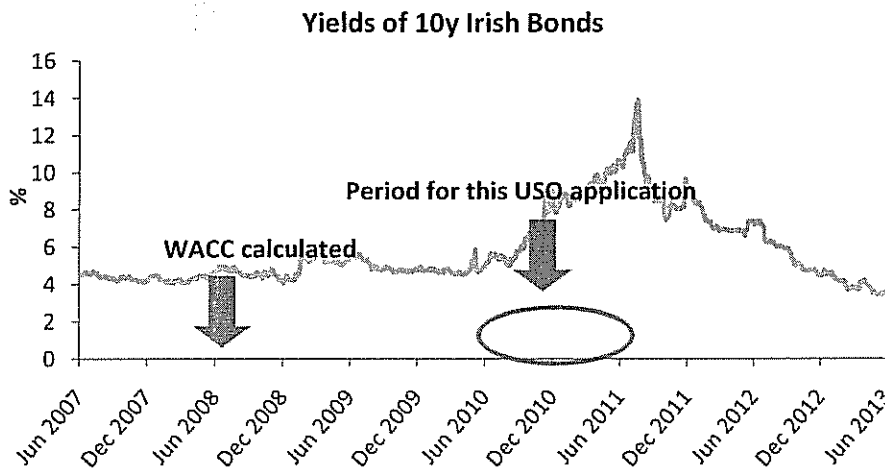
²⁰<http://www.comreg.ie/fileupload/publications/ComReg0788a.pdf>

²¹ Source: Yahoo finance

²² Source: <http://www.ise.ie>



The increased volatility in global and Irish financial market meant that both equity holders and bond holders were requiring higher returns on their investment. The implications of this can be seen in the yields of Irish bonds. Yields on Irish bonds²³ had also increased and by June 2010 they had reached a level of 5.6% and went on to reach a high of 8.7% by the end of 2010. While the yields of these bonds are now close to pre-crisis levels, the period after 2010 would see these yields reaching unsustainable levels.



In summary, the increased volatility in global and Irish financial market meant that both equity holders and bond holders were requiring higher returns on their investments. Therefore, eircom

²³ Source: CapitalIQ

would have had to fund its operations, including the USO, with a higher cost of capital during 2009/10.

To assess the possible impact on the cost of capital, two of the parameters that are used for the calculation of the cost of capital need to be adjusted: the risk free rate and the beta.

The changes in the risk free rate are a result of the increased yields of the Irish sovereign debt and its effects on the cost of debt of Irish companies as these generally pay a spread over this debt. The changes in the beta measure how the perception of risk of a specific business changed given the increased perception of risk in the market.

The table below shows the effects of adjusting these two parameters. This is not intended to be taken as a rigorous recalculation of the WACC but rather as an indication of the possible cost of capital that Irish telecommunications companies could have faced in 2009/10, in 2010/11 and 2011/12.

Parameter	ComReg's 2008 WACC	2009/2010 reality	2010/2011 reality	2011/2012 reality
Risk Free (10yr Irish Bonds)	5%	6% ²⁴	8% ²⁵	8.2%
Cost of debt	6.9%	7.9%	9.9%	10.1%
Asset beta	0.57	0.78 ²⁶	0.76 ²⁷	0.59 ²⁸
Equity beta	1.02	1.4 ²⁹	1.36	1.06
Post tax cost of equity	10.87%	14.21%	16.18%	14.55%
WACC pre-tax	10.21%	13.03%	15.05%	14.02%

The above does not take into account the fact that equity risk premiums should have also increased nor the fact that eircom's debt is considerably more expensive than market rates. For instance, eircom's last debt issuance reached yields of 9.5%³⁰.

²⁴ Based on CapitalIQ data and taking into account the yield levels seen throughout 2010

²⁵ Based on CapitalIQ data and taking into account the yield levels seen throughout 2011

²⁶ Source <http://pages.stern.nyu.edu/~adamodar/> Based on Damodaran's beta for telecommunications services companies for as of 01/01/2011

²⁷ Source <http://pages.stern.nyu.edu/~adamodar/> Based on Damodaran's beta for telecommunications services companies for as of 01/01/2012

²⁸ Source <http://pages.stern.nyu.edu/~adamodar/> Based on Damodaran's beta for telecommunications services Global

²⁹ The adjustment originally used by Oxera to convert from asset to equity beta is unclear. An approximation has been made by increasing it in the same proportion, taking into account that the D/E ratios and tax rates remain the same.

³⁰ <http://www.independent.ie/business/irish/eircom-set-to-pay-95pc-rate-in-new-bond-issue-29253089.html>

To conclude, the actual cost of capital that was faced by Irish telecommunications companies in 2009/10 was above the levels that were estimated in November 2007. It is therefore 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. While the determination of a regulatory WACC for ex-ante remedies is generally in line with international practice, the assessment of the existence of the unfair burden is carried out as ex-post analysis. ComReg can therefore use existing historical information from the relevant periods (e.g. 2009/10) as a basis for its analysis.

- **ComReg has set materiality thresholds at unreasonably high levels**

Following on from its profitability analysis (test 4), Oxaera undertakes a further separate analysis to understand if the impact on the USP's profitability is material (test 5). Oxaera considers that this additional analysis is necessary because ComReg's decision states that it will "assess whether or not this net cost **significantly** affects a USP's profitability".

It is not obviously clear how one can assess whether the effect of a net cost is significant or not. In the modern competitive telecoms environment where there is an ever-increasing focus on cost reduction programmes and achieving marginal gains, the concept of a net cost being immaterial is simply anachronistic.

Oxaera have relied on definitions of materiality used in 'precedents' by a variety of institutions outside the telecoms industry.

- Ofwat;
- Ofcom (for postal sector);
- Ofgem;
- International Federation of Accountants; and
- Australian Accounting Standards Board.

Ofwat (1)

Ofwat uses materiality when determining what Licensees need to report in their financial statements.³¹ Companies are required to separate out their total business into the regulated and non-regulated activities. Ofwat however has allowed companies to publish the financial statements for the total business if the non-regulated activities are less than 1% of the total business in terms of turnover, profit and assets.

Ofwat explain that "A low materiality threshold of 1% has been chosen for this purpose since the implicit threshold in the Licence is 0% and because companies should only disregard non – appointed activities if they are genuinely immaterial in the context of the total business of the Appointee".³²

This reference to materiality by Ofwat is clearly being used to reduce the reporting burden of a licensee. It acts to set the maximum level that a company can potentially deem to be immaterial

³¹ Ofwat, Regulatory Accounting Guidelines 3.06, February 2007, Found at http://www.ofwat.gov.uk/regulating/eud_rag_contregacc_306.pdf

³² Ibid para 3.2.8

in the context of its reporting, rather than imposing on companies a level below which a cost (that is actually incurred by the company) can be regarded as immaterial.

Royal Mail Group (mistakenly referred to as Ofcom)

Oxera claim that "Ofcom also uses 1% of revenues or costs as a materiality threshold in the context of regulatory reporting for postal services" based on an unnamed and undated document they have found on Ofcom's website³³. Some further research into this document shows that in fact that it was published on 25th June 2010, prior to Ofcom taking responsibility for the Postal Sector. In fact the document was prepared by Royal Mail and is an earlier version of an annex from its ABC Costing Manual³⁴. Oxera appears to have mistaken this document as prepared by a regulator.

Royal Mail Group has explained that it uses a materiality threshold of 1% of costs to determine whether its modeling has been compliant with its modeling principles. There is no reference to a threshold of 1% of revenues at all within the cited document. This use of methodology by Royal Mail in its modeling is not relevant at all to that which Oxera is seeking to implement for determining a level of costs to be immaterial. It is one thing not to have to report an amount but quite another to have to pay that amount.

Ofwat (2)

Oxera included a second precedent from Ofwat within its report. Ofwat sets prices for water companies on an ex-ante basis for a five yearly price review period. However within this ex-ante price setting arrangement, Ofwat allows interim determinations whereby water companies seek to reset their price limits if "specific changes lead to a significant reduction in their revenues or increase in their costs"³⁵.

The materiality threshold that Ofwat uses for the aggregate effect of changes to be considered "significant" is 10%, with a change related to an individual issue being considered to be a relevant if it is worth more than 2% of revenue.

Oxera claims that this precedent is "arguably a more direct read-across to the imposition of a sharing mechanism to fund the net cost of the USO". However a materiality threshold that is being set to define the level of changes which is "significant" to force a change in the price regulation mechanism would naturally have to be set at relatively high levels (as revenues fluctuate and are difficult to predict). This type of materiality threshold has no relevance to the question to be addressed, namely what constitutes a level of net USO costs that is so immaterial that it can be expected to be borne by one of them

Ofgem

Ofgem has also used a materiality threshold to determine the uncertainty mechanism for when it may be justified for its ex-ante eight year price control to be amended. Ofgem has set the

³³<http://stakeholders.ofcom.gov.uk/binaries/post/1878.pdf>

³⁴ See Royal mail Group. ABC Costing Manual 2012-13. December 2012. Annex B for an undated version of this same document (found at http://www.royalmailgroup.com/sites/default/files/ABC_Costing_Manual_v2012-3.pdf)

³⁵<http://www.ofwat.gov.uk/pricereview/setting/interim/>

threshold at one per cent of allowed expenditure in year one of the price control. However, just as with the Ofwat precedent, we do not think a materiality threshold that is being set to define the level of changes which is “significant” to force an ex-ante price to be changed has any relevance to eircom’s funding application.

International Federation of Accountants

The IFA precedent that Oxera relies heavily on relates to materiality in the context of an audit and determining if financial statements have been misstated. Oxera suggests that the IFA has suggested rules of thumb values for assessing materiality in these contexts. In fact the numbers quoted by Oxera are merely “*illustrative examples of percentages applied to benchmarks that might be considered.*”³⁶ However the IFA is clear that “*the determination of what is material to the users is a matter of professional judgment*”³⁷ and “*the auditor may consider higher or lower percentages than those illustrated above to be appropriate.*”³⁸ Referring to this illustrative example as a “precedent”, as Oxera has done, does not appear well founded.

More importantly the IFA example is again not relevant to eircom’s funding application. This materiality is assessing whether a mistake in financial reporting needs to be corrected or not. This auditing definition of materiality is used to determine what needs to be reported. It is not relevant to the actual costs a company would consider to be immaterial, and therefore would not be concerned if remained unfunded.

Australian Accounting Standards Board

The final precedent relied upon by Oxera also relates to what level of materiality is relevant in the context of financial reporting. Just as the IFA has done, the Australian Accounting Standards Board notes that materiality is a matter of professional judgment but has provided guidance to explain that if the omitted/misstated item is worth less than 5% of the relevant total base amount (e.g. in terms of revenue/cost/profit) then it is typically considered immaterial and if it worth more than 10% it is typically considered material. Oxera has only included half this guidance (the reference to 10% figure) within its reference.

More importantly this precedent is again not relevant to eircom’s funding application. Just as with the IFA reference, this materiality is assessing whether a mistake in financial reporting needs to be corrected or not. This auditing definition of materiality is used to determine what needs to be reported. It is not relevant to the actual costs a company would consider to be immaterial, and therefore would not be concerned if remained unfunded.

None of these precedents are relevant to these USO circumstances. They instead 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. The precedents chosen do not act to give support for Oxera’s presumption that eircom would consider a 5-10% tax on its profits to be immaterial.

³⁶ International Federation of Accountants, *Materiality in the Identification and Evaluation of Misstatements*, 2004, paragraph 14 (See <http://www.ifac.org/sites/default/files/meetings/files/1568.pdf>)

³⁷ Ibid paragraph 13

³⁸ Ibid paragraph 14

We submit that it is simply inappropriate that ComReg would transpose concepts from one area of regulation to something completely different. Oxera uses these unrelated precedents as the basis for its calculation, because it states that "There appear to be few other regulators that have used the concept of materiality in the context of the net cost of the USO"³⁹. In eircom's view, this confirms that the approach followed by Oxera and ComReg is neither necessary nor appropriate for the purpose of the Universal Service Directive and Regulations.

Oxera's Report nonetheless includes a reference, in a footnote to a decision of Anacom's (the NRA in Portugal) concerned with determining a materiality threshold for USO costs. Oxera does not consider this to be "*strictly linked to an assessment of materiality*" and so does not rely on this as a precedent. However having reviewed the Anacom document it is clear that this is in fact what Anacom is doing when setting a materiality threshold of €2.5m. This precedent is much more relevant than the convoluted precedents that Oxera uses, which are irrelevant for this regulatory purpose.

In any event, the Anacom decision considers another materiality threshold for assessing USO costs. In particular, Anacom was guided by the threshold of €4m set by the Arcep (the NRA in France) when considering USO costs in France. This is also a direct precedent that Oxera should have made use of.

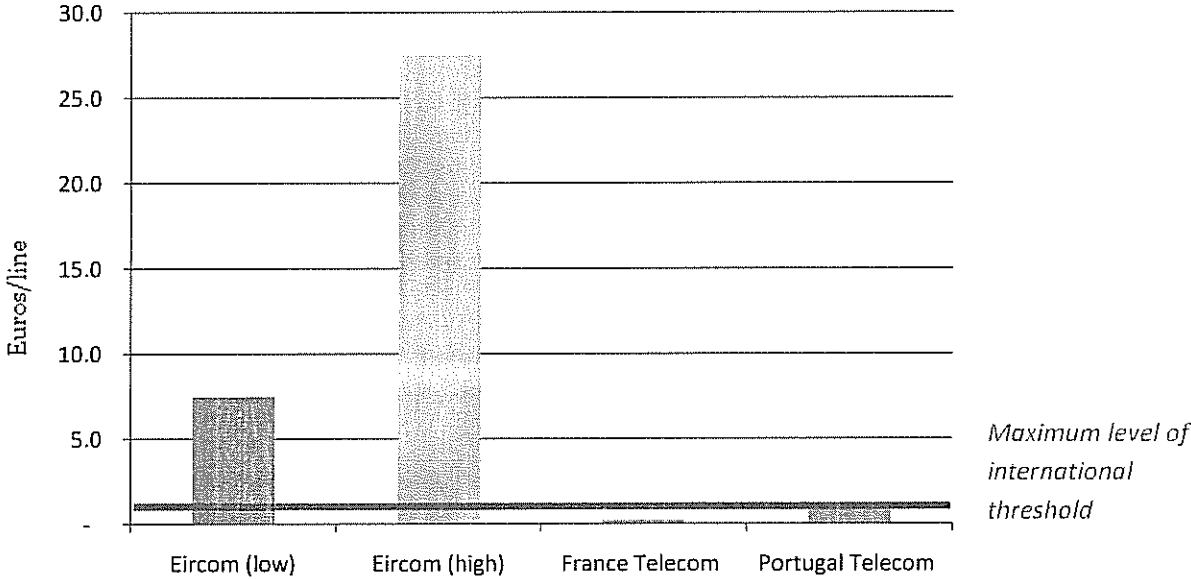
It is striking that the materiality levels chosen in France and Portugal, for the same purpose, are significantly lower and this is all the more striking when account is taken of the significantly higher subscriber numbers and revenues that Portugal Telecom and France Telecom have, as shown below in the table and charts below.

Operator	Materiality threshold (€m)	Fixed line Revenue (€bn)	Threshold as % of revenue	Number of Fixed Line subscribers	Threshold as proportion of lines (€/line)
eircom (low threshold)	€6m	€1.6bn	0.4%	0.8m	7.5
eircom (high threshold)	€22m	€1.6bn	1.4%	0.8m	27.5
France Telecom	€4m	€12.4bn	0.03%	17.6m	0.2
Portugal Telecom	€2.5m	€2.7bn	0.09%	2.6m	1.0

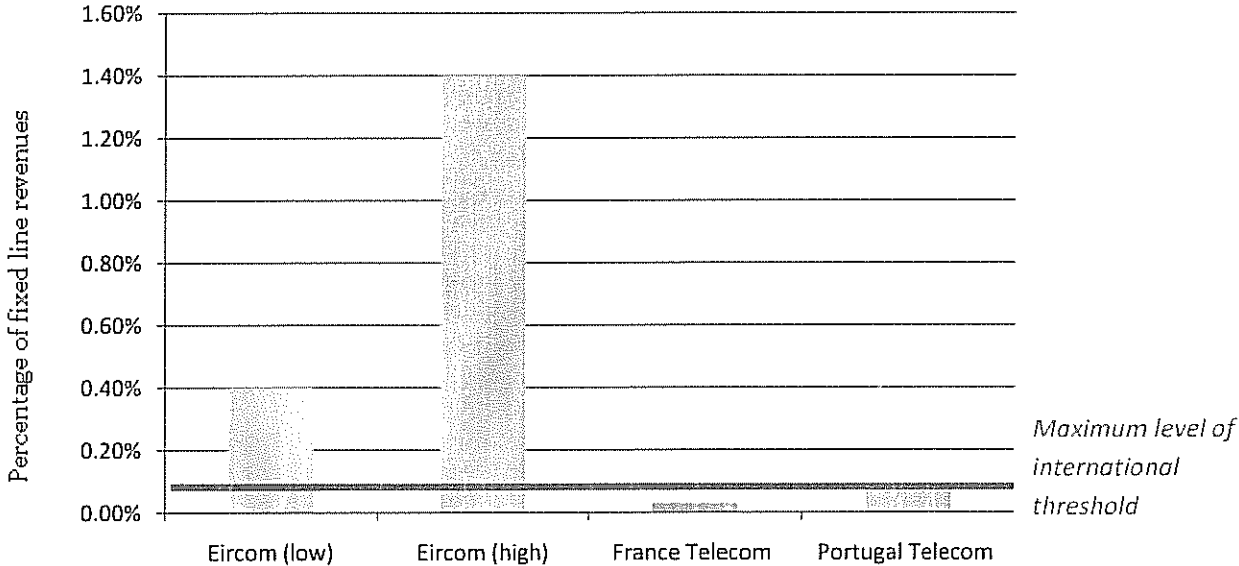
³⁹Page 15 of the Oxera report

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USO materiality threshold as a proportion of fixed line subscribers (€/line)



USO materiality threshold as a proportion of fixed line revenues (%)



Given the precedent for significantly lower materiality thresholds, and the lack of basis for Oxera’s approach, we believe that the net cost of the Universal Service in Ireland definitely should be considered material.

- **ComReg’s analysis is incomplete**

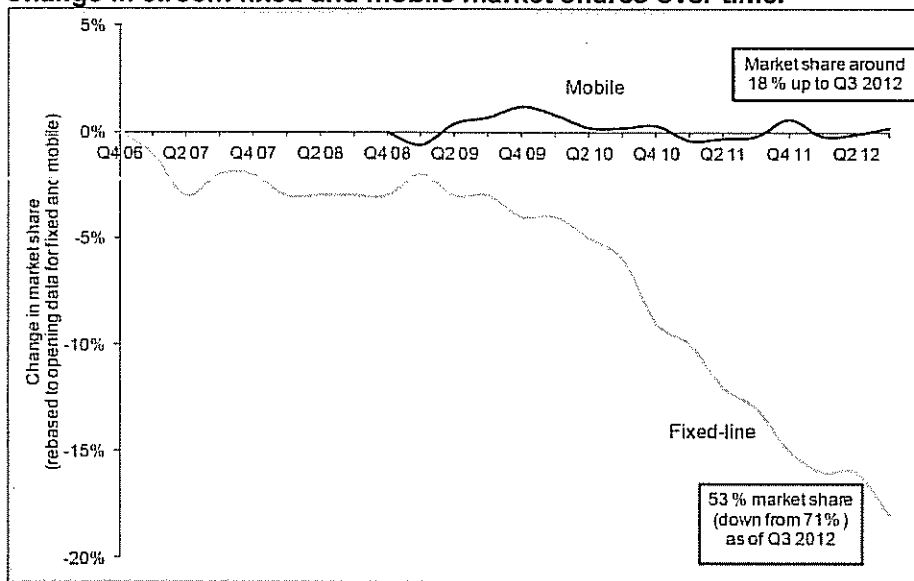
ComReg is of the view⁴⁰ that it is “... not necessary for the 2009-2010 application and draft determination under D04/11 to consider Decision 41 of D04/11 for the reasons outlined in section 6.4.1.4 of this chapter [i.e. that eircom’s fixed line business achieved ROCE in excess of the WACC that ComReg established in 2008]) ... 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.”

In doing so, ComReg declined to conduct the analysis that ComReg had proposed in Decision 41 of D04/11, namely: Does a positive net cost impact eircom's ability to compete on equal terms with competitors going forward?

Such an approach totally ignores the profitability implications of the loss of lines, and thus of revenue market share in the fixed line business. 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. This approach also disregards the impact that other ComReg decisions have on these outcomes. The combined effect of these oversights distorts the results of the analysis, thereby reaching economically incorrect conclusions.

As the Oxera report itself acknowledges, during the period in which eircom was allegedly earning supra-competitive profits, its market share by revenues of the fixed line market declined quite massively.

Change in eircom fixed and mobile market shares over time.



⁴⁰ComReg 13/45, paragraph 6.48

In a number of European Member States, it has been argued that an incumbent that continues to possess more than an 80% market share is not subject to an Unfair Burden. The incumbent is still presumed to possess substantial pricing power. It should be possible for the incumbent to cross-subsidise the loss on uneconomic customers from those customers from whom the incumbent continues to make substantial profits.

eircom was not in that position in 2009/10, and is far from that position today. Per Oxera's own figures, eircom's fixed line market share by revenues was 71% in 2009, and declined to 53% in Q32012.⁴¹

eircom's ability to cross-subsidise is greatly undermined by this line loss. Moreover, the lines that are lost tend to be those that are most profitable. Line loss has been more significant in urban areas than in rural areas.

Under other circumstances, eircom would respond to increasing competition by reducing prices in areas where competition is most intense; however, the USO requires eircom to maintain uniform prices and has the perverse effect of preventing eircom from taking those actions that a prudent business would normally take.⁴²

The net cost of universal service is not the only factor at work here, but it is a significant factor that has been improperly analysed by ComReg and its consultant. The true effect of the net cost of providing universal service has been a substantial impact on eircom's competitiveness, and thus a substantial impact on eircom's profitability going forward. ComReg's analysis is deficient as it has failed to consider the impact on competitiveness.

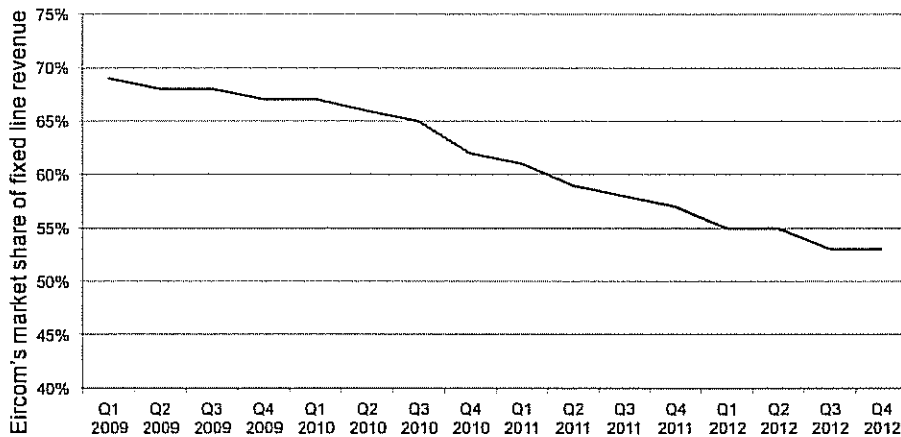
- Conclusion

It is clear under the case law of the Court of Justice of the European Union that in assessing whether there is an unfair burden, consideration must be given to whether that burden is excessive in view of the undertaking's ability to bear it, account being taken of all the USP's own characteristics, in particular the quality of its equipment, its economic and financial situation and its market share. It is eircom's view that in the light of this, it is an inescapable conclusion that a positive net cost in excess of €5 million constitutes an unfair burden for it to bear, that is, an excessive charge.

It is useful to recall the evolution of market shares in Ireland. The following diagram shows eircom's revenue share in the fixed line market in Ireland.

⁴¹ ComReg 13/45c, page 20

⁴² eircom has, of course, used price differentiation to retain market share in instances where it is permitted to, such as competition for the business of enterprise customers.



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Between 2009 and 2012, eircom's share of fixed line revenue has decreased from around 69% to around 53%. Given this level of eircom's market share and given the trend involved (a loss of around 16 percentage points amounts to a loss of 23% of eircom's share over the course of four years!) it would be extremely difficult for anyone to argue that the Irish telecoms sector is akin to a monopolistic environment in which there is a strong incumbent who can be asked to shoulder the burden without any concern for its long term viability.

An even more drastic picture emerges when one considers the more relevant market as set out above (IDD and national calls, and corporate customer revenues). In this market, eircom has lost over 70% as competitors, naturally, have concentrated on high margin products and customers – often without committing to infrastructure investment anywhere near the order of magnitude of eircom's.

Given that these revenues now accrue to several operators in the market, clearly, the funding of the positive net cost should be provided by all of those parties including – but not limited to – eircom.

The question of materiality, as such, is also a valid one. Suppose the positive net cost calculation resulted in a negligible amount (say €1,000 –€10,000), presumably, there would not be any debate about the funding of such costs. On the other hand, the question is whether €5m - €6m is negligible. That a sum of €5m - €6m could ever be considered negligible is a proposition that is simply untenable.

In this regard, eircom's fundamentally disagrees with Oxera's approach to determining the existence of an unfair burden. In particular the successive application of separate profitability and materiality tests as part of the review of the 2009/10 funding applications is unnecessary and out of line with international best practice. Having reviewed Oxera's methodology in detail we have further concluded that these unnecessary tests have been applied in the wrong way.

We believe that the following changes need to be made to Oxera's profitability assessment to make it robust and in line with international best practice;

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- The correct definition of eircom for the profitability assessment is the USO business, as opposed to the fixed line business;
- The correct basis for the Mean Capital Employed is the economic value, proxied by the replacement costs of assets, as opposed to the historical costs;
- eircom's profitability needs to be compared to its actual cost of debt from 2009/10, as opposed to the ex-ante WACC calculated in 2007/08.

These changes would lead to eircom's ROCE falling to \times or \times under a fair value or replacement value respectively, significantly lower than the actual WACC faced of \times . There are no super-normal profits to subsidise the USO costs.

There is also no appropriate precedent for Oxera's materiality assessment.

eircom's view in respect of materiality is that in view of the amount of the net positive cost for the year 2009-2010, it is not necessary to seek to set the level of materiality at which the net positive cost becomes an unfair burden. This is because €5 million is clearly material. However, eircom notes in any event that a sum in excess of a sum of €5m - €6m will be considered to be material both when compared with the costs of implementing a funding mechanism and where compared against international benchmarks.

We note in this regard that the cost of the funding mechanism was estimated at a maximum of €400,000 by ComReg and there is no doubt that the positive net cost (whether as calculated by eircom or as adjusted by ComReg) significantly exceeds this threshold.

As for international benchmarks, we are aware of two other countries only where a materiality threshold has been imposed in the context of funding: France and Portugal. The thresholds were set at €2.5m (Portugal) and €4m (France). The positive net cost in Ireland as adjusted by ComReg exceeds both of these values, even without making any adjustments for country size.

Adjusting for country and/or network size only makes it even more evident that eircom's net positive cost exceeds the benchmark thresholds by a large margin:

- On a per line basis, the materiality thresholds in France and Portugal are €0.2 per line and €1 per line, respectively. The positive net cost per line in Ireland, however, is in excess of €5 per line.
- On a revenue basis the materiality thresholds in France and Portugal are 0.03% and 0.09%, respectively. The net positive cost as a share of Fixed Line revenue in Ireland, however, is in excess of 0.3%.
- A similar calculation looking at the benchmark materiality thresholds as a share of profits leads to the same conclusion.

eircom accordingly submits that ComReg's preliminary finding that a positive net cost does not constitute an unfair burden, that is, that it does not constitute an excessive charge for eircom having regard to eircom's own characteristics, is simply untenable.

Taking all of the above into consideration the only reasonable conclusion that can be reached is that the positive net cost in 2009/10 was an unfair burden on eircom. ComReg must therefore move forward to establish a funding mechanism.

Magnet Networks Limited (hereinafter 'Magnet') welcomes the consultation and ComReg's conclusion being that *"the positive net cost does not represent an unfair burden on Eircom"* as set out at page 68 of the ComReg Consultation paper.

1. Transparency:

Magnet is concerned that throughout the various documentation published by ComReg and its agents, a perception arises that a disproportionate approach to *"commercially sensitive information"* may have been taken or allowed.

2. Discussion/Information gaps:

Magnet is concerned that gaps emerge in relation to key components of the net cost calculation. We particularly emphasise the calculation of uneconomic customers.

3. Divergence of Approaches:

Magnet is concerned at the scale of divergence by Eircom from ComReg's methodology as specified by ComReg in document/decision reference 04/11, should be fully addressed in any further outputs.

4. Flexibility of approach taken by ComReg:

Magnet is concerned that an overly flexible or tending to be permissive stance taken by ComReg to the level of Eircom divergence from ComReg document/decision 04/11, should be addressed in any further outputs.

5. Verification of Eircom inputs to the net cost calculation:

Magnet is concerned about the process and verification undertaken by ComReg to the various inputs in the net cost calculation. This relates directly to point 1, above and should be properly addressed in any further output from ComReg.

6. ComReg and its agents approach and methodology in dealing with unverified Eircom inputs related to the net cost calculation:

Magnet is again concerned about the process and verification thereof. Again, this relates directly to point 1, above and should be properly addressed in any further output from ComReg.

It is Magnet's view that the combined effect of the above items may result in systemic flaws, especially, if certain assumptions and assertions are left unverified and unavailable to the market for review.

Magnet would prefer a regime and process whereby any unsubstantiated figure or input is simply rejected until such justification or defence can be proffered to validate the impugned input/s.

Further, Magnet expresses serious concerns on the approach taken by ComReg to the extent that it will allow Eircom simply *"fix issues in future applications"*. Magnet believes that this approach is seriously, if not fundamentally flawed and the current application should fail for lacking clarity and merit.

The market, and indeed ComReg, deserves better treatment than to be told to assume certain matters that are simply left period upon-period for a decision to be taken *ex ante* and those matters can be “*fixed*” at a later time.

Magnet submits 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. Anything less must simply be rejected in its entirety.

Magnet believes, as will be apparent from the above listing 1 – 6, that this USO Consultation process has not been sufficiently transparent. The obvious and varied lack of detail on many key elements relating directly to the net cost calculation are such that Magnet are simply unable to properly, and moreover cogently, evaluate ComReg’s draft decisions.

Magnet remark that it is obvious that the continual permitted extensions to the USO processes, stemming from the applicant operator, exemplify the imbalanced nature of this and future USO consultation processes. This is evident on a simple review of ComReg Reference 13/49 and its accompanying documentation.

Magnet firmly believes 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. That finding being that Eircom has met the first condition for determination of an unfair burden in its application for 2009 - 2010, namely that: “*There must be a verifiable and verified direct net cost*”.

Magnet have numerous concerns relating to a plethora of issues not specifically addressed by the questions posed by ComReg in the within consultation document.

Finally, Magnet suggests that USO remains an unwanted hangover that should simply be dispatched on terms and conditions properly consulted upon by ComReg. Having long and protracted periods of USO funding reviews creates a privative or jaundiced view of the Irish Communications market that should be ended. This is over and above the almost permanent search for information Magnet’s CEO/CFO and investor on any potential accrual for paying into a USO fund – which is the correct and responsible approach in the circumstances, however, leads to budgetary uncertainty year on year in an organisation.

Interpretation of the Universal Service Directive:

It is Magnet’s view that Eircom, ComReg and their various consultants (in this instances: Oxera and TERA) appear to assume that the relevant component of universal service is necessarily delivered using Eircom’s fixed line network.

At paragraph 3.1 of ComReg 13/45, ComReg states that:

“the USO ensures basic fixed line telephone services are available to end users at an affordable price” (emphasis added).

Magnet disagrees with this interpretation of the Universal Service Directive 2002/22/EC.

The Directive as transposed into Irish law states;

“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.”¹

As such, the Directive does not specify service provision through fixed line technology as implied by ComReg and might include other technologies.

ComReg’s assumed and as yet unjustified provision of universal service through fixed line technology carries throughout the consultation.

For example *Figure 1: Overview of the net cost calculation and unfair burden assessment methodology*² this seems to imply that ComReg reviewed only the historic cost of the copper network model in assessing the cost of the universal service provision.

Magnet believes this is not correct, as the cost of Universal Service should be assessed on the basis of efficient provision that extends to use of alternative technologies.

Unfortunately, Magnet is not in a position to quantify the impact of this incorrect approach, given the lack of detail provided in the ComReg consultation documents.

However, 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.

Magnet believes that these omissions and deficiencies in ComReg’s methodology, and in Eircom’s approach in its application, need to be properly and thoroughly addressed.

ComReg’s intention to commission an expert report and publish a decision on the sharing mechanism, even though as yet there is no unfair burden or need for sharing:

Paragraph 2.10 states that: *“ComReg is 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”)⁹, which will be published in due course, ComReg is commissioning an expert report in respect of the most appropriate principles of any mechanism established in an Irish context”.*

Magnet believes that this is potentially a wasteful and inefficient use of ComReg and industry resources given that ComReg’s initial assessment of Eircom’s first application for funding (2009 – 2010) concludes that there is no unfair burden and therefore no need for a sharing mechanism now.

Additionally, Magnet believe, that based on European precedent, the level of any potential net cost will fall drastically over time. Trend experienced in Europe clearly show significant declines in net cost amounts from the initial assessment over subsequent years, as unjustified costs are simply removed.

Question 1

¹ S.I. No. 337 of 2011, section 3.

² P. 19 ComReg 13/45.

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.

Magnet agrees with ComReg's preliminary view that consultancy costs should not be included in direct net costs. These costs are optional and are not a core part of providing an universal service to an end user and thus, should not be recovered by the USO.

Question 2:

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

Magnet would point out the inclusion of one off connection charges that were averaged across 2006-2010 (as outlined in the TERA report at page 15) is incorrect. However, Magnet submits that one off connections relates to new units/premises built in this period and the percentage decline in new premises from 2006 where 93,419 houses were completed to 26,420 completed in 2009, which indicates a 72% decline.³ Thus, it can be taken that in 2006 eircom incurred nearly 3 times the once off cost of connections than in 2009 and thus, Magnet believe a downward adjustment in this is required to reflect the reduced number of avoidable costs in non-economic areas. Thus, due to Magnet's inability to verify data it is unable to agree or disagree with ComReg's preliminary view.

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 detailed reasoning to support your views.

Magnet questions why ComReg have proposed a decrease in the life cycle benefits. Thus, Magnet believes that the intangible benefits to Eircom are €2,087,105. Magnet also contends that though Eircom may have a USO, they do not service all areas of the country and the National Broadband Scheme provides broadband which allows VoIP calling, thus, removing need for eircom's wired or wireless service. Magnet also believes that there is a tipping point in the customer lifecycle where they become profitable and thus, the life cycle amount estimated by Eircom should not be reduced.

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 detailed reasoning to support your views.

Due to the fact as outlined in Answer 3, Magnet does not agree with the intangible benefits and also believe that the direct costs should be reduced to reflect reduced costs of one off connections in non economic areas, the figures outlined above should in fact be less than that indicated.

³ <http://www.independent.ie/irish-news/number-of-houses-built-at-35year-low-26619071.html>

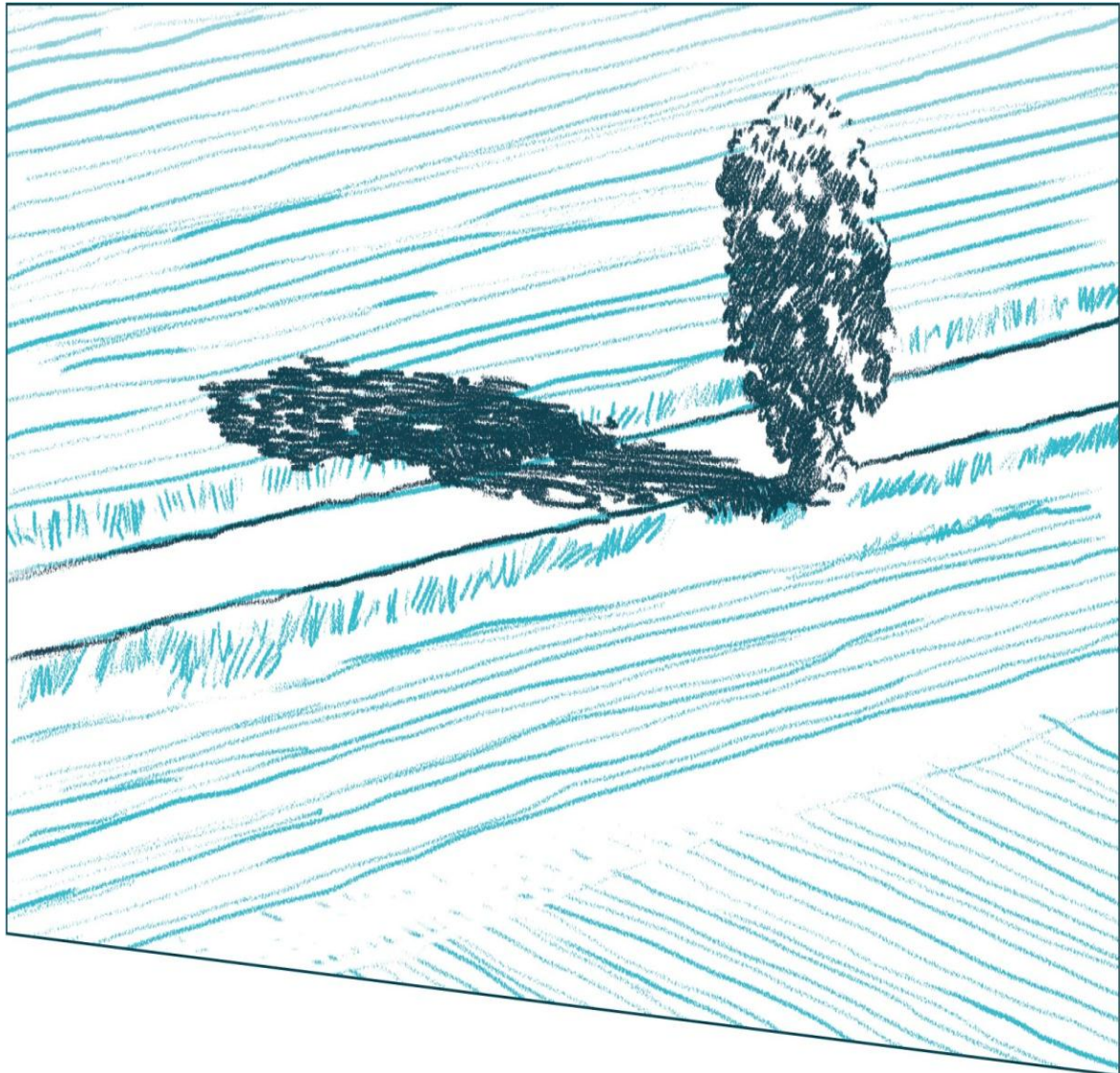
Question 5:

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.

Magnet agrees with ComReg's assessment that it is not an unfair burden on Eircom to provide the USO service. All the reasoning that ComReg have outlined is sufficient support to Magnet's view.

Overall, Magnet believe that the data set out within this consultation should be verified in greater depth rather than complicity accepting eircom's approach and figures. Magnet do not believe that the USO is an unfair burden and that burden will decrease in the future. Magnet feels that with the current rollout, and the Ministers announcement on broadband rollout plans (which is sufficient for VoIP) that the concept of a USP is now redundant.⁴

⁴ <http://www.irishtimes.com/news/technology/government-starts-logging-reach-of-broadband-1.1449066>



**Response to Draft Decision
on the
Assessment of eircom's Universal Service Fund
Application 2009-2010**

Telefonica

Preliminary Comments

Telefonica welcomes ComReg's draft decision on the assessment of eircom's universal fund application 2009-2010, and supports ComReg's draft decision in relation to the non-existence of an unfair burden.

In previous responses to ComReg on Universal Service, Telefonica has made it clear that it disagrees with ComReg that Telefonica, as a mobile operator, would have any liability to a fund created to compensate a fixed Universal Service Obligation (USO). Telefonica would argue that USO is the provision of a service to a fixed location. This is clearly stated in the Universal Service Directive. Telefonica does not provide a fixed service, except under an access contract to fixed business customers, and at maximum any consideration of Telefonica's liability should be based on its activity in the fixed market only.

Telefonica also has concerns that ComReg did not take the opportunity in this draft decision to clearly define a funding mechanism which would clarify for operators ComReg's approach to a funding mechanism. It is also disappointing that ComReg did not take the opportunity to clarify the funding status for future years. In fact ComReg added to the uncertainty by announcing its intention to commission a new expert report on the sharing mechanism despite finding there was no unfair burden. The uncertainty remains as this draft decision only relates to one year and eircom have the opportunity to apply for funding for subsequent years despite there being a clear set of criteria to define an unfair burden which would not change significantly from year to year. If ComReg can prospectively define a Universal Service designation and scope, ComReg can also define the criteria and likelihood of unfair burden based on existing eircom financial data.

Telefonica would note the long time this process has taken and the obvious difficulty in getting the complete and correct set of data. ComReg should argue that any unsubstantiated figure or input supplied by eircom is simply rejected until such justification is provided. Telefonica also has serious concerns that ComReg appear to allow Eircom simply "*fix issues in future applications*". There are issues of transparency and process which are of concern in this draft decision that may emerge in future consultations in this area.

Response to Consultation Questions:

Q. 1. Q. 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.

Telefonica agrees with ComReg's preliminary view.

Q. 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.

Telefonica has concerns that the calculation of the net cost is based on assumptions and incomplete data and we cannot accept that the value arrived at is a correct net cost.

Q. 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.

Telefonica, for the reasons highlighted above, is not in a position to agree with ComReg's calculation of the intangible benefits.

Q. 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.

Please refer to responses 2 and 3 above.

Q. 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.

Telefonica agrees with ComReg that a positive net cost does not automatically mean an unfair burden nor does it automatically give rise to the need for USO funding. We agree with ComReg that this is not an unfair burden.

Telefonica would further note that the reasoning from ComReg implies that in part the criteria for assessing an unfair burden has been partially met through the assessment of a net cost. Telefonica would disagree that the net cost has been assessed either completely or transparently. It is evident throughout the consultation documents published by ComReg that there are significant deficiencies in the data provided to ComReg in the Eircom application.



**UPC Ireland Response to: ComReg 13/45
Consultation and Draft Decision on the
Assessment of Eircom's Universal Service
Fund Application for 2009-2010**



Introduction

UPC Communications Ireland Limited (“UPC”) welcomes the opportunity to provide its response to ComReg on its Consultation and Draft Decision (“the consultation”) on the assessment of eircom’s universal service fund application for 2009-2010.

While UPC welcomes ComReg’s overall conclusion that “*the positive net cost does not represent an unfair burden on Eircom*”¹, UPC has a number of serious concerns in the following areas:

1. Lack of transparency throughout the four documents published by ComReg and a disproportionate approach to “commercially sensitive information”.
2. Lack of information on key components of the net cost calculation. In particular, the calculation of uneconomic customers.
3. Scale of divergence by eircom from methodology as specified in ComReg 04/11.
4. ComReg’s overly lenient approach to the level of eircom divergence from ComReg 04/11.
5. Scale of unverified eircom inputs to the net cost calculation.
6. ComReg and ComReg consultants’ approach to dealing with unverified eircom inputs to the net cost calculation.

Taken together, the effect is that ComReg and its consultants consistently accept assumptions, assertions and figures which are subject to severe methodological flaws and lack of appropriate justification and substantiation. UPC strongly believes any figure that increases the net cost calculation which is not appropriately substantiated by eircom and subsequently validated by ComReg should be rejected by ComReg. Further, 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 believes that this approach is fundamentally flawed - the current application (2009 – 2010) should stand or fall on its own merit or lack thereof. ComReg should not accept in the current application or future applications, ‘fixes’ which result in figures falling short of unequivocal verification. The onus is on eircom as the applicant to make the case for inclusion in a robust and verifiable manner.

In addition, UPC believes the current USO consultation process has not been sufficiently transparent. The lack of detail provided on key elements of the net cost calculation is such that UPC is unable to properly evaluate ComReg’s draft decisions. These deficiencies will be further highlighted throughout this response. 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 – 2011², the deadline for which has now been extended to 11th November 2013 following an extension request from one single entity, eircom, the current USO provider.

UPC believes the lack of detailed information makes it impossible for third parties such as UPC to verify the basis for ComReg’s proposed decision. However, based on the

¹ ComReg 13/45 page 68.

² ComReg 13/49.



limited information that is available, UPC would strongly assert that the number of errors made by eircom in its application, the frequency of deviation from the ComReg methodology as specified in Document 04/11 and the scale of unverified inputs should be enough cause for ComReg to have found that eircom did not meet the first condition for determination of an unfair burden namely that, “*There must be a verifiable and verified direct net cost*”.

Finally, UPC has concerns on a number of issues not specifically addressed by the questions posed by ComReg in the consultation document which are set out as follows:

1) Incorrect interpretation of the Universal Service Directive

Eircom, its consultants, ComReg and its consultants (Oxera and TERA) all appear to have assumed that the relevant components of universal service are necessarily delivered using eircom’s fixed line network. In paragraph 3.1 of ComReg 13/45, ComReg states that “*the USO ensures **basic fixed line** telephone services are available to end users at an affordable price*” (emphasis added). UPC disagrees with this interpretation of the Universal Service Directive 2002/22/EC (‘the directive’). The directive as transposed into Irish law states;

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.*³

As such, the directive does not specify service provision through fixed line technology as implied by ComReg and can in fact include other technologies such as mobile.

ComReg’s unjustified and in UPC’s view, incorrect assumption that the universal service can only be delivered via fixed line technology is referenced throughout the consultation. For example, *Figure 1: Overview of the net cost calculation and unfair burden assessment methodology*⁴ seems to imply that ComReg reviewed only the historic cost of the copper network model in assessing the cost of the universal service provision. UPC believes that this is incorrect as the cost of universal service should be assessed on the basis of efficient provision which extends to use of alternative technologies including mobile. Unfortunately, given the lack of detail provided in the ComReg consultation documents, UPC is not in a position to quantify the impact of this incorrect approach. However, as 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 would eliminate or very substantially mitigate any net cost to eircom. UPC believes that these deficiencies in ComReg’s methodology and

³ S.I. No. 337 of 2011, section 3.

⁴ p.19 ComReg 13/45.



in eircom’s approach to its application should ideally be addressed in the current application review process and has to be addressed in future applications.

2) ComReg intention to commission an expert report and publish a decision on the sharing mechanism, even though as yet, there is no unfair burden incurred or requirement for a funding mechanism

Paragraph 2.10 states that: *“ComReg is 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”)⁹, which will be published in due course, ComReg is commissioning an expert report in respect of the most appropriate principles of any mechanism established in an Irish context”.*

UPC believes that this is a wasteful and inefficient use of ComReg and industry resources particularly given that ComReg’s assessment of the eircom application for 2009 – 2010 does not give rise to an unfair burden and as a result, there is currently no need for a sharing mechanism. Further, UPC believes the level of any potential net cost will fall over time. As ComReg will be aware, the trend in Europe clearly shows significantly declining net cost amounts from the initial assessment over subsequent years, as unjustified costs are removed from the net cost calculation. For example, in France the original net cost amount calculated in 1998 of €275m declined to €30m by 2010, and in Spain the original net cost amount of €203m declined to €43m by 2010.

USO Net cost (France and Spain)

	1998	1999	2000	2001	2002	2003	2004	2009	2010
Spain			€203m	€181m	€110m	€120m	€83m	€46m	€43m
France	€275m	€110m	€128m	€142m	€124m	€53m	€33m	€29m	€30m



UPC's response to specific questions in ComReg 13/45:

Q. 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.

UPC agrees with ComReg's preliminary view that consultancy costs incurred in respect of any application do not form part of the direct net cost. Firstly, these costs were not directly incurred as a result of the provision of USO services and secondly, although not stated, were surely not incurred during the funding period under review i.e. 2009 – 2010. Further, this expenditure by eircom was entirely discretionary and in any case should be excluded as an inefficiently incurred cost.

Q. 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.

As a rule, UPC believes that increases to the net cost calculation should be excluded if their inclusion is not properly validated and decreases should be included if not shown to be legitimately excluded. The onus is on eircom as the applicant to make the case for either in a robust, verifiable and transparent manner.

Given the scale of unverified inputs used by eircom in the net cost calculation and the lack of detail provided by ComReg, UPC is not in a position to agree or disagree with ComReg's calculation of the direct net cost for 2009 – 2010 of €7,139,331.

UPC concerns on the direct net cost calculation include the following:

- ComReg's consultation document contains one and a half pages of discussion on the eircom customer model, which in of itself provides very little information. Similarly the model is also discussed in minimal detail in the various consultant documents, but there is little to be gleaned from these as they are so heavily redacted. Given that eircom's alleged "Uneconomic Customers" make up €6,454,978 (over 90%) of the direct net cost calculation, UPC believes this lack of detailed discussion is unacceptable and has resulted in an entirely unbalanced consultation process. ComReg must address this imbalance by significantly increasing the level of transparency and most definitely if it ever finds in favour of an unfair burden which results in industry funding.



- UPC is particularly concerned with regard to the leniency with which ComReg and its consultants treat clearly flawed inputs by eircom in its application. For example, the replacement call rate used by eircom was deemed acceptable even though the rate used by eircom dates from 1997. TERA consultants acknowledge that the “*replacement call data is old⁵ and that telecommunications have evolved a lot during the last 15 years*”, yet do not insist that eircom use more recent and valid data for the calculation of the replacement rate. Further, TERA also state that the fixed replacement call rate is linked to the mobile penetration rate, stating that “*in Belgium, where the mobile penetration rate was low (92% - 102.9%)⁶ the replacement rate on the fixed network was high i.e. 9 – 13%*”, yet TERA go on to state that “*eircom’s fixed replacement call rate of 2 – 8% is consistent with international benchmarks*”. UPC is surprised by this statement given that the mobile penetration rate in Ireland in 1997 was no more than 46%⁷. This illogical statement is wholly unacceptable to UPC. ComReg and its consultants must clarify this statement.
- 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. While there is reference to these payments in the TERA report (paragraph 1.1.1), it is still unclear exactly how these subsidies were assessed. UPC requests ComReg to clarify this point.
- The exclusion of certain revenues from the calculation as stated in paragraph 4.14 of ComReg 13/45, “*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*” (also referred to in paragraph 1.1.1 of the TERA report as *VOIP over fibre and data services over fibre*) is unacceptable to UPC. All revenues derived as a consequence of Universal Service Provider (USP) designation should be included. Further it is certainly not acceptable that “time constraints” are stated as a reason for TERA not seeking further information to validate their exclusion given that this process has been on-going for a number of years. UPC requests ComReg to quantify and clarify the exclusion of revenues not generated over the copper network. In this context, it is also not clear to UPC how eircom revenues from its home security service for the period under review 2009 – 2010 i.e. (pre-disposal) have been considered in the net cost calculation. UPC requests ComReg to provide clarification on this point.
- UPC believes that there are far too many deviations by eircom from the net cost calculation methodology specified in ComReg 04/11 for this to be a credible application by eircom and more importantly, for this to be acceptable to ComReg

⁵ TERA: Assessment of eircom’s USO funding application for 2009 – 2010, section 1.1.4.1.

⁶ Table 3 p.20 TERA report

⁷ ODTR0021, section 3.2



and its consultants. Eircom's treatment of one-off charges is a good example of the unacceptable level of divergence from 04/11 which when combined, not only call into question the credibility of eircom's application, but also the assessment of that application.

- UPC also believes there has been inappropriate use of sampling and incorrect geographic allocation of revenue in eircom's application. In paragraph 4.16 ComReg states: "*Sampling methods were applied to direct revenue, as only calling party aggregated data was available for the whole year*". Again, UPC would argue that in general, increases to the net cost calculation should be excluded if their inclusion is not properly validated. Similarly, decreases should be included if not shown to be legitimately excluded.
- With regard to the "Payphone model", ComReg state in paragraph 4.46 that "*WiFi costs were incorporated*". UPC does not understand why WiFi costs should be incorporated since this is not within the scope of universal service unless used as a delivery technology for provision of the telephone service. UPC requests ComReg to clarify this point.

Q. 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.

Given the lack of detail provided by ComReg, UPC is not in a position to agree or disagree with ComReg's calculation of the intangible benefits for 2009 – 2010 which amounts to €2,043,786.

UPC is particularly concerned with the degree of criticism the consultants themselves have in relation to eircom's approach in its calculation of "Brand recognition benefits". The seriousness of the criticism is at a level that it calls into question the credibility of the entire eircom application for 2009 – 2010. These criticisms include:

- Formula errors "*in the calculation of the willingness to pay premium using Amarach's customer survey data*". As stated by Oxera, "*the required adjustment led to an increase in the willingness to pay premium and the brand recognition estimate.*"⁸
- Concerns expressed by Oxera regarding the appropriateness of the survey questions posed by Amarach in order to estimate the USO related premium.
- Concerns on the survey sample size used. "*Oxera queried the reliability of survey data owing to the small sample size used to estimate key parameters of the USO related premium*"⁹ (emphasis added).

⁸ ComReg 13/45, p.45, section 5.12

⁹ ComReg 13/45, p.46, section 5.14



- Counterintuitive model predictions used by WIK which as stated by Oxera “raise questions about the validity of WIK’s assumptions and the applicability of the model.”¹⁰

Unfortunately UPC does not have sufficient information to understand the cumulative impact of these deficiencies in the eircom application and would request ComReg to clarify and quantify the impact.

UPC is also concerned that eircom’s approach to the calculation of marketing benefits is very narrow in scope and as a result, understates the level of benefit considerably. For example, UPC would question why the following benefits do not appear to be included:

- Improved targeted marketing and uptake of *all* eircom products (broadband, bundles, home security, mobile) as a result of access to customer information acquired by consequence of the USP designation.

Q. 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.

Please see our response to questions 2 and 3 above.

Q. 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.

UPC agrees with ComReg’s statement in paragraph 6.3 that “*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*”.

However ComReg goes on to state in paragraph 6.8 that:

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

- There must be a verifiable and verified direct net cost;*

¹⁰ ComReg 13/45, p.45, section 5.11



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”.*

ComReg further states in paragraph 6.9 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**.....”* (emphasis added).

UPC strongly rejects this preliminary view that the first two criteria are met. It is evident throughout the consultation documents published by ComReg that there are significant deficiencies in the data provided to ComReg by eircom in its application. UPC believes that the scale of these deficiencies is such that the credibility of eircom’s application is significantly undermined and it is clear that the first of the criteria stated above has not been met, namely that *“there must be a verifiable and verified direct net cost”*. In particular, the lack of transparency or ability for third parties to verify costs put forward by eircom for “Uneconomic Customers” which account for 90% of the net cost calculation is entirely inappropriate. Further, such an approach is unlikely to withstand more rigorous scrutiny by the industry should operators decide to challenge any future finding of an unfair burden on the USO provider.

In Conclusion

While UPC welcomes ComReg’s overall conclusion that *“the positive net cost does not represent an unfair burden on Eircom”*, UPC believes that eircom’s application and ComReg’s review of that application are fundamentally flawed. The entire process has not been sufficiently transparent to enable UPC to properly evaluate eircom’s application or ComReg’s preliminary decisions based on that application. The scale of divergence from the methodology as specified in ComReg 04/11 and the level of unverified inputs to the net cost calculation is such that the credibility of the application and ComReg’s review of the application is called into question.

Based on the above, UPC calls upon ComReg to reverse its preliminary finding that eircom has met the first condition for determination of an unfair burden in its application for 2009 – 2010, namely that *“There must be verifiable and verified direct net cost”*.

Finally, that this condition has not been met should not reverse the final outcome of this decision, namely *that a positive net cost of €6,225,219 or €5,095,545 for 2009 – 2010 is not an unfair burden on eircom.*





Vodafone Response to ComReg Consultation and Draft Determination on the Assessment of Eircom's Universal Service Fund Application for 2009-2010

Non Confidential

Introduction

Vodafone is taking this opportunity to comment on ComReg's consultation and draft determination on the assessment of Eircom's Universal Service Fund (USF) Application for 2009-2010. Vodafone's views are summarised as follows;

- It 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 believes that this consultation process is seriously flawed as the level of redaction implemented by ComReg means that it is impossible to meaningfully assess whether the ultimate costs of USO arrived at by ComReg and its advisors have been properly derived.
- Vodafone believes 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.
- 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.
- In summary Vodafone believes that the net cost to eircom of its designation as USP is far lower than assessed by ComReg and that the "profitability" analysis carried out by ComReg to ascertain 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.

These points are expanded upon in the body of Vodafone's response.

Validity of eircom's funding claim

Given that this claim is for the period July 2009 to June 2010 inclusive, it is Vodafone's view that the claim is governed by the European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) Regulations 2003 (SI 308 of 2003) 'the Regulations'.

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**, [emphasis added] it may submit to the Regulator a written request for such funding.*"

It is clear that what is permitted to be claimed by a designated undertaking is the net cost of meeting the obligation, not funding for attempting to meet it, partially meeting it or failing to meet it. For a request for funding to be valid the undertaking must have actually met its obligation. This is a necessary precondition for submitting a request.

Therefore the procedure to be adopted in assessing any request must have as its first step an assessment of whether eircom as USP has met its obligation. This element is entirely absent from ComReg's analysis of eircom's request.

Regulation 10(4) of the Regulations provides that *"(T)he Regulator may set performance targets for those designated undertakings in respect of the services referred to in Regulation 3 and in respect of such other services referred to in Regulations 4, 5, 6 and 8 as the Regulator deems appropriate from time to time. In so doing it shall have regard to any views expressed by interested parties, in particular pursuant to public consultations carried out in accordance with Regulation 27."*

ComReg did precisely this by way of its decision instrument D02/08. In this Decision ComReg specified the performance targets for the provision and repair of access at a fixed location. This Decision therefore defines the minimum service levels that must be achieved for eircom to have met its obligations imposed under Regulation 3 of the Regulations.

In its information notice 10/80 ComReg itself confirms this interpretation where it states at page 2 *"ComReg D02/08 published on 28 May 2008, set legally binding performance targets for eircom to meet its obligations in respect of the services referred to in Regulation 3 of the European Communities (Electronic Communications Networks and Services) (Universal Service and Users' Rights) Regulations 2003. In accordance with ComReg D02/08, the failure by eircom to achieve any of the targets constitutes non-compliance with its regulatory obligations."*

In the same information notice, ComReg sets out eircom's actual performance against the mandated targets in respect of fault rate occurrence, service connection and fault repair for the period July 2009 to June 2010.

In respect of "In-situ Connections" eircom failed to meet one of the three performance targets. In respect of "All Other Connections" eircom failed to meet one of the five performance targets. In respect of "Agreed Date completion for all connections" eircom failed to meet the sole performance target. In respect of "Fault Rate Occurrence" eircom failed to meet the sole performance target. In respect of "Fault Repair Times" eircom failed to meet all four of the performance targets. In respect of "Agreed Date completion for Repairs" eircom failed to meet the sole performance target.

ComReg itself has set out that eircom has failed to meet the mandated performance targets under all headings. As a result eircom has failed to meet its obligations under Regulation 3 of the Regulations for the period July 2009 to June 2010. eircom is not permitted to submit a request for funding in accordance with the provisions of Regulation 11(1) in respect of meeting the obligation imposed under Regulation 3 as it has not met this obligation.

As a matter of law ComReg must therefore reject any such claim as invalid.

Viewed through a different lens ComReg, in D02/08, has set the minimum mandatory service performance parameters which a service must meet before it can be considered to be a fit for purpose Universal Service. A service which doesn't meet these minimum parameters may be similar to Universal Service in many respects but it is not Universal Service as defined by ComReg. If it is not Universal Service then the USP has no right to seek funding from others for its provision.

Other matters

Without prejudice to Vodafone's position as to the legal validity of eircom's funding request in respect of its obligations Regulation 3, Vodafone wishes to make further comments on the consultation. These comments are set out further below.

Assessment of Confidentiality

Regulation 15 of the Framework Regulations provides that *"For the purpose of these Regulations the Regulator shall, subject to the Freedom of Information Acts 1997 and 2003, accept as confidential any information provided to the Regulator which is expressed to be confidential, except where the Regulator has good reason to consider otherwise."*

ComReg has set out guidelines for how it will treat confidential information (ComReg document 05/24). In its own analysis of the relevant statutory provisions relating to the treatment of confidential information ComReg concludes *"... all of the above provisions give ComReg a measure of discretion with regard to the treatment of information for which confidentiality is claimed."*

In relation to the carrying out of consultations the basis for conducting valid consultations has been summarised as follows: *"To be proper, consultations must be undertaken at a time when proposals are still at a formative stage; **it must include sufficient reasons for particular proposals to allow those consulted to give intelligent consideration and an intelligent response;** [emphasis added] adequate time must be given for this purpose; and the product of consultation must be conscientiously taken into account when the ultimate decision is taken."*

More recently it has been elaborated that even after a confidentiality undertaking has been justifiably given, a consulter remains under a positive duty, at appropriate stages in the process, to take all reasonable steps to obtain permission to disclose the information. In deciding what are reasonable steps it must keep firmly in mind the high importance of fairness and transparency, and the importance of the respective information to understanding the appraisal. Having regard to other case law it must particularly strive to seek permission to disclose the economic model and /or the data contained therein. In proceedings for judicial review, the court should afford due weight to the decision of the consulter as to what amount to reasonable steps, but may grant relief if the court considers that the consulter has not taken such steps as are reasonable in all the circumstances of the case.

Elsewhere decisions have been overturned on appeal by virtue of the fact that the consulter failed to make available executable versions of economic/financial models during the consultation process [reference].

These clarifications of the duties of consulters must condition how ComReg exercises the discretion, which it itself asserts it has, in the treatment of confidential information.

The ultimate purpose of the process being consulted on would be to determine the level of contribution that operators (including eircom) might have to make in respect of the provision of USO. Eircom has two distinct roles in this process, on one side it is the potential beneficiary of any Universal Service Fund (USF) and on the other in common with other operators it is a potential contributor to any Universal Service Fund. In respect of this second aspect there exists a very significant information asymmetry between eircom and the other operators. Not only has eircom had full visibility of its own information but it would appear that it

has had visibility of the analysis carried out by ComReg and its advisors and has had an opportunity to provide substantive and detailed comment on this.

It is clear from even a cursory examination of the consultation documents that ComReg has failed to carry out a critical assessment of assertions of confidentiality. By way of example, in the Tera report titled "Assessment of eircom's USF funding application for 2009/10 financial year" (hereafter the Assessment Report) at pages 14, 15 and 19, not only is the substantive data redacted but so too is the source of this data. It is difficult to conceive that in the circumstances of a USO funding application the sources of data could be properly maintained as confidential. 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). This blanket approach to redaction indicates that ComReg has not properly assessed the confidentiality/transparency balance. This in turn calls into question whether any of other redacted information should properly have been made available to consultees.

Vodafone also has concerns that ComReg has incorrectly redacted information relating to the generic telecommunications market generated by it or its advisors which it relies on but has not made available for comment or review. By way of example, an assessment of replacement call rates is not information related to eircom or its business but is an assessment of the calling habits and patterns of end-users. This information, which is independent of eircom, would apply no matter what undertaking was designated as the USP. Where this information has been produced by ComReg there does not appear to be any reason why ComReg should assert confidentiality over it, especially in circumstances where it appears to have shared it with one operator. Even where this information has not been shared with eircom, ComReg would have to justify why market generic information which is relied on in the decision making process has not been made available for comment. The apparent flaws in the reasoning behind this redaction call into question the validity of all other confidentiality assessments made by ComReg.

Leaving aside the details of the redactions in the workings of the modelling perhaps the most obvious instance of questionable redaction is the fact that ComReg and eircom consider as confidential the number of lines provided under the USO. We 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. Given that these are meant to be lines that are uneconomic to provide absent the USO, there does not appear to be any market impact from revealing how many of them there are.

It is relevant to note instances where comparative information has been referenced from other jurisdictions. This information is obviously in the public domain. This raises the question as to why this type of information would be confidential in Ireland but not elsewhere.

Consultation Questions

Q. 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.

In evaluating the net cost of providing USO, the approach adopted is to consider what costs could have been avoided if eircom did not have USO. Absent USO as a eircom, as a rational profit maximising entity, would only provide those services on which it did not incur losses. In order to do this it would need to model the profitability breakpoint for the service in question.

It would appear that the modelling carried out by eircom in respect of its USO funding request, including estimation of intangible benefits, is substantially the same as it would need to carry out absent USO in order to determine which requests for PSTN connection it should refuse to meet on the basis that they were not profitable.

It would appear therefore that the 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.

Q. 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.

General Principles

At paragraph 4.2 of the consultation document ComReg sets out that "A key factor in assessing the direct net cost involves ascertaining the efficiency of the USP, *"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."*

In order to properly give effect to the requirement that *"the USP is not compensated for inefficient decisions in the past or costs incurred inefficiently"* it is necessary to determine whether the technology that the USP has chosen to meet its obligation is efficient particularly in terms of cost.

The 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.

This is reflected at paragraph 3.81 of D04/11 where ComReg states:

"As discussed in the Draft Decisions Paper, the efficiency adjustment is not based on whether or not the USO service could now be delivered more efficiently. Rather, ComReg will reasonably assess, at a high level, the appropriateness and efficiency of technology (including the efficiency from a cost perspective of implementing and maintenance of such technology) used at the time of instalment or upgrade when verifying the net cost calculation (i.e. for those uneconomic areas and uneconomic customers identified)."

Entirely absent from ComReg's analysis is any consideration of 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.

For example eircom deploys a "Fixed Cellular Solution" to provide fixed PSTN services to some customers. Eircom itself must feel that this solution represents a cost efficient and operationally effective alternative to the use of copper in some circumstances. There 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 were correctly calibrated against costs. Even where eircom did use FCS there is no exploration of whether it used the lowest cost mobile provider.

The designation of a USP creates the potential for additional retail PSTN connections which would not otherwise have been commercially provided. This in turn creates demand for the upstream wholesale inputs required to deliver them. This wholesale demand is at a higher price point than the general narrowband access market. Eircom appears to have made a decision to self-supply this additional higher priced wholesale demand, and in doing this it has held the additional demand off the wider wholesale market. It is arguable that where an alternative to eircom's self-supply was used for the access layer for USO areas or lines and at a higher price than normally commercially justified by the retail market prices, this would

enable the access provider to offer services at incremental or marginal costs in neighbouring non-USO areas. This would have positive competition impacts in the downstream retail market in which eircom has been found to have SMP. An approach to the assessment of eircom's funding application which did not assess whether alternatives to eircom's copper based solution were more cost effective is arguably distortive, does not promote efficient investment or competition, and is not in keeping with ComReg's objectives.

In addition to the assessment of efficient technology choice, a significant issue arises as to the cost efficiency of eircom's operational cost base. Over the period from 2009 eircom has engaged in a series of well publicised headcount reduction exercises and other operational cost improvements. When coupled with the simultaneous improvement in operational performance in terms of its USO performance targets, these provide evidence that eircom's operational costs for the period of this funding request were inefficient. ComReg's analysis does not make the necessary adjustment to take account of these manifest cost inefficiencies.

Assessment Report

Revenue Data

Due to the level of redaction it is impossible to properly review or comment on the detailed assessment carried out by Tera under each revenue heading. In addition the summary nature of the descriptive information given in respect of each of the line items in Table 1 makes it impossible to properly assess whether the proposed exclusions or inclusions are correctly categorised or whether they might include inappropriate items.

Notwithstanding the level of redactions, Vodafone wishes to make the following observations . These observations are not exhaustive but are illustrative that the approach adopted by Tera will recognise less than the appropriate levels of revenue and so will tend to overestimate the net direct cost of USO

DSL retail

It is proposed to exclude satellite rentals and connections. However unless it can be shown that such retail services are not sold in conjunction with retail PSTN services (whether or not as part of a bundle) then it is not certain that the satellite "DSL" (a contradiction in terms) sale and revenues are not dependent on the fact that the customer also has a PSTN service. Given that the type of customer who must be provisioned using a satellite connection for broadband rather than a copper based broadband connection is likely to be the type of customer with longer loop lengths and therefore a USO customer, this is a relevant consideration.

Leased Lines

It is proposed to exclude all revenues associated with fibre based connections and wholesale Ethernet connections. Vodafone believes that some of this will contribute to shared cost items such as field force, buildings, and potentially duct and overhead infrastructure. In order to properly exclude such revenue, a very strong validation exercise must be undertaken to ensure that on the cost side the appropriate proportion of cost is attributed to the USO service under these cost headings. From the information made available it is impossible to comment on whether the proper cost exclusions have been made

Freephone

In the commentary Tera incorrectly states that these revenues are not attributable to uneconomic customers because the terminating business customer will not be a "USO" customer. However for freephone the revenue causation is the person making the call. This may well be a "USO" customer. There will be no direct revenue attributable to the "USO" customers' bill as these calls must be free to the caller. Similar reasoning applies to the calls to shared cost and PRS numbers where there is partial revenue directly attributable to the USO customers' bill but eircom derive additional revenue from these calls from the terminating customer.

Revenue not intrinsic to a particular MDF

Using the fact that a revenue stream isn't attributable to a particular MDF as a blanket reason to exclude it is not in itself a valid approach. Such revenue can only be excluded if it can be shown that there is no causation between the USO and the revenue source.

Retail Remaining – VOIP

It is proposed to exclude **all** revenues associated with VOIP based on the fact that the **majority** are based on fibre based connections. Vodafone believes that some of this revenue will contribute to shared cost items such as field force, buildings, potentially duct and overhead infrastructure. In order to properly exclude such revenue a very strong validation exercise must be undertaken to ensure that on the cost side the appropriate proportion of cost is attributed to the USO service under these cost headings. From the information made available it is impossible to comment on whether the proper cost exclusions have been made.

Retail Remaining – VPN

The reason given is that there is insufficient data for allocation through the model – not that the revenues are not relevant to USO. On its face the mere absence of data does not appear to be a sufficient reason to exclude these revenues in a blanket fashion with no attempt to estimate the relevant revenue contribution.

Staff on Loan

The revenue from staff on loan is in effect an efficiency adjustment to eircom's general Opex. Staff "loaned" to other entities are obviously surplus to the numbers of staff needed to run eircom's own network. If they were not then eircom would not be in a position to release them. The revenue obtained from "loaning" out these staff offsets their operational headcount costs. As these headcount costs relate to staff not necessary to run the eircom network their exclusion for the eircom cost base by way of the balancing revenue is a necessary efficiency adjustment in reckoning the net direct cost of USO.

Cost Data

Replacement calls

In terms of the replacement call rate Tera has 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.

Consider the situation that, absent USO, these customers are provided with connection on commercial terms by the market. In this case there is no need for a USO but there are also no replacement calls for eircom as the calls will be made by these end-users via the network of their alternative supplier.

Alternatively if there is no provision of service on commercial terms by the market then there is a need for a USP to be designated. In the test to be applied to determine net cost of USO to eircom you must assume

that this is not eircom, but of regulatory necessity it must be someone else. This means that even if eircom is not designated as USP the USO demand from individual end users will be fulfilled by providing them with the PSTN connection. As with the previous scenario, where this connection is provided on a commercial basis, there are no replacement calls for eircom as the calls will be made by these end-users via the network of their alternative USO supplier.

In either scenario, 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.

General

Due to the level of redaction it is impossible to comment on the detailed assessment carried out by Tera under each cost heading. In addition the summary nature of the descriptive information given in respect of each of the line items in Table 4, Table 5 and Table 8 make it impossible to properly assess whether the proposed exclusions or inclusions are correctly categorised or whether they might include inappropriate items.

In terms of Table 8 it is noticeable that some figures are included from the BT model – the question arises as to why if this information is not considered confidential by an incumbent USP in one jurisdiction, similar information under other cost headings would be considered confidential in eircom's cost model here.

As set out previously direct market evidence in the form of eircom's operational cost improvement programmes since 2009 demonstrate that these 2009 operational costs were inefficiently high. There has been no adjustment to deal with this issue. The Opex efficiency adjustment based on LFI only excludes the cost of activities which would not have been appropriate to assign to USO in any event., it does not deal with this more general cost inefficiency.

Summary

Notwithstanding our inability to intelligently assess and comment on the consulted on issues due to the level of redactions, it has been possible to identify areas where the assessment method proposed will yield an overestimate for net direct cost. It is impossible for Vodafone to quantify this due to the lack of information but 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.

Q. 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.

ComReg's own consultant (Oxera) has concerns regarding the methodology adopted by eircom in estimating the single largest portion of the intangible benefits. In these circumstances Vodafone cannot agree with ComReg's preliminary assessment.

Oxera's report on the Assessment of WIK's calculation of intangible benefits sets out at table 6.1 that some 90% of the intangible benefits are attributable to enhanced brand recognition.

At section 7.1 OXERA summarises its assessment of WIK's work in this area. This concludes that the WIK model gives counterintuitive outcomes "*which raises questions about the validity of WIK's assumptions, as well as the applicability of its model*"

In addition Oxera sets out four areas of concern with WIK's empirical estimation of the benefit of enhanced brand recognition.

These shortcomings in the category which is most material indicate that the WIK report is not suitable to be used as an input to the USO funding application. The fact that part of eircom's submission is unreliable means that ComReg should reject this request as not being capable of being adjudicated.

As USP, the onus is on eircom to submit a fit for purpose funding request. It has had a number of time extensions to allow it to do this. ComReg should not consider or accommodate a deficient application.

Q. 4 Following ComReg's assessment, detailed in Chapter 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.

Vodafone does not agree that ComReg has used the correct methodology to assess the net direct cost to eircom of providing Universal Service. Vodafone believes that this cost is too high and that positive net cost is overstated by some considerable degree.

Q. 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.

Vodafone is of the view that the first question to be asked in determining undue burden is *could* the USP recover the costs of Universal Service provision and not whether it *did* actually recover this cost? The gap between these two questions is important. If the USP could recover the costs but due to some inefficiency, poor business planning or execution or a deliberate commercial decision, did not do so, then it is Vodafone's view that there is no case for it to be compensated as any funding shortfall is entirely of its own making.

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 exercising SMP on the national market for Retail Fixed Narrowband Access. 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.

Conclusion

ComReg has obviously invested significant resource into the assessment of eircom's request for funding of it meeting its USO obligation in the period 2009/2010. It has reached a preliminary view that this request should not be acceded to.

While Vodafone believes that this is the correct outcome from any assessment of eircom's request, it is also of the view that this conclusion is more properly based on more fundamental reasoning than that relied on by ComReg. Primarily these are the serious deficiencies in the validity and sufficiency of eircom's request.

Without prejudice to the view that the request should not be considered at all, and notwithstanding the impossibility for Vodafone to carry out a meaningful review of the consulted on matters due to the level of redaction, Vodafone believes that the net cost claimed is significantly overestimated.

Even if the size of the funding request was not overstated then Vodafone is of the view that there are fundamental reasons related to eircom's SMP designation which mean that any net cost to eircom of the USO is not an undue burden.

The issues raised by Vodafone in respect of this funding request will also be relevant to requests for later periods and we would urge that ComReg take them into account in assessing any such future funding requests.