An Coimisiún um Rialáil Cumarsáide
Commission for Communications Regulation

Assessment of eir's 2015-2016 Universal Service Fund Application:

Assessment of the net cost and unfair burden for the period 2015-2016

Submissions to Consultation

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Content

Section

alto

alternative operators in the communications market

Consultations: Assessments of eir's 2010 - 2011; 2011 - 2012; 2012 - 2013; 2013 - 2014; 2014 - 2015; 2105 - 2016 Universal Service Fund Applications - Refs: 17/73; 17/81; 17/95; 17/109; 18/36 & 21/17.

Submission By ALTO

Date: May 18th 2021

ALTO is pleased to respond to the Consultations: Assessments of eir's 2010 – 2011; 2011 – 2012; 2012 – 2013; 2013 – 2014; 2014 – 2015; 2015 – 2106 Universal Service Fund Applications - Refs: 17/73; 17/81; 17/95; 17/109; 18/36 & 21/17.

ALTO welcomes this opportunity to comment on this timely and important set of consultation papers.

ALTO notes that ComReg had previously permitted industry to respond to each of the USO Assessment Consultations on a collective basis, six weeks in time from the publication of the 2014 – 2015 Universal Service Fund Application publication, ComReg Ref. 18/36. ALTO responded on a collective basis on 11 June 2018.

In order to keep matters together and to maintain consistency of approach on the subject of USO, ALTO now responds to Consultation Ref. 21/17 in the same manner and maintaining a collective approach to addressing the running total or account that ComReg has maintained with the industry on the subject of USO.

ALTO notes that at the time of submission that eir reserves its position on Universal Service Funding Applications for the periods 2018 – 2019 and 2019 – 2020.[1] Contained within that document are references to funding for the periods 2016 – 2017[2] and period 2017 – 2018 with ComReg Document Reference 19/74.

Preliminary Remarks

ALTO notes and welcomes the fact that considerable effort has been expended in analysing the various eir USO funding claims.

[1] ComReg Document Reference 21/44
[2] ComReg Reference 18/76r

It is highly undesirable to have taken over [seven] years to reach this stage of the process with over €**64.86m** of claims being processed together, as a result creating a considerable risk and an unacceptable level of uncertainly for all operators. Nevertheless, we agree with ComReg's conclusions that there should be no funding awarded to eir.

ComReg must ensure that this level of delay and inertia on any regulatory subject is not permitted to occur again.

ALTO has already made various representations to Government seeking additional resources for ComReg in all areas of its work and we anticipate that if the resourcing issues are adequately addressed, there should be no reason for any future delays.

ALTO notes that the 2016 – 2020 period funding applications are all pending now. We seek that ComReg will not delay in producing high quality analysis and reports to support its findings for publication in due course.

It is evident that eir has failed on a number of counts – for example, they did not recover amounts for which they were legally permitted to do so under the price cap regime, totalling €45.5m, they did not offset the benefits they achieved from the various discount schemes and promotions, together with various self-inflicted uneconomic decisions.

Substantial Increases In USO costs

ALTO notes with surprise that eir, while constantly cutting costs with *inter alia* voluntary redundancy schemes and closing old platforms, seem to see the value of USO claims growing considerably for the past four years where services included such as payphones in decline and a falling market of access lines according to ComReg[3]. Hence the market does not appear to be aligning with the increasing direct costs and we consider ComReg should review transparently and seek

[3] ComReg Quarter Reports documents 15/49, 14/97, 13/87, 12/101, 11/66 text and numbers around figure 2.2.1.1.

justification why the direct costs are increasing so substantially. For example Directory costs have risen from zero in year 2012/2013 to €1.4m in 2014/2016 which is a staggering increase and little is said whether approach by eir was efficient. We would ask ComReg review other jurisdictions where Directories can still make a profit and where innovation and a more flexible approach can reduce these costs.

ALTO is concerned that more of eir's costs are being outsourced, but the various studies by ComReg do not appear to consider whether the outsourcing company is offering value for money or whether it is applying the principle of avoidable costs, etc. We note ComReg in its review of the ECAS Call Handling Fee engaged and reduced the prices of an outsourcing company providing services to ECAS, hence we consider similar equivalent treatment should be applied for the USO both for items such as line work and directories.

Future benefit of the National Broadband Plan – NBP (Enter NBI)

ALTO submits that the existing eir copper is ubiquitous and has already assisted eir to reach most of the rural uneconomic locations in the country over past decades.

This investment has provided eir with an extensive duct and pole (PIA) infrastructure into rural areas to support copper phone lines that can significantly assist the rollout of highspeed broadband services for the winner of the Government NBP tender - NBI.

ALTO considers this investment therefore adds considerable value beyond the existing assessments of uneconomic lines as considerable revenue can now be earned from leasing PIA facilities. This does not appear to have been considered in the review.

ALTO considers that this has considerable commercial value to eir and should be added to its intangible benefits. ALTO believes this is proven by the decision of eir to roll out the 300k area without State Aid as considerable infrastructure was already in place from less than economic copper deployment. We consider the 300k area should be reviewed as adding to the economic viably of USO deployments and a reduce claim submitted.

The market has changed very significantly in recent years, whether that be through fibre investments, the entry of NBI and other forms of merger and acquisition activity. A key issue identified by ALTO and communicated to ComReg at length now is that it will be almost impossible to revisit the USO figures or apportionment in any fair and equitable manner considering the passage of time. ALTO has also made the point that the reopening of financial accounts to deal with historical funding applications will also be a huge issue for the market.

Furthermore, we note the position in relation to the legal proceedings brought by eir appealing the USO decisions to the High Court. We also note that an Article 267 Preliminary Reference has been made to the Court of Justice of the European Union on the basis of the *Base* case and the position in European Law on the subject of burden. The relevant judgment referring to the Court of Justice being published on 14 May 2021.[4] ALTO would welcome the participation of the European Commission in relation to this Preliminary Reference given the nature of the uniquely Irish position pending on the subject of USO.

ALTO states without any hesitation that the position concerning USO funding applications in the Irish market is a fissure that will not be capable of, or amenable to, resolution given the systemic delays in application, assessment, consultation and appeals present throughout this issue. The aggregate funding figures in this area are very significant, totalling at **€64.86m** and at an adjusted level of €**52.74m** with the potential for a further figure of **€97.29m** or on adjusted basis **€79.11m** (taking a rolling average based on previous years application amounts and adjustments).

[4] https://www.courts.ie/acc/alfresco/d0691e18-8ee0-4397-833c-ffd3d0222843/2021_IEHC_328.pdf/pdf#view=fitH

Weighted Average Cost of Capital – WACC

ALTO notes with very significant interest that the WACC beta used in the calculations here, while relevant, must be noted by ComReg in the context of its decision and the Market Analysis exercise undertaken during 2019 and 2020. With USO funding applications pending from eir, the EU Commission recommendation to ComReg in E/2020/2250 should be rehearsed here, as though to remind ComReg to deploy its decision on WACC as USO is affected by it:

> "***3.2 Ensuring that prices reflect current market conditions***
> *While the Commission welcomes the revisions of the WACC value notified under IE/2014/1649, ComReg must adjust all regulated princes that are significantly affected by the WACC value in line with the considerable decrease of the WACC (from 8.18% (current) to 5.61% (notified) for the fixed-line market). The Commission* ***urges ComReg to update relevant pricing decisions as soon as possible****, to ensure that prices to the Irish wholesale markets reflect current market conditions, as the WACC us a significant and central determinant of prices."*[5]

ALTO reminds ComReg of the need to press ahead with its WACC decision in conjunction with work on the ANM area currently under consideration.

Funding Application Analysis: 2010 – 2016

USO funding sought by eir stands at **€64.86m** and was adjusted by ComReg to **€52.74** now spread across five separate applications dating back to 2010. A breakdown of the funding applications is as follows:

[5] See Appendix letter from Roberto Viola to ComReg dated 9 July 2020.

Period 2010 – 2011:

1. For the year 2010 to 2011 eir made a retrospective USO funding application to ComReg in the sum of **€9.95m** - Adjusted to **€7.93m**
Result: <u>No Burden on assessment</u>
ComReg Consultation/Decision Reference: 17/73
Positive net cost for 2010 – 2011 was <u>€7</u>.5m
WACC **10.21%**
ROCE **26.1%**

CPI 2009 – 2010 (CSO figures): 0.59%
Average annual air retail access lines (Quarterly Data): 1200
Price cap if availed of at €20.96 (price at 1 May 2008): €21.084
Price Cap under-recovery €1.8m

CPI 2010 - 2011: 2.26%
Average annual eir retail access lines: 1100
Price cap if availed of: €21.561
Price Cap under-recovery €7.9m

Period 2011 – 2012:

2. For the year 2011 to 2012 eir made a retrospective USO funding application to ComReg in the sum of **€7.26m** - Adjusted to **€6.97**
Result: <u>No Burden on assessment</u>
ComReg Consultation/Decision Reference: 17/81
Positive net cost for 2011 – 2012 was <u>€6.7m</u>
WACC **10.21%**
ROCE **22.3%**
CPI 2011 - 2012: 1.72%

Average annual eir retail access lines: 999

Price cap if availed of: €21.932

Price Cap under-recovery €11.6m

Period 2012 – 2013:

3. For the year 2012 to 2013 eir made a retrospective USO funding application to ComReg in the sum of **€7.95m** - Adjusted to **€8.01m**

Result: <u>No Burden on assessment</u>

ComReg Consultation/Decision Reference: 17/95

Positive net cost for 2012 – 2013 was <u>€7.7m</u>

WACC **10.21%**

ROCE **16.0%**

CPI 2012 - 2013: 0.28%

Average annual eir retail access lines: 961

Price cap if availed of: €21.994

Price Cap under-recovery €11.9m

Period 2013 – 2014:

4. For the year 2013 to 2014 eir made a retrospective USO funding application to ComReg in the sum of **€11.3m** - Adjusted to **€10.0m**

Result: <u>No Burden on assessment</u>

ComReg Consultation/Decision Reference: 17/109

Positive net cost for 2013 – 2014 was <u>€9.5m</u>

WACC **10.21%**

ROCE **12.6%**

CPI 2013 - 2014: 0.56%

Average annual eir retail access lines: 887

Price cap if availed of: €22.119

Price Cap under-recovery €12.3m

Period 2014 – 2015:

5. For the year 2014 to 2015 eir made a retrospective USO funding application to ComReg in the sum of **€14.7m** - Adjusted to **€12.43**
Result: <u>No Burden on assessment</u>
ComReg Decision Reference: 18/36
Positive net cost for 2014 – 2015 was <u>€11.6m</u>
Price Cap under-recovery: N/A
WACC **8.18%**
ROCE **11.4%**

Period 2015 – 2016:

6. For the year 2015 to 2016 eir made a retrospective USO funding application to ComReg in the sum of **€13.7m** - Adjusted to **€7.4m**
Result: <u>No Burden on assessment</u>
ComReg Decision Reference: 21/17
Positive net cost for 2014 – 2015 was <u>€6.7m</u>
Price Cap under-recovery: N/A
WACC **8.18%**
ROCE **10.8%**

<u>Total Price Cap under-recovery: €45.5m</u>

Price Cap and Promotions

ALTO submits that during the currency of the funding applications listed above, eir failed to recover revenues permitted for recovery by virtue of the existence of what is known as the price cap on copper lines.[6]

Since September 2008 eir has been free to raise retail access rental prices by <u>CPI-0%</u> each year under the existing price cap regime that was last amended in September 2007.[7] This was replaced in the latest year, however the amount of <u>€45.5m was not recovered by eir</u> at all and appears to have not been considered by ComReg or its consultants in its analysis of the USO funding applications in each discrete year.

It should be noted that ALTO's calculations above do not include the additional revenue that would have been earned from SB-WLR rental that would have increased in parallel with any retail price increases. This is because SB-WLR pricing was determined by retail minus pricing regime, at circa CPI-14%.

ALTO further notes that ComReg appears to have not taken into account the position of promotions and operator discount schemes that were permitted and run throughout the periods in question above. ComReg will be aware that in May 2013, eir ran a WLR promotion of a €3 monthly discount on WLR pricing. The said, the promotion ended on 1 January 2015. The decision to end the promotion was clearly motivated by eir's desire to drive uptake in its new NGA services.

It is submitted that if those promotions together with the price cap allowances were taken full account of, then eir's request for funding would have reduced dramatically. However, the reality is that eir's credibility and veracity of the pending USO funding applications is questionable. Furthermore, these are <u>self-inflicted uneconomic decisions made by eir</u>. ComReg noted in the statement accompanying Decision D04/11 that "<u>*ComReg must ensure that the USP is not compensated for inefficient*</u>

[6] This was later replaced by cost orientation
[7] See ComReg document 07/76

<u>decisions in the past or costs incurred inefficiently</u>".[8] As it stands, eir failed to recover **€45.5m** in allowed revenues (a principle which should simply <u>cancel out</u> any and all USO funding applications) to underpin ComReg's findings, which ALTO also agrees with. ALTO previously made these points to ComReg in December 2015 under Consultation Reference 15/124.[9]

Decision Instrument D04/11

Decision D04/11[10] ComReg's "*Decision on the Costing of universal service obligations: Principles and Methodologies Ref. 11/42*" was consulted publicly and all parties had the opportunity to appeal the Decisions. Hence the formal public consultation process was executed correctly and the rules were set and not appealed or changed. eir and the wider industry must accept that basis.

[8] Paragraph 2.8, https://www.comreg.ie/publication/report-on-consultation-and-decision-on-the-costing-of-universal-service-obligations-principles-and-methodologies/
[9] https://www.comreg.ie/media/dlm_uploads/2015/12/ComReg15124s.pdf
[10] https://www.comreg.ie/publication/report-on-consultation-and-decision-on-the-costing-of-universal-service-obligations-principles-and-methodologies/

Response to Consultation Questions:

Q. 1. Do you have any observations on the results of ComReg's direct net cost calculations?

A. 1. ALTO is of the opinion that ComReg has properly deployed the principles; processes and methodologies appropriate in order to calculate the direct net cost in the circumstances. However, we have two observations that are causing us concern:

1. Has ComReg applied the requirement to ensure the USO solutions offered by eir were efficient and cost effective? See Directories discussion and were there any efficiency benchmarks compared with other countries? and

2. Has ComReg reviewed the claims against what is happening in the market in its analysis? For example a falling access lines market would suggest less faults and less installations (two key USO costs), so substantial year on year increases in costs appear surprising and need to be justified in a transparent way.

ALTO notes that ComReg has undertaken a full and thorough consultation on the principles, processes and methodologies in Decision 04/11 whilst noting the above observations.

ALTO has reviewed ComReg's findings and the relevant decisions in each funding application period and submits that ComReg further transparency of activities for efficiency and benchmarking are required. appears to be correct.

ALTO also notes that ComReg has deployed the principles in Case C-389/08 *Base & Others v Ministerraad* concerning the discretion permitted when a National Regulatory Authority undertakes the task of assessing burdens.

Regarding the direct net costs part of the calculation:

ALTO is at a loss to understand how it is that eir's costs are substantially increasing year-on-year for the past four years given the extremely healthy position that eir is in, with certain legacy offerings simply becoming obsolete; and the uneconomic fixed line market appears to be growing in a declining fixed lines market. Hence the market does not appear to align with the substantially increasing direct USO costs and we consider ComReg should review and seek justification why the direct costs are increasing so substantially year-on-year. For example Directory costs have risen from zero in year 2012/2013 to €1.4m in 2014/2016 which is a staggering increase and little is said whether approach by Eir is efficient. We would ask ComReg review other jurisdictions where Directories can still make a profit and where innovation and a more flexible approach can reduce these costs.

In the event that eir has outsourced costs, then this is a matter that must be considered outside of the USO, given that management decisions to outsource declining markets should not be simply paid for by the industry.

Directories

ALTO notes ComReg's comments that telephone directory aspects of the eir's business were outsourced for a fixed price and that this has simply been accepted by ComReg as the direct net cost.

We have two concerns in the matter as follows:

a. Directories were a good source of income in past years and there is little information whether any efforts were made to find a profitable solution rather than a straight cost. We consider efforts should be made to obtain a positive return for Directories whether by a more innovative approach to directories in line with the modern world such as a mobile app and other technological innovations.

b. We note the ComReg price review of the ECAS services investigated the outsourced party for a certain activity to force a reduction of the costs to BT which were then reflected in the ECAS call handling fee. There is no evidence in the USO consultation that such an approach was considered for the outsourcing of directories and we consider this both an oversight and is not consistent with how ComReg has treated other projects.

In conclusion we do not agree with the direct net cost of directories as there appears to have been no attempt to make this positive and the supplier should have also been reviewed to ensure the costs were appropriate.

Public payphones

ALTO notes that ComReg introduced procedures for reducing the number of public payphones some years ago, and although there is no underlying detail to consider we assume the programme actively continues to reduce this uneconomic cost and note the reductions highlighted by Terra in table 1[11]. If eir were to make a commercial decision to stop removing uneconomic payphones then we consider that would be a commercial decision of eir and at its own cost. As above, eir should not be compensated for inefficient decisions or inefficiently incurred costs.

Q. 2. Do you have any observations on ComReg's preliminary view that consultancy costs incurred in respect of a USO funding applications do not form part of the net cost?

[11] Assessment of Eir's US funding application – Direct net cost 2014-2015 – Non-Confidential

A. 2. ALTO agrees with ComReg's preliminary views and findings across all five Consultation papers. In particular, ComReg's summary to the extent that:

> "*The decision to make a USO application for funding is eir's commercial decision and is not required by any universal service obligation. It should be noted that ComReg also considers that the costs attributable to preparing a USO funding application should decrease over time.*"

is correct, and at no stage should the incumbent be permitted to recover costs on the basis of hiring experts to undertake the task of ascertaining the recoverable amount under the USO framework.

ALTO submits that it would be incorrect to straddle industry with the following costs:

2010 – 2011: €419,717;

2011 – 2012: €269,797;

2012 – 2013: €269,797;

2013 – 2014: €291,369;

2014 – 2015: €291,369;

2015 – 2016: €239,380.

ALTO observes that the above figures were submitted to ComReg without any required and/or adequate explanations to assist ComReg in its work. Such an approach is not good practice. ALTO notes that ComReg state in each year that: *"No explanation[s] [were] given for the inclusion of [these] figure[s]"*

ALTO supports the view that having regard to the Universal Service Directive, the Universal Service Regulations and Decision 2 of D04/11, that consultants' fees incurred by eir should be disallowed from the net cost as they relate to the preparation and submission of the USO funding application and not to the provision of USO services.

Q. 3. Based on ComReg's assessment detailed in Sections 5, and 7 of this consultation, do you have any observations on ComReg's preliminary view that the positive net cost for:

2010 – 2011 is €7,503,531;

2011 – 2012 is €6,712,966;

2012 – 2013 is €7,723,749;

2013 – 2014 is €9,514,559;

2014 – 2015 is €11,526,418;

2015 – 2016 is €6,701,390?

A. 3. ALTO agrees with ComReg's assessments arising from Sections 5, and 7 of each Consultation paper.

ALTO would like to make the following observations concerning the net costs for each year:

> With regard to directories, it's not clear whether there was effort to recover costs or make a profit from this activity as in the past.

ALTO notes, as it has above, that eir has failed to recover amounts legally permitted to it during the periods set out above. It is also submitted that during the periods in question, eir ran various discount schemes and promotions which had the effect of reducing the revenues ascertainable from their customer base.

ALTO considers that ComReg needs to review the USO investments in economic areas including the eir 300k area to determine whether eir could reasonably achieve a return on this investment by leasing infrastructure to the winner of the NBP bid or from the self-supply of FTTP services. Given recent press about the rental price of poles it appears eir could make a substantial recovery and we consider ComReg should consider making an assessment on the increasing value of the eir access network through USO investments.

Q. 4. Following ComReg's assessment, do you have any observations on ComReg's preliminary view that a positive net cost of:

1. **€7,503,521 (or €7,929,495 as claimed by eir)**
2. **€6,712,966 (or €6,986,518 as claimed by eir)**
3. **€7,723,749 (or €8,012,033 as claimed by eir)**
4. **€9,514,559 (or €10,008,142 as claimed by eir)**
5. **€11,526,418 (or €12,432,981 as claimed by eir)**
6. **€6,701,390 (or €12,861,430 as claimed by eir)**

is not an unfair burden on eir for the periods:

1. **2010 – 2011?**
2. **2011 – 2012?**
3. **2012 – 2013?**
4. **2013 – 2014?**
5. **2014 – 2015?**
6. **2015 – 2016?**

A. 4. ALTO agrees with ComReg's position in each year under consultation at this time.

ALTO notes that for there to be an unfair burden, three cumulative conditions 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."

In each instance it is clear from eir's remarkable financial performance, its market share/dominance and significantly higher returns that anticipated, it is not the case that an unfair burden be determined on any objective assessment of the company's results and financial performance.

1. 2010 – 2011: WACC 10.21% - ROCE 26.1%
2. 2011 – 2012: WACC 10.21% - ROCE 22.3%
3. 2012 – 2013: WACC 10.21% - ROCE 16.0%
4. 2013 – 2014: WACC 10.21% - ROCE 12.6%
5. 2014 – 2015: WACC 8.18% - ROCE 11.4%
6. 2015 – 2016: WACC 8.18% - ROCE 10.8%

USO Assessment Rules

ALTO notes that ComReg set out a clear set of conditions for the USO in Decision D04/11[12] which was consulted publicly and all parties had the opportunity to appeal the Decisions. Hence the formal public consultation process was executed correctly and the rules were set and not appealed or changed. eir and the wider industry must accept that basis.

[12] https://www.comreg.ie/publication/report-on-consultation-and-decision-on-the-costing-of-universal-service-obligations-principles-and-methodologies/

ALTO notes that ComReg and its consultants Oxera provide considerable clarity with the consultation and associated reported in the application of the various rules of D04/11 to assess whether the USO costs were an unfair burden on eir. On reading the various consultations the rules do appear to have been implemented correctly.

Unfair Burden

We agree with the assessment within the Oxera unfair burden report throughout that the USO cost was not an unfair burden as eir was able to maintain a Return On Capital Employed (ROCE) above the maximum of the range for the allowable Weighted Average Cost of Capital (WACC). i.e., it was able to maintain a return on investment above the level expected by regulation.

In each instance below ALTO emphasises eir's position regarding unfair burden versus financial performance concerning unfair burden.

Oxera Report Extract 2010 – 2011 – Page 12:

> *"[A] comparison of eir's actual profitability (ROCE) against the competitive benchmark return (the WACC). This shows that in 2010/11, eir's fixed-line business ROCE exceeded the WACC by 15.9%.*
>
> *To further contextualise eir's financial position, it is relevant to note that:*
>
> - *the ROCE for the fixed-line business exceeded not only the point estimate of the allowed WACC, but also the upper end of the WACC range estimated by ComReg, by 15.1%;*
>
> - *for there to be no returns above the WACC, the net cost of the USO would have to have been around **31 times higher**; or, alternatively,*

• the absolute profit (EBIT) for the fixed-line business would have to have been around <u>61% lower for the application period</u>, 2010/11.[13]'

Oxera Report Extract 2011 – 2012 – Page 12:

"[A] comparison of eir's actual profitability (ROCE) against the competitive benchmark return (the WACC). This shows that in 2011/12<u>, eir's fixed-line business ROCE exceeded the WACC by 12.1%.</u>

To further contextualise eir's financial position, it is relevant to note that:

• the ROCE for the fixed-line business <u>exceeded not only the point estimate</u> of the allowed WACC, <u>but also the</u> <u>upper end of the WACC range estimated by ComReg, by 11.2%</u>;

*• for there to be no returns above the WACC, the net cost of the USO would have to have been around **<u>27 times higher</u>**; or, alternatively,*

• the absolute profit (EBIT) for the fixed-line business would have to have been around <u>54% lower for the application period</u>, 2011/12.[14]"

Oxera Report Extract 2012 – 2013 – Page 13:

"[A] comparison of eir's actual profitability (ROCE) against the competitive benchmark return (the WACC). This shows that in 2012/13, <u>eir's fixed-line business ROCE exceeded the WACC by 5.8%.</u>

To further contextualise eir's financial position, it is relevant to note that:

[13] https://www.comreg.ie/publication/oxera-report-unfair-burden-report-2010-2011/
[14] https://www.comreg.ie/publication/oxera-unfair-burden-report-201112/

- *the ROCE for the fixed-line business exceeded not only the point estimate of the allowed WACC, but also the* <u>*upper end of the WACC range estimated by ComReg, by 5.0%;*</u>

- *for there to be no returns above the WACC, the net cost of the USO would have to have been around* ***<u>13 times higher</u>****; or, alternatively,*

- *the absolute profit (EBIT) for the fixed-line business would have to have been around* <u>*36% lower for the application period, 2012/13*</u>*.[15]"*

Oxera Report Extract 2013 – 2014 – Page 13:

"[A] comparison of eir's actual profitability (ROCE) against the competitive benchmark return (the WACC). This shows that in 2013/14<u>*, eir's fixed-line business ROCE exceeded the WACC by 2.4%*</u>

To further contextualise eir's financial position, it is relevant to note that:

- *the ROCE for the fixed-line business exceeded not only the point estimate of the allowed WACC, but also* <u>*the upper end of the WACC range estimated by ComReg, by 1.5%*</u>*;*

- *for there to be no returns above the WACC, the net cost of the USO would have to have been around* ***<u>5 times higher</u>****; or, alternatively,*

- *the absolute profit (EBIT) for the fixed-line business would have to have been around* <u>*19% lower for the application period*</u>*, 2013/14.[16]"*

[15] https://www.comreg.ie/publication/oxera-unfair-burden-report-201213/
[16] https://www.comreg.ie/publication/oxera-report-unfair-burden-report-2013-2014/

Oxera Report Extract 2014 – 2015 – Page 12:

"[A] comparison of eir's actual profitability (ROCE) against the competitive benchmark return (the WACC). This shows that in 2014/15, <u>eir's fixed-line business ROCE exceeded the WACC by 3.2%</u>.

To further contextualise eir's financial position, it is relevant to note that:

- *the ROCE for the fixed-line business exceeded not only the point estimate of the allowed WACC, but also the <u>upper end of the WACC range estimated by ComReg, by 2.0%</u>;*
- *for there to be no returns above the WACC, the net cost of the USO would have to have been around <u>**5 times higher**</u>; or, alternatively,*
- *the absolute profit (EBIT) for the fixed-line business would have to have been around <u>28% lower for the application period</u>, 2014/15.[17]"*

Oxera Report Extract 2015 – 2016 – Page 13:

"[A] comparison of eir's actual profitability (ROCE) against the competitive benchmark return (the WACC). This shows that in 2015/16, eir's fixed-line business ROCE exceeded the WACC by 2.6%.

To further contextualise eir's financial position, it is relevant to note that:

- *the ROCE for the fixed-line business exceeded not only the point estimate of the allowed WACC, but also the <u>upper end of the WACC range estimated by ComReg, by 1.4%</u>;*
- *for there to be no returns above the WACC, the net cost of the USO would*

[17] https://www.comreg.ie/publication/oxera-report-unfair-burden-report-2014-2015/

*have to have been around **5 times higher**; or, alternatively,*

• the absolute profit (EBIT) for the fixed-line business would have to have been around 24% lower for the application period, 2015/16.[18]"

Conclusion

ComReg and the industry can be left in no doubt that no unfair burden existed in any of the periods under consultation based on the assessments and independent expert information provided above.

ALTO also submits that it is an intolerable position to have USO funding applications pending in the manner that they are and with a potential upper end value of €97.29m on a non-adjusted basis suspended over industry like this considering the changes to the market and dynamics of communications services during the periods open for Consultation currently.

ALTO

18 May 2021

18 https://www.comreg.ie/publication-download/oxera-unfair-burden-report-2015-16

Appendix 1 – EU Commission Letter to ComReg concerning WACC

EUROPEAN COMMISSION

Brussels, 9.7.2020
C(2020) 4837 final

Commission for Communications
(ComReg)
One Dockland Central
Guild Street
D01 E4X0 Dublin 1
Ireland

For the attention of:
Mr. Garrett Blaney
Chairperson of the Commission

Subject: Case IE/2020/2250: Determination of the WACC for the purpose of price control obligations in Ireland
Commission comments pursuant to Article 7(3) of Directive 2002/21/EC

Dear Mr Blaney,

1. PROCEDURE

On 10 June 2020, the Commission registered a notification from Ireland's national regulatory authority (NRA), the Commission for Communications (ComReg)[1], concerning the weighted average cost of capital (WACC) for the purpose of price control obligations in Ireland.

The national consultation[2] ran from 31 May to 13 August 2019.

The Commission sent a request for information (RFI)[3] to ComReg on 17 June 2020 and received a reply on 22 June.

Under Article 7(3) of the Framework Directive, NRAs, the Body of European Regulators for Electronic Communications (BEREC) and the Commission may make comments on notified draft measures to the NRA concerned.

1 Under Article 7 of Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive) (OJ L 108, 24.4.2002, p. 33), as amended.

2 In accordance with Article 6 of the Framework Directive.

3 In accordance with Article 5(2) of the Framework Directive.

2. Description of the draft measure

2.1. Background

The Commission was previously notified of the Irish WACC methodology and assessed it under Case IE/2014/1649[4]. The current notification concerns the second WACC methodology of which ComReg has notified the Commission.

In Case IE/2014/1649, ComReg notified applicable WACC values for markets 2-7[5] under the 2009 Recommendation on relevant markets, and two markets for broadcasting. It used the capital asset pricing model (CAPM) to set values of 8.48% for markets 2-6 and 8.66% for the two broadcasting markets. These included an 'aim-up' to compensate for the potential under-recovery of investments made by the incumbent[6].

The Commission commented on the 'aim-ups' and invited ComReg to reconsider the validity of its approach, pointing to the WACC values derived solely under CAPM (8.17% for the mobile markets, 8% for the fixed-line markets and 8.11% for the broadcasting markets).

In its final measure, ComReg applied a WACC value of 8.18% for the fixed-line markets and 8.63% for the mobile market.

2.2. Notified WACC methodology

ComReg has now notified a new methodology for setting the WACC for future pricing decisions. It sets out the methodology and calculates the corresponding WACC value, without transferring this to any specific price decisions. Therefore, all current maximum prices set by ComReg remain unchanged until updated in a future pricing decision. For prices set by reference offer, the regulated operator must rely on the most recent WACC value to ensure compliance with the cost-orientation obligation.

ComReg calculates different WACC values for the fixed-line, mobile and broadcasting markets. It intends to update these annually. In its reply to the RFI, it explained that a future review of the mobile voice-call termination market is not envisaged, as single maximum EU-wide termination rates are scheduled for application by 2021.

To calculate the WACC, ComReg estimates a number of parameters, in particular (in line with common practice and the Commission Notice on WACC[7]):

- the *cost of equity* – for this, it has established two methodologies:
    - one based on the Commission Notice; and

4 C(2014) 7576.

5 The 2007 recommendation covered the following markets (old numbers): call origination on fixed network (2), local/national call for residential (3), international call for residential (4), local/national call for non-residential (5), international call for non-residential (6) and retail local loop (7).

6 The purpose of aiming up was to reflect the asymmetry of consequences between setting the WACC too low and setting it too high.

7 Commission Notice on the calculation of the cost of capital for legacy infrastructure in the context of the Commission's review of national notifications in the EU electronic communications sector.

- the other based on its current WACC methodology (IE/2014/1649), with values updated to reflect current conditions.

ComReg thus estimates two costs of equity and takes the average of the two as input for the final WACC value (see below). It explains in its reply to the RFI that this is a justifiable way of taking account of the harmonised approach described in the Commission Notice and specific circumstances in the Irish market; and

- the *cost of debt* – ComReg calculates this according to four different approaches and evaluates the results and methods before choosing one for the setting of the WACC.

2.2.1. Cost of equity

As input for the CAPM method of estimating the cost of capital, ComReg calaculates the risk-free rate (RFR), the equity risk premium (ERP), total market return (TMR), asset beta, gearing and equity beta. For this, it takes a 'Commission Notice' approach and a '2014 approach'. The WACC methodology sets values for the fixed-line, mobile and broadcasting markets, and some parameters (the asset beta, gearing and equity beta values) vary from one setting to another.

For the 'Commission Notice' approach, ComReg calculates the RFR from the yields of 10-year Irish government bonds, averaged over 5 years. For the ERP, it first estimates the TMR, from which it then subtracts the estimated RFR to obtain the ERP. It therefore does not use the ERP computed by Dimson, Marsh and Stanton (DMS), but rather on the TMR from the same source. It argues that this gives a more accurate (and higher) estimate of the ERP. It acknowledges that this approach is not fully in line with the WACC Notice, but concludes that the results are closer to the values observed elsewhere in the market. As explained in the notification documents and in the reply to the RFI, this approach involves using the ECB's 5-year eurozone inflation forecast. For the asset beta, it uses weekly data over a 5-year period from the established peer group. Gearing is derived directly from the hypothetical efficient operator and the tax rate is the statutory Irish tax rate.

The '2014 approach' is methodologically identical to the approach notified under Case IE/2014/1649. The nominal RFR is estimated on the basis of forecasts taking account of Irish and EU GDP growth and inflation. Again, the ERP is derived from the DMS-based TMR, but only the Irish TMR, which means that the resulting values differ slightly from those derived from the 'Commission Notice' approach. Inflation is based on a blend of Irish and eurozone forecasts, with the former being used for the short term (2 years) and ECB forecasts from 2022 onwards. The asset beta comes from a 2-year data series based on daily observations. Gearing and tax are the same for the two approaches.

Using the two approaches, ComReg derives values for each parameter and computes an average. The parameter values and the resulting cost of equity relevant for the fixed-line market are presented in Table 1.

Table 1: Cost of equity for fixed-line market

	Commission Notice	The 2014 approach
Nominal risk free rate	0.824%	3.28%
ERP	7.21%	4.90%
Real TMR	6.35%	6.65%
Asset beta	0.48	0.43
Gearing	40%	40%
Equity beta	0.80	0.71
Nominal post tax cost of equity	6.59%	6.75%
Nominal pre tax cost of equity	7.53%	7.71%
Average nominal post tax cost of equity	6.67%	

The resulting cost of equity used for estimating the WACC for the fixed-line market is 6.67%. The costs of equity derived using similar methodology (but different values for gearing and betas) are 7.01% for the mobile and 7.11% for the broadcasting market.

2.2.2. *Cost of debt*

For cost of debt, ComReg sets out four approaches based on various assumptions and resulting in different values:

- approach 1 (1.44%) – 'Commission Notice' approach based on debt premia and 5-year historical data;
- approach 2 (3.96%) – taking account of observed government spot rates and a debt premium obtained by comparing the spreads between operator bonds and domestic government bonds;
- approach 3 (2.6%) – equivalent to the approach followed under the WACC methodology notified by ComReg in 2014; and
- approach 4 (0.75%) – based on observed data on Eircom's most recent bond issuances.

Although approach 1 is similar to that described in the Commission Notice, ComReg does not use it for the current notification. Instead, it takes the average of the range from the four approaches (0.75-3.96%). It further argues that approach 1 takes account only of investment-grade debt, which does not apply for the incumbent (Eircom).

ComReg calculates an average of 2.4%. Then, from approach 1 (1.44%) and aproach 2 (3.96%), it calculates an average of 2.7%. Since this is close to the result from approach 3, it uses that approach.

Therefore, it dismisses the approach as advocated in the Notice (approach 1) and rather takes the approach used in 2014, resulting in a 2.6% cost of debt, which it uses as input for all WACC calculations.

2.3. Final WACC values and future updates

Taking the above approaches and averages, ComReg applies the typical CAPM formula, resulting in the WACC values in Table 2. Across the markets, the notified values are lower than those from the 2014 WACC decision, as applied in current price decisions.

Table 2: WACC values derived for the three markets

Parameters	Fixed	Mobile	Broadcast
Cost of equity	6.67%	7.01%	6.22%
Cost of debt	2.60%	2.60%	2.6
Notional gearing	40%	40%	25%
Tax rate	12.50%	12.50%	12.50%
Nominal pre-tax WACC	5.61%	5.85%	5.98%

ComReg will annually review and where necessary update the WACC parameters, but it does not intend to change the methodology itself.

The updated WACCs, like the current one, will be used in the context of upcoming pricing decisions, including decisions on price controls following a market analysis and updating/amending decisions.

Where ComReg has set prices previously, these will remain in place until it issues a new pricing decision. Where a cost-orientation obligation applies, but ComReg has set no specific price (e.g. certain access reference offer tariffs), the SMP[8] operator must monitor its ongoing compliance and update prices subject to the obligation with reference to the most up-to-date WACC value.

3. COMMENTS

The Commission has examined the notification and the additional information provided by ComReg and has the following comments[9]:

3.1. Future updating of the WACC methodology

The Commission considers that ComReg will have to notify it of future updates of the WACC in accordance with Article 7 of the Framework Directive. After 1 July 2020, and from 1 July 2021 at the latest[10], the Commission will assess any notification of a WACC methodology or value for legacy infrastructure on the basis of the principles set out in the Notice. Thus, in the future, ComReg should take account of the methodology applied by the Commission on the basis of the Notice.

8 Significant market power.

9 In accordance with Article 7(3) of the Framework Directive.

10 In justified cases and at the request of the notifying NRA, the Commission will not base its review of draft measures on this methodology during a transitional period of up to a year (from 1 July 2020).

3.2. Ensuring that prices reflect current market conditions

While the Commission welcomes the revision of the WACC value notified under IE/2014/1649, ComReg must adjust all regulated prices that are significantly affected by the WACC value, in line with the considerable decrease of the WACC (from 8.18% (current) to 5.61% (notified) for the fixed-line market). The Commission urges ComReg to update relevant pricing decisions as soon as possible, to ensure that prices in the Irish wholesale markets reflect current market conditions, as the WACC is a significant and central determinant of prices.

Under Article 7(7) of the Framework Directive, ComReg must take utmost account of the comments of other NRAs, BEREC and the Commission and may adopt the resulting draft measure. Where it does so, it must communicate it to the Commission.

The Commission's position on this particular notification is without prejudice to any position it may take on other notified draft measures.

Pursuant to point 15 of Recommendation 2008/850/EC[11], the Commission will publish this document on its website. If ComReg considers that, in accordance with EU and/or national rules on business confidentiality, this document contains confidential information that you wish to have deleted prior to publication, please inform the Commission[12] within 3 working days of receipt and give reasons for any such request[13].

Yours sincerely,

VOOR GELIJKLUIDEND AFSCHRIFT
Voor de secretaris-generaal

Jordi AYET PUIGARNAU
Directeur van de Griffie
EUROPESE COMMISSIE

For the Commission
Roberto Viola
Director-General

11 Commission Recommendation 2008/850/EC of 15 October 2008 on notifications, time limits and consultations provided for in Article 7 of Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (OJ L 301, 12.11.2008, p. 23).

12 By email to CNECT-ARTICLE7@ec.europa.eu.

13 The Commission may inform the public of the result of its assessment before the end of the 3-day period.

BT Communications Ireland Ltd ["BT"] Response to the ComReg's:

Assessment of eir's 2015-2016 Universal Service Fund Application.
Assessment of the net cost and unfair burden for the periods 2015-2016

Issue 1 – 18th May 2021

1.0 Introduction

We welcome that ComReg and its consultants have applied considerable effort into analysing the eir USO claims, however the considerable delays in ComReg resolving the USO claims situation has created unnecessary uncertainty in the market due to the substantial combined value of unresolved claims. Whilst we appreciate the complexity, such delays should never have occurred and must be avoided in future.

Scope - We note the consultations only concern the evaluation of eir's claims for USO payments with reference to the Decisions set out in ComReg Decision D04/11, and not USO policy matters, hence our response is focused on addressing the eir claim and ComReg's findings against the Decisions in D04/11[1].

High USO costs – we find it surprising given years of eir cost cutting with voluntary redundancy schemes, many customers moving to broadband access, closing old platforms etc. and yet the value of USO claims continue to be very high.

2.0 Response to the detailed questions

Q1 Do you have any observations on the results of ComReg's direct net cost calculation?

Response 1. We would like to make the following comments to the direct net costs part of the assessment as follows:

1. We consider there is a need for eir to explain why the USO fixed access line costs are staying so high at a time when the market for access lines used for copper access is decreasing. We would observe two other important trends in the market which makes us challenge the findings:

    a. We note the growth of access services in Ireland is largely around the provision of broadband services and broadband is not included within the legislation or regulation for the USO. ComReg commented in its FACO consultation of 2020 that Broadband provides a substitute path for voice so if this is the case then all lines provided over Broadband whether carrying voice or not do not fall within the costs of the USO – so the base of the claim for USO lines should be falling.
    b. We are also aware to the frustration of BT and our customers that eir often defaults to using the Fixed Cellular Service (FCS) to meet its USO obligations

[1] D04/11 Decision No. 8. - The avoidable costs included in the net cost calculation, shall be those costs reflecting the provision of the USO which a commercial operator would not ordinarily have provided, and which were incurred in the most efficient way. These costs shall relate to: (a) the avoidable capital costs associated with CAPEX i.e. depreciation; (b) OPEX; and (c) overheads for the appropriate financial year.

to provide USO voice access solutions, hence is this saving built into the study given there is minimal infrastructure involved?

2. Directories – We would re-iterate our comment to the 2014 to 2015 submission noting ComReg's comments that the Directories aspects of the eir USO were outsourced and this has been accepted by ComReg as the direct net cost. We welcome that the level of cost has reduced since the last claim but it's not yet clear whether the solution is efficient or cost effective. We would like to make the following comments concerning the distribution of paper phone directories:
    a. Although after the period being analysed by this submission, we note thejournal.ie 3rd May 2020 reported ComReg had indicated the level of demand for telephone directories in 2019 was fewer than 2400 copies following its Decision to allow an on-request process in 2018. We welcome this change of approach, but such should have been realised and deployed earlier.
    b. Our experience of telephone directories before they moved to an on-request service is they were becoming smaller and smaller in size as people chose to become x-directory or simply gave up their PSTN phone number. Hence we would have expected the costs of producing and distributing directories to have been steadily falling but the data supplied does not let us see this characteristic.
    c. Going forward we believe ComReg should accurately monitor the level of demand for paper telephone directories and consult on whether to change or remove this aspect of the USO obligation.
    d. We note the ComReg price review of the ECAS CHF considered the reasonableness of the costs of our outsourced supplier but there is little evidence of this happening concerning efficiency in the USO analysis. We would have expected ComReg to have acted in an equivalent way.

3. Payphones

We agree with ComReg's approach to apply the rules that were established some years ago for eir to manage uneconomic payphones. We therefore agree with the net amount ComReg has determined rather than the eir claim level as eir had the opportunity to avoid most of the costs.

4. Services for disabled end users.

We agree with the conclusions in this aspect of the claim.

Q2. Do you have any observations on ComReg's preliminary view that consultancy costs incurred in respect of a USO funding application do not form part of the net cost?

Response 2 – We agree with the ComReg analysis that it was called out clearly in the legislation and the Decision D04/11 that USO provision is not made for claiming consultant costs for making a claim. Notwithstanding our view it's not clear why the consultant's costs are so high for a process that is repeated annually.

Q3. Based on ComReg's assessment detailed in Sections 5, and 7 of this consultation, do you have any observations on ComReg's preliminary view that the positive net cost for 2015-2016 is €6,701,390?

Response 3 – We would like to make the following observations concerning the net cost for 2015-2016.

As highlighted in our response to question 1 we are struggling to understand why the line costs are not following market changes and why eir cost savings are not coming through in the assessment.

Q4. Following ComReg's assessment, do you have any observations on ComReg's preliminary view that a positive net cost of €6,701,390 (or €12,861,430 as claimed by eir) is not an unfair burden on eir for the period 2015-2016?

Response 4 – We would like to offer the following observations.

USO Assessment Rules

1. We observe ComReg set out a clear set of conditions for the USO in Decision D04/11 which was consulted publicly, and all parties had the opportunity to appeal the Decisions. Hence the formal public consultation process was executed correctly, and the rules were not appealed or changed. We base our observations purely on the rules in place.

Unfair Burden

2. Based on the rules in place in Ireland we agree with the ComReg's and Oxera's assessment that USO did not provide an undue burden on the profitability to eir over the period of the claims.
3. We note and agree with Oxera's observation in the Oxera unfair burden report 2015/16 page 13 as extracted below:

Start of Extract

To further contextualise eir's financial position, it is relevant to note that:

- The ROCE for the fixed-line business exceeded not only the point estimate of the allowed WACC, but also the upper end of the WACC range estimated by ComReg, by 1.4%.
- for there to be no returns above the WACC, the net cost of the USO would have to have been around 5 times higher; or, alternatively,
- the absolute profit (EBIT) for the fixed-line business would have to have been around 24% lower for the application period, 2015/16.

End of Extract

End

eir

Response to ComReg Consultation and Draft Determination:

Assessment of eir's 2015-2016 Universal Service Fund Application
Assessment of the net cost and unfair burden for the period 2015-2016

ComReg Document 21/17

18 May2021

DOCUMENT CONTROL

Document name	eir response to ComReg 21/17
Document Owner	eir
Status	Non-Confidential

EXECUTIVE SUMMARY

1. Once again, we are extremely disappointed to find that Universal Service Obligation (USO) conferred upon eir is not considered an unfair burden according to ComReg despite the acknowledgment of a very tangible and substantial net cost.

2. ComReg has acknowledged that each of eir's five previous applications for USO funding covering the financial years from 2010/11 to 2014/15 were fit for purpose, and that the provision of universal services represented a positive net cost for eir in each of these years. For 2015/16, the funding application subject to the adjustments made by ComReg (to which we do not agree as discussed in the following) has also been deemed fit for purpose. In total the net cost for eir over the six financial years in question is more than €50 million.

3. Recovery of these net costs is permitted by the Regulations as these are costs that would have been avoided in their entirety had there been no USO imposed on eir. The continued failure of ComReg to set up a funding mechanism is a significant competitive distortion and puts eir at a significant disadvantage relative to its competitors.

4. The five funding submissions from 2010/11 to 2014/15 have had an average net cost claim of €9 million, with 2014/15 being the highest of €12.4 million. These have all been accepted by ComReg. In our most recent submission for 2015/16 the claimed net cost is €12.8 million. While ComReg have made minor adjustments to eir's claims in the past, in the case of 2015/16 eir has substantial concerns with the new methodology proposed by ComReg for the customer model. ComReg's proposed methodology results in a materially lower net cost and is nearly half of the net cost eir has calculated for uneconomic customers in economic areas. A change of €5.7 million is not proportionate, is unjustified and is also not supported by or compliant with the requirements of ComReg D04/11 and the underlying Universal Service Regulations 2011 and Directive.

5. ComReg offers no rationale, justification or documentation for how this result can be consistent with USO net cost figures that ComReg has accepted for previous years. In fact, the net cost generated by the TERA adjusted customer model is the lowest in all years that eir has applied for funding. The TERA result rests on applying "rules of thumb" with an artificially applied 3km boundary and a new L/N methodology. No sensitivity analysis is provided by ComReg or TERA, nor is any comparison made to previous results or actual network build — as required by ComReg D04/11. Such real-life comparisons by eir in previous submissions have substantiated the accepted net cost claims of €9 million from 20010/11 to 2014/15. In addition, as required in all submissions, auditors PwC have performed the procedures agreed with ComReg to verify the net cost calculation. This work has been performed in accordance with the International Standard on Related Services (ISRS) 4400 'Engagements to perform agreed-upon procedures regarding financial

information.' No such procedures have been undertaken on ComReg's adjusted customer model. Such a proposed change by ComReg, can only be proposed, pursuant to Decision 15 of ComReg D04/11, following assessment by ComReg of eir's USO funding application and only in circumstances where material discrepancies are found in the reality "sense" checks in eir's submission. No such discrepancies have been identified by ComReg and the "sense" checks of eir's submission and the results of PwC's agreed upon procedures are consistent with eir's previous submissions. Consequently, eir submits that ComReg's proposed change is not supported by or compliant with ComReg D04/11, and in particular does not meet the precondition in Decision 15 that 'material discrepancies' must be identified by means of sample reality checks, before any 'proportionate adjustment' can be proposed. It is also not compliant with the underlying statutory principles in the Universal Services Regulations 2011. What ComReg has undertaken is a change in methodology and cost calculation which cannot be implemented without consultation with interested parties and requires a fresh USO net cost methodology and principles decision and notification to the EC before it can be implemented by ComReg.

6. In terms of eir's approach, ComReg state without adequate reasoning that the mixed use of the 2009 CAM and the 2016 CAM is incorrect and creates an inconsistency in the cost avoidability and cost allocation assumptions used in the USO model and this affects the accuracy of the net cost calculation for the financial year 2015 resulting in a materially miscalculated net cost of uneconomic customers in economic areas. Very limited analysis is provided by ComReg or TERA to substantiate the alleged "error" in eir's approach. ComReg simply assume that the approach proposed by TERA is better or more accurate despite having accepted eir's previous results in previous years that have relied on a not too dissimilar methodology to that employed again by eir in its 2015/16 funding application. ComReg claim that the 2016 CAM model is more advanced and capable of more advanced analysis. While we agree that the 2016 CAM represents the most up to date information, that is not to say that the hybrid approach adopted by eir is erroneous. Furthermore, ComReg's new adjusted approach relies on a novel methodology using "rules of thumb" for USO net cost purposes and requires very significant iterations before data from it can be created used in the revised customer model proposed by ComReg. eir disagrees with the output of the revised proposed customer model and has in this submission made numerous observations that raise concern with the validity of the TERA approach. Use of the 2016 CAM as proposed by TERA will not, as ComReg would appear to believe, automatically lead to better or more accurate results. It does, however, provide a supplemental analysis and one that would appear to contain significant flaws.

7. The approach used by eir (subject to agreed minor updates over time with ComReg) has been providing consistent results year on year that have been agreed to. Even the latest mix of the 2009 and 2016 CAM has given consistent results. Without prejudice to eir's view that ComReg's new methodology is ultra vires to ComReg D04/11 and the underlying legislation,

ComReg cannot now simply introduce a new avoided cost methodology without providing substantial documentation for its methodological approach to justify claims that it is superior compared to previous approaches and reliable. These issues are discussed in more detail in our response question 1.

8. ComReg D04/11 gives clear guidance on the approach to follow and the requirements necessary. ComReg have in the current case introduced (without consultation) their own cost assumptions using a new methodology to estimate the net cost of uneconomic customers in economic areas. While the approach relies on aspects of the eir approach, such as the probability calculation, it is mechanically different in the way it estimates avoidable costs. Based on our review of this new approach it is also clear that it has not undergone the same rigorous requirements set out in ComReg D04/11. The new approach cannot simply be regarded as an "adjustment" to the net cost calculation. In addition, ComReg has determined other changes such as the exclusion of consultancy fees and removal of payphones. ComReg's new methodology bypasses many of the key established calculations in the customer model replacing it with an alternative calculation. In this regard ComReg are going beyond D04/11 by now specifying its own approach.

9. Notwithstanding, the agreed format and structure enshrined in previous eir's submissions there are issues of process leading to the current proposed net cost by ComReg that should be highlighted, as failing to comply with ComReg's legal obligations to act fairly and proportionately. First, the original request by ComReg for use of the different CAM (TERA document "*Tutorial: Using the bottom-up model for the USO net cost estimation*") was provided to eir only 10 days before the submission was due (31 March 2017). Suggesting another methodology (including the use of the 2016 CAM) so close to the deadline for submission is unreasonable given the complexity of the modelling approach and effort required for make any changes. This is clearly illustrated by our comments to the TERA approach in this submission. Second, on <u>24 December 2019</u>, eir received a letter from ComReg stating that it had instructed TERA to propose a new methodology for the customer model and requesting eir's view on the proposed methodology by 13 January 2020 (i.e., within 12 working days). In that letter an annex of less than one page sets out at an extremely high-level overview of the proposed ComReg approach. Clearly this was a manifestly unreasonable request both considering the timing, complexity and paucity of information provided to eir. eir requested an extension and requested greater detail to support and substantiate the single page previously provided to eir on Christmas Eve. This request for further information was only provided to eir some five months later in May 2020 and was the first time eir received more detailed information from ComReg on their approach including adjusted Excel versions of the customer model. Having reviewed the associated materials, and as requested by ComReg, eir provided comments on ComReg's proposed changes on the 5 June 2020 stating in particular that it did not agree with the proposed changes and that instead ComReg should use eir's calculations as submitted.

Unfortunately, ComReg did not engage further with eir on the response provided and proceeded instead some nine months later to publish consultation 21/17 which incorporates its own new customer model methodology. As identified above, and as set out in previous correspondence to ComReg, eir considers that ComReg's new methodology is inconsistent with Decision 12, Decision 14 and Decision 15 of ComReg D04/11 as well as the underlying legislation.

10. As ComReg is aware, ComReg's previous assessments of eir's USO funding applications are the subject of ongoing legal proceedings before the Irish High Court (Case 2019/167 MCA Eircom Limited -and- the Commission for Communication Regulation, the 'USO Case'). Further to a request first made by ComReg, this case has been referred to the Court of Justice of the European Union ('CJEU'), to rule on a point of EU law, relating to the question of what factors ComReg is required to take into account in assessing unfair burden. In the circumstances it is surprising the ComReg is now proposing to apply to this funding application the very analysis that is subject to legal appeal and awaiting a ruling. If ComReg proceeds to a final Decision before the CJEU and the Irish High Court have delivered their rulings, eir will have no option but to also appeal this Decision and join it to the existing proceedings.

11. eir disputes ComReg's exclusion of Consultancy fees and the arguments made. These costs have to be incurred for the purpose of meeting the requirements of ComReg D04/11. Indeed, recovery of these costs is permitted by the Regulations as these are costs that would have been avoided in their entirety had there been no USO imposed on eir. These costs were incurred only to comply with the requirements of ComReg D04/11. ComReg's decisions to exclude consultancy costs in previous USO funding decisions are also the subject of legal appeal in the USO Case referred to above. We expand on this point in our answer to question 2.

12. eir does not accept ComReg's preliminary view that the positive net cost to date is not an unfair burden. The concept of an unfair burden of the costs of the USO has been interpreted in a very restrictive way by ComReg and Oxera making it highly unlikely that any net cost would ever be considered to represent an unfair burden. eir submits that ComReg's approach, as such, is unlawful and contrary to EU law. The methodology followed by ComReg is in essence a close reproduction of previous assessments of eir's USO funding applications. Hence, the arguments conveyed in our previous responses are equally valid in our response to question 4.

13. It is eir's submission that eir's submitted net cost (adjusted for the inclusion of consultancy costs) is an unfair burden on eir, and that consequently a funding mechanism must be established in accordance with the requirements of the Universal Service Directive and Regulations.

RESPONSE TO CONSULTATION

Question 1: Do you have any observations on the results of ComReg's direct net cost calculation?

14. eir does not agree that the consultancy costs incurred in preparing the necessary USO Funding applications in compliance with ComReg D04/11 should be excluded from the direct net cost. This matter is addressed more comprehensively in our response to question 2 below.

15. The net cost calculation covers five distinct models: Area Model, Customer Model, Payphone Model, Directories Model and Disabled End Users' Services Model. ComReg and its consultant TERA have reviewed all five models and found reason to correct two of them: the Payphone Model and Customer model. In the following we provide comments to the corrections made to these two models.

A new Customer Model methodology

16. ComReg has implemented a new methodology which in comparison to eir's approach results in a comparative downwards "adjustment" in the cost of uneconomic customers in economic areas by €5,681,354 leading to a total net cost of the adjusted Customer Model of €6,289,628 (as compared to €11,970,982 proposed by eir). While it is presented as an "adjustment" in ComReg D04/11 it is in fact a fundamental re-work using a new methodology to determine the cost avoidability distribution used in the probability analysis (notwithstanding that the previous methodology was previously agreed by ComReg and adopted in five previous USO net cost submissions by eir) which is the basis for the calculation of the net cost of uneconomic customers in economic areas.

17. Determining the degree of avoidability for individual customers is challenging. TERA have implemented a different and novel methodology which uses a distance from exchange approach. Specifically, TERA identifies urban / high density areas with reference to a 3 km boundary. According to ComReg use of 3 km is appropriate because such an approach has been used in pricing models. For the remaining network outside the boundary TERA then apply a refined L/N methodology[1] to rank network sections from "the most expensive" to "the least expensive" considering that underground deployment is more expensive than pole deployment. These "scores" are aggregated into groups. The 2016 CAM is then used to calculate 100 "incremental inventories", i.e. assets required to deploy a certain increment corresponding to a percentile of lines (i.e. 1%, 2%, 3% … until 100%). This allows TERA to estimate a cost avoidability distribution by MDF area that can be compared to the equivalent net revenue distribution as part of the probability analysis.

[1] L = length of an access line and N = the number of access lines that follow the same path. The higher the L/N factor is the more expensive the line.

18. The new methodology results in a very significant and lower net cost of uneconomic customers in economic areas. More importantly, as identified by eir, changes can only be proposed by ComReg — pursuant to Decision 15 of ComReg D04/11 — following assessment by ComReg of eir's USO funding application only in circumstances where '*material discrepancies'* are found in the sample "reality" checks of eir's application. No such material discrepancies were found in the sample "reality" checks of eir's application. Indeed eir's results are consistent with previous USO net cost submissions which included independent auditor PwC performing the agreed upon procedures as specified by ComReg to verify the net cost calculation. In other words, ComReg has not met its own pre-condition for the making of a 'proportionate adjustment' as required by Decision 15 i.e. that ComReg has carried out sample reality checks and found material discrepancies. There is therefore no basis for the making of any 'proportionate adjustment' in ComReg's proposed decision. eir also notes that the proposed adjustment involves almost halving the net cost from €11.97 million to €6.28 million. As a matter of plain English this is not a 'proportionate adjustment', and indeed there is no assessment of the proportionality or fairness of what ComReg is proposing, or whether it complies with the underlying requirements of the Universal Service Regulations 2011 concerning the basis upon which ComReg may assess unfair burden. In particular, Regulation 11 sets out the basis on which ComReg may legally assess unfair burden, noting that it may request information from the USO under Regulation 11(2). Regulation 11(3) then provides that ComReg is to assess unfair burden '*on the basis of such information, including information supplied under paragraph (2)'*. The Regulations do not however permit ComReg to, post-hoc, unilaterally replace the USO's information provided under Regulation 11(2), with its own cost assumptions using its own, unilaterally devised methodology.

19. The key driver of this result is the newly introduced TERA estimated cost avoidability distribution that results in a probability of being an uneconomic customer in an economic area that is much lower than estimated by eir in all other previous submissions (and accepted by ComReg).

20. Conceptually, the use of the 2016 CAM to estimate is possible, and the adjustments made by TERA to their methodology to capture concerns by eir are in some cases an improvement over the methodology as it was first explained to eir in 2018. For example, the use of an underground factor of 6 to capture the difference between in cost of underground and overhead deployments is certainly better than no such adjustment. However, more significantly, we continue to have material concerns with the proposed new TERA methodology. For example, the use of a 3km boundary is particularly problematic. With this approach uneconomic customers can essentially only exist on a probability basis beyond a fixed 3 km boundary from the exchange. Regardless of this and more fundamentally,

ComReg's proposed approach is not supported by the requirements of ComReg D04/11 or the underlying legislation.

21. Without prejudice to the detailed concerns set out above concerning the legal validity of making the proposed changes (including that ComReg has not met the preconditions set out in Decision 15) in order to test the validity of the assumptions and methodology employed by TERA we undertook a number of steps to review the proposed methodology.

22. First, we reviewed the new elements TERA has added to the Excel part of the USO model. Specifically, the changes made to "200501_Workbook A TERA Adjusted Customer Model Access part". The key new input is the 'TERA_I_Alloc' sheet that stores the new cost curves calculated based on the 2016 CAM. Using the same cost basis at the MDF level as in our version of the model, TERA estimate the avoidable costs over percentiles of lines for each asset category. This is in turn used to calculate the final distribution of lines per access cost band that feeds into the Main part of the customer model. With the data from the access part of the model imported into the main customer model it is able to derive an estimate of the net cost of uneconomic customers in economic areas.

23. Our review of the TERA methodology to the access part of the customer model suggests that the implementation of the final distribution of lines per access cost bands is consistent with the input needed in the main customer model, subject to the following comments or caveats:

- In the sheet 'TERA_C_AM', TERA summarise costs from the Area Model into several categories (Cable_OH, Cable_UG, Poles, Trenches, Total, Equi – range AK:AP). The cost of each category is used together with input sheet 'TERA_I_Alloc' in the sheet 'TERA_C_Cost_alloc' to estimate the costs per percentile per access category, i.e. the avoidable cost. The exception is the 'Equi' cost category that is simply allocated equally to each percentile. TERA has provided no justification for this treatment of the cost. The approach to allocate equally to each category suggests that the number of lines is the same in each percentage group of all MDFs, however closer inspection of section ranking Excel file provided by ComReg (SectionRanking.xlsx) suggests this is not the case (see also below in para 24, first bullet). Nevertheless, the approach as currently implemented by TERA results in a cost distribution where there is always one cost band with a very high proportion of lines and this cost band is where 1% of the assumed 'Equi' cost category falls within. If the 'Equi' cost category instead is allocated to the 'Total' category, i.e. treated in the same way as distance sensitive OPEX in the model, the net cost of uneconomic customers in economic areas increases by about €1.5 million

- In the sheet 'TERA_C_AM' TERA adjust the distance sensitive and non-distance sensitive OPEX costs from the Area Model with avoidability percentages from the 'I_Acc_Avoidability' sheet. These percentages have been estimated within the framework of the original eir approach. It is unclear whether they are appropriate for the TERA approach. For example, for the distance sensitive OPEX, TERA add these together with other cost categories (together termed 'Total') which are subsequently adjusted for availability in the 'TERA_C_Cost_alloc' sheet, in other words TERA has adjusted for avoidability twice. Removing the avoidability correction of the distance sensitive OPEX regulating from the 'I_Acc_Avoidability' sheet increases the net cost of uneconomic customers in the economic areas in the customer model by almost €2 million. Making a similar correction to the non-distance sensitive OPEX the net cost increases by an additional €0.5 million.

- According to TERA the assumed degree of avoidability is estimated with reference to the "*level of avoidability of CAPEX beyond the 3km boundary based on the 2016 CAM*"[2]. In other words, it is CAPEX that is the main driver of avoidability. No reference is made by TERA to the avoidability of OPEX. In the eir version of the USO model considerable attention and detail is applied to estimate the avoidability of OPEX. The new TERA methodology would appear, as it has done with its simplified 3km boundary assumption, to treat estimate avoidability of OPEX (with the exception of non-distance sensitive, see bullet above) and service specific costs as it would network build CAPEX in the model. No justification is provided by TERA for this assumption.

24. Second, we attempted to reconstruct the inputs needed to the access part of the customer model, i.e. the 'TERA_I_Alloc' sheet. This requires setting up the 2016 CAM aspect of the modelling according to methodology described by TERA, including use of a weighting between underground and overhead deployment, ranking according to the L/N methodology, implementation of the 3km boundary assumption and running the incremental and iterative aspects of Microsoft Access part of the CAM. As part of the review process, we were, upon extension of the deadline for submission, finally furnished with the additional files from ComReg after two previous requests for this information were not assented to by ComReg[3]. These were helpful in our reconstruction efforts but should have been provided from the outset as significant time and effort was wasted trying to decipher the TERA approach. Even with the new information provided by ComReg following from the extension of the response deadline, the lack of any detailed explanation for how the Microsoft Access section of the CAM has been used, gives rise to considerable uncertainty in interpretation of the TERA approach. No adequate or detailed model documentation for the TERA approach has been provided leaving us to "fill in the blanks". The results produced by our reconstruction are close but not equal to the TERA model. During our reconstruction attempts we noted the following concerns / observations:

[2] Instruction tab in "200501_Workbook A TERA Adjusted Customer Model Access part"
[3] These files were requested by eir in January 2020 and June 2020.

- The file ‘SectionRanking.xlsx’ shows that the number of lines differ by percentile. This would appear to be contrary to the L/N specification. For example, based on our calculations there are 3 percentile groups (4%, 5% 6%) which were empty, i.e. do not include active or passed lines at all. It is unclear how this can be reconciled with the statement in the ‘Instructions’ sheet in the access part of the Customer Model: "*The Microsoft Access section of the 2016 CAM generates 100 incremental inventories; each incremental inventory corresponds to a percentile of lines (i.e. 1%, 2%, 3% … until 100%, which represents the whole network modelled in the 2016 CAM following a scorched node approach).* "

- The 2016 CAM can be set with different parameters, use of bottom-up vs top-down, active vs. total lines etc. TERA has not provided any justification for the parameters it has selected to develop the avoidability percentiles. We note in this regard that the year of calculation is set to 2016 which refers to the 2016/17 financial year which is not consistent with the USO funding year of 2015/16.

- As explained above, several cost categories are used in the USO modelling (Cable_OH, Cable_UG, Poles, Trenches, Total, Equi). In the 2016 CAM model each percentile is allocated according to each MDF’s total cost (as of 2014, see the ‘Network roll-out over time’ sheet). This suggests that each percentile reflects the same cost ratios between MDF, i.e. the cost ratios in the sheet ‘FAR depreciation’ table 5 “Share by MDF based on 2014”. It is unclear how use of a fixed ratio would affect results, but it is likely to result in distortions.

- The 2016 CAM appears to exclude several asset classes in the process of calculating the cost allocation tables. This can be viewed in the ‘Results’ sheet of the 2016 CAM where Table no. 8 “USO Export” summarises selected annual network costs elements from Table no. 5 “Network annual cost”. The principles of exclusion/inclusion have not been explained and require clarification, in particular how this treatment relates to the calculation of avoidable costs of the cost categories (see previous bullet) in the access part of the Customer Model.

25. Third, having reconstructed (at least partially) the key calculations from the 2016 CAM we attempted to sensitivity test the model. Given the size and complexity of the model set-up this turned out to be a very lengthy and cumbersome task. In order to generate the required input in the form of the ‘TERA_I_Alloc’ input sheet the cost curves using the Microsoft Access section of the 2016 CAM need to be generated for 100 incremental inventories. This requires significant time and effort. Specifically, with the computing power available to us one full run of the model takes more than 30 hours. We find this to be a highly problematic aspect of the TERA approach and contrary to Decision No. 23 in ComReg D04/11: “*USO funding applications shall be supported by calculations in an MS Excel, or MS Access format,*

or alternative software *__which is reasonably capable of proper access and review".__* In this regard it is also unsurprising that no sensitivity analysis results have been provided by ComReg. However, without a detailed understanding of the implications of the assumptions made or indeed the ability to run an error identification process it is not possible to rigorously conclude on the adequacy of the TERA approach and therefore by association whether it would be capable of passing the stringent "sense-checks" and real-life verification requirements of ComReg D04/11. In all regulatory model work a key requirement is transparency and testability.[4] In both cases, the USO model input provided by TERA fail. It is therefore surprising the ComReg have elected to place such great faith in the results in the new TERA methodology, especially, when they differ so demonstrably from the results that have been produced by eir and approved by ComReg in previous years. Given the uncertainty in our attempt at reconstruction of the TERA approach and time required to run the sensitivities we opted not to pursue this option at this time. Accordingly, we present our concerns with the 3 km boundary and UG/OH ratio of 6 without any detailed analysis of the numerical implication of changing these assumptions.

3 km boundary

26. TERA claim that the 3km proxy is used to differentiate between isolated areas and "high-density"/more built-up areas. While an attempt to differentiate between isolated and non-isolated housing areas is certainly worthwhile and the agreed approach from previous funding applications, no evidence is offered by TERA or ComReg as to the appropriateness of using a 3km boundary. The only reference is to this being consistent with previous pricing decisions. In our view the use of the 3 km boundary raises several concerns:

- First, it is not clear why consistency or alignment between the USO modelling and these pricing decisions using the 3km boundary is important or logical. ComReg note that its "*methodology is a reasonable proxy to reflect the reality of eir's network and is aligned with approaches previously adopted by ComReg for costing similar wholesale access products and component products."*[5] However, the USO exercise differs fundamentally from other pricing and costing decisions made by ComReg. The 3km boundary is a technical feasibility assumption related to local loop unbundling which is not relevant for USO. Further, developing an avoidable cost profile for the customer model should not be compared to determining the cost of copper loop in a specific geotype based on irrelevant technical feasibilities for the purposes of a net cost calculation.

[4] Decision No. 24 in D04/11 makes clear that "*Any models submitted in support of a USO funding application shall be transparent:…"* & "*The models submitted shall be set out in a clear and transparent manner, showing the separate calculations for each component…*"
[5] Paragraph 48, second bullet, ComReg 21/17.

- Second, a key requirement for the USO model for the purpose of calculating uneconomic customers in economic areas is to differentiate between areas that are of low density and those that are of a high density. This is to ensure that the model adequately captures the differences in cost avoidability on a per line basis. Line density is a key driver of the degree of cost avoidability. In very dense areas most of the access infrastructure will be shared between customers, while in less dense areas the scattering of customers may require poles or trenching specifically for individual customers. In line with the above, the level of avoidability for individual customers would therefore also be expected to increase as line length increases. This is of course a general rule only. Some customers may be clustered in areas of low density and as such will share a much larger part of the access infrastructure compared to a situation where the same customers had been dispersed evenly in the specific area. For these reasons it was also a critical part of the development of the original customer model developed for the 2009/10 funding submission to capture the difference between isolated houses and housing areas. Segmenting the customer model into degrees of cost avoidability using a 3 km boundary is very crude. Exchange areas differ considerably in geographic size and how houses are dispersed. It is far from clear that a one-size-fits-all 3km boundary is appropriate for all exchange areas. No analysis or documentation by TERA is presented to justify this assumption nor has any indication been provided that alternatives were considered, for example, the use of different length assumptions by geotype or some other method that adequately captures the specific characteristics of an individual exchange areas. While it is not unreasonable to assume that cost avoidability for individual customers is higher the longer the line, use of a 3km boundary in our view not helpful in improving the accuracy of the customer model as suggested by ComReg, on the contrary, it is an arbitrary boundary, that implements a crude 'one-size-fits-all' segregation of premises into economic/uneconomic, which runs counter to the reality on the ground.

- Third, this simple rule of thumb results in cost curves which per definition lead to exclusion of uneconomic customers that are located in closer proximity to the exchange. This is contrary to what ComReg has accepted in previous applications and leads by design to a lower probability of customers being uneconomic in an economic exchange area. Despite this ComReg assert that it "*disagrees that its methodology materially underestimates the number of uneconomic customers.*"[6]

- Fourth, no sanity checks have been documented. Here ComReg Decision No. 15 clearly states that "*during the course of ComReg's assessment of a USO funding application, a number of sample "reality" checks will be undertaken*". Based on eir's analysis and verified "reality" checks undertaken in previous USO funding applications coupled with

[6] Paragraph 48, third bullet, ComReg 21/17

the sample checks undertaken by eir on the proposed methodology reveals that ComReg's approach is incapable of meeting its own requirement.

UG / OH ratio

27. TERA use an underground factor of 6 to capture the difference between cost of underground and overhead deployments. While use of such a ratio is better than no ratio, it is crude. The ratio between overhead and underground deployment will depend on the surface type. Trenching is considerably more expensive in built-up areas compared to rural areas, especially where the type of surface is soft such as grass and verge.

28. Using the 2016 CAM we have estimated the ratio for the whole network to be 6.28. This is reasonably close to 6, but raises the question why TERA have opted to use an integer of 6 when a more accurate number is available. However, more importantly, when we do the same analysis of the network beyond the 3km boundary limit we get a much larger factor of around 7.6-7.8 or approximately 25% higher. We would have liked to test the implications of changing this assumption, but as explained above this has not been possible.

Other considerations and findings

29. As noted above the key driver of the lower net cost figure is the revised distribution of access lines per cost band which TERA has calculated using the 2016 CAM. Essentially, TERA's calculations result in a cost distribution that skewed to the left compared to the one estimated by eir. This is illustrated in the figure below (note that the figure's y-axis is capped at 100,000 lines for illustrative purposes):

✂

30. ✂. Given such substantial differences in avoided cost it is unsurprising and consistent from a modelling perspective that TERA's changes lead to a very substantial reduction in net cost.

31. It is also possible to compare the distribution of uneconomic customers of the two approaches. This is shown in the figure below:

✂

32. It is difficult to make concrete conclusions based on these distributions, both models have a relatively significant number of uneconomic lines in the intervals between 17 to 20 and 27 to 30. However, it is clear that TERA's approach with its fewer uneconomic customers produces a lower net cost. Historically the distributions of uneconomic lines in previous verified and accepted funding applications are not too dissimilar to the one that is the result

of eir's analysis for the 2015/16 funding application. The TERA outcome is in this case a clear outlier.

33. To supplement our evaluation of the two approaches we made some high-level comparisons of the outcomes. Since the number of uneconomic customers in economic areas is spread across a very large number of MDF areas we opted to look only at a subset of exchange areas. Specifically, we decided only to consider those exchange areas where the net cost difference between the approaches was €50,000 and €100,000. This high-level evaluation suggested a tendency for the TERA approach to underestimate the number of uneconomic customers. While individual exchanges contribution might be relatively small to the total net cost of uneconomic customers in economic areas, cumulatively the effect of this underestimate of the number of uneconomic customers by TERA adds up to a very significant amount with over 1000 economic exchanges.

Summary of customer model evaluation

34. In our view it is not possible to say with any confidence that ComReg's new proposed methodology is an improvement over the established methodology as used (and accepted by ComReg) in all previous submissions by eir. It is only an alternative and one which cannot be proposed by ComReg unless there is material discrepancies in the sample "reality" checks in the uneconomic customers model as submitted by eir.

35. In our review of the 2016 CAM model and the Excel implementation of the CAM results in the Customer Model we have identified a significant number of potential shortcomings and issues which require clarification. Until these have been adequately dealt it is not possible to have faith in the results and certainly not possible to assert as ComReg does that its approach leads to better outcomes than the one submitted by eir. Note in particular, there is no principle in ComReg D04/11 that allows for the unilateral substitution of methodology based on alleged "better" outcomes – the requirement in Decision 15 is that 'material discrepancies' must first be identified based on carrying out reality "sense" checks, before any 'proportionate adjustment' can be proposed.

36. TERA has failed to document how the approach used by eir "*creates an inconsistency in the cost avoidability and cost distribution assumptions used in the USO Customer Model, which materially misestimates the total net cost of uneconomic customers in economic areas*"[7]. TERA has also failed to provide a model specification or documentation that adequately explains what they have done and why it is appropriate.

[7] TERA, Assessment of Eir's USO funding application – Direct net cost 2015-2016 – Confidential, p. 58

37. Finally, ComReg fail to demonstrate how their proposed approach is consistent with their own requirements outlined in D04/11. ComReg cannot reasonably propose an alternative calculation without also clearly setting out how it is compliant with its own requirements, this despite the responsibility for development of the customer model resides with eir. Given that the responsibility resides with eir, it is not clear on what basis, especially given the concerns outlined above, ComReg is entitled to unilaterally substitute its assessment for eir's.

Payphone Model

38. The Payphone Model calculates the cost to eir of providing uneconomic payphones in economic areas. Only those payphones that are subject to USO obligations may be considered as part of the USO net cost.

39. According to analysis by TERA an adjustment is required to the Payphone Model relating to advertising revenue. The Payphone Model calculates the net cost of uneconomic payphones both excluding advertising revenue and including advertising. In our funding application we excluded this revenue. TERA disagree with this treatment and add advertising revenue leading to a decrease in net cost and reduced number of uneconomic payphones in economic areas. TERA then make a further adjustment based on ComReg's Payphone 'Removal Policy' (ComReg Decision D08/14) leading to removal of additional payphones from the analysis and a resultant direct net cost of €22,929. A reduction of €360,331 compared to the amount of €383,260 claimed by eir.

40. With regard to the adjustment for advertising we acknowledge the need to avoid double counting with the intangible benefit calculation (see our response to question 4).

41. Regarding the adjustment related to the 'removals policy' we disagree and consider that the number of payphones used in the calculation of the net cost for uneconomic payphones is appropriate. We have in our responses to ComReg 17/73, 17/81,17/95, 17/109 and 18/36 laid out our view on the inadequacy of the 'removals policy' as a basis on which to inform an adjustment to the payphone model. eir considers that the criteria set out in the 'removals policy' do not allow for the efficient management of the payphone base and that the approach followed by TERA suffers from several practical issues. None of these have been addressed by TERA or by ComReg. While we agree to the publication of a 'removal policy' such a policy cannot reasonably be used as an instrument to remove existing payphones from the net cost calculation. There are real costs from provision of the existing payphone base. As part of the USO, the USP is required to maintain a significant number of payphones around the country, including locations where demand is too modest to cover the costs of service provision. These could have been avoided had eir not had the obligation and hence should be treated as such in the net cost calculation – this is consistent with ComReg

D04/11 which states that *"With respect to loss making payphones, ComReg proposes to assess these costs — by reference to the difference in actual costs that the USP as a commercial operator would have incurred had the USO be withdrawn for the year of an application for funding"*.

42. Given this, eir disagrees that a downward adjustment should be considered to reflect an efficient and appropriate number of payphones. It is unwarranted that ComReg should deny funding for uneconomic payphones which are in place solely because of ComReg's removals policy, which precludes the economically efficient discharge of the public payphone obligation.

Question 2: Do you have any observations on ComReg's preliminary view that consultancy costs incurred in respect of a USO funding application do not form part of the net cost?

43. eir 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 solely for the purpose of meeting the requirements of ComReg D04/11. Recovery of these costs is permitted by the Regulations as these are costs that would have been avoided in their entirety had there been no USO.

44. ComReg has justified this preliminary view by stating that the consultants' fees are not net costs of the universal service but were incurred in relation to the preparation of the funding applications. This is an unacceptably narrow interpretation of the applicable regulatory framework and therefore any decision to exclude these costs is flawed.

45. According to the Universal Service Directive (USD), "*It is important to ensure that the net cost of universal service obligations is properly calculated and that any financing is undertaken with minimum distortion to the market and to undertakings*".[8] This means that ensuring that the financing of the USO - be it in the form of the USP internalising its costs, or through a sharing mechanism - is undertaken in a competitively neutral manner. This requires that the net costs to the USP be determined in the first place.

46. eir's decision to seek funding is made within the scope of the USD and in the context of ensuring that the USO does not represent an unfair burden, a requirement that undoubtedly rests with ComReg to satisfy. It is not, as ComReg's puts it, that "*The decision to make a USO application for funding is eir's commercial decision and is not required by any universal service obligation*".[9]

47. The legislative framework establishes that these costs should be determined against a counterfactual which departs from standard commercial decision-making.[10] In this regard, ComReg has determined that an independent verification must be completed[11] and the estimation of indirect benefits associated with the USO must be conducted separately to

[8] Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2012 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive), Recital 18.

[9] Para 204, ComReg Document 21/17

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

[11] ComReg D04/11, Decision 22, "*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*".

eir.[12] Both these stipulations by ComReg mean that eir must incur these costs when preparing and submitting an application due to the requirements imposed on it by ComReg D04/11.[13] As such the consultancy costs are solely and directly attributable to eir'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*".[14] The consultancy costs clearly fall into the category of avoidable costs if there had been no USO.

48. eir's view is supported by international precedent. For example, in France the funding of the net cost of USO is done through a sharing mechanism (a fund managed by Caisse des Dépôts on behalf of the regulator ARCEP), which includes the costs of managing the fund itself (including regulatory audits required to calculate the net cost and turnover relevant for the assessment of contributions, costs of 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).[15] In Italy, where it was judged that a sharing mechanism was not necessary (given that the benefits were in excess of the costs calculated), the verification costs incurred by AGCOM were nevertheless shared between operators.[16] As ComReg is aware, ComReg's exclusion of consultancy costs from the net calculation is currently under appeal by eir in the USO Case referenced in paragraph 11 above. It is therefore surprising that ComReg is proposing to make a Decision on this point, when it is before the Irish courts for decision. If ComReg does proceed to a final Decision on this point, eir will have no option but to apply to the court to have this Decision added to the current proceedings.

[12] ComReg 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.

[13] For these reasons we find that ComReg's comment in paragraph 196 of ComReg document 21/17 that "*No explanation was given for the inclusion of this figure*" (i.e. Consultancy fees costs) disingenuous. The explanation, as ComReg is well aware, and has been made aware previously resides in the applicable legal requirements associated with the preparation of a USO funding application.

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

[15] ARCEP, "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

[16] 46 AGCOM, Decision 100/14/CIR

Question 3: Based on ComReg's assessment, detailed in Sections 5 and 7, do you have any observations on ComReg's preliminary view that the positive net cost for 2015/16 is €6,701,390?

49. We do not agree with ComReg's preliminary view that the direct net cost for 2015/16 is €6,701,3980. As explained above in response to questions 1 and 2, ComReg's new methodology is extreme and often undocumented. The treatment of OPEX is a specific case in point. Here we have found no documentation for the approach used and that changing allocation assumptions can increase the net cost of uneconomic customers in economic areas by several million euro. In addition, legitimately incurred consultancy costs of €2,387,956 must be included.

50. As set out in eir's response to Question 1, ComReg new methodology is inconsistent with a number of key requirements of ComReg D04/11 including Decision 12, Decision 13 and Decision 15. Importantly, as set out in eir's response to Question 1, ComReg's new methodology proposal is ultra vires to the requirements which allows for such a proposal pursuant to ComReg Decision 15 of ComReg D04/11.

51. In terms of the life-cycle benefit calculation we agree with the correction made by Oxera. We also agree with the consistency adjustment made for marketing benefits.

Question 4: Following ComReg's assessment, do you have any observations on ComReg's preliminary view that a positive net cost of €6,701,390 (or €12,861,430 as claimed by eir) is not an unfair burden on eir for the period 2015-2016?

52. eir does not agree with ComReg's preliminary view. A positive net cost as per ComReg's primary view or indeed the cumulative net cost over six years in excess of €50m is clearly an unfair burden to impose exclusively on a single operator. It is a cost that is manifestly excessive for one operator to bear, considering that no positive benefit whatsoever accrues to the operator concerned, as any benefit is included in determining the net cost.

53. In our response to ComReg 17/73, 17/81, 17/95, 17/109 and 18/36 we discussed the shortcomings of ComReg's approach to determination of an unfair burden. ComReg has in their evaluation of eir's 2015/16 funding submission essentially used the same logic of analysis as applied previously. eir's response on the unfair burden to ComReg 17/73, 17/81, 17/95, 17/109 and 18/36 is therefore still applicable to the analysis conducted by ComReg for the 2015/16 funding period, and we would refer ComReg to those responses. eir has also made further and more detailed submissions concerning errors in ComReg's approach and findings on unfair burden, in the USO Case referenced at paragraph 10 above. The points made, both in previous USO consultations and in the USO Case apply mutatis mutandis to ComReg's proposed analysis and conclusions on unfair burden in this case. We refer ComReg to all these submissions, copies of which ComReg already has, and which should be treated as part of eir's response to the present consultation (noting however that the USO Case submissions remain confidential in their entirety and may not be published at this point in the litigation). Please also see eir's comments in paragraph 10 above, noting that if ComReg proceeds to a Decision on unfair burden while the matter is still before the CJEU and the Irish courts, eir will have no option but to apply to the court to have ComReg's Decision added to the ongoing appeal.

54. In the following we summarise briefly a number of the points made in the previous response and provide additional commentary where appropriate (however we refer ComReg to the detailed submissions referenced above, for the full details of eir's arguments):

- <u>ComReg's assessment makes no material use of the USO net cost submissions</u>: ComReg conclude that there was no evidence of the net cost of the USO being an unfair burden given that eir's returns on capital is above the regulated WACC. However, this conclusion could have been derived without making use of the USO submissions. While ComReg do compare the effect of the net cost with respect to its impact on profitability (measured as a ROCE of the fixed-line business), the conclusion reached could have been derived without making use of the USO submissions given that the current ROCE is above the WACC. Accounting for the net cost serves only to increase the ROCE, hence there is, as previously argued by eir, no material use of the USO net cost submission. What the analysis by Oxera suggests is that for there to be no returns above the WACC in 2015/16, the net cost of the USO would have to have been around five times higher to supress the ROCE sufficiently (i.e., more than € 60 million in 2015/16 alone). In other words, this is the implicit bar ComReg is setting for the determination of an unfair burden. Clearly, this is a disproportionately high bar to set.

- ComReg's competitive benchmark approach is flawed: ComReg's profitability assessment is based on a comparison between eir's profitability and a "competitive benchmark". While eir can accept more recent estimates of the competitive benchmark for earlier years of funding applications where the 2008 WACC is used[17] eir disagree with the approach and continue to believe that significant ex post adjustments are required as it underestimates the real cost of capital for eir at that time. Departing from the regulatory (ex ante) WACC for the specific purpose of determining an unfair burden would not as suggested by ComReg[18] result in uncertainty and inconsistency in regulatory decisions.

- The 'Fixed-line business' is not the correct definition for the purpose of ComReg's assessment of eir financial position: eir considers the 'USO business' to be a more appropriate definition as it includes only those services which are related to the discharge of the USO and hence a better representation of the return on capital of a USP operator. The reasons for this view are set out in our response to ComReg 17/73, 17/81,17/95, 17/109 and 18/36.

- ComReg use an inappropriate judgment of what the relevant time-period for analysis should be: eir considers that given the multi-year nature of the USO, the assessment of whether it constitutes an unfair burden should in principle be made with reference to a period longer than one year. The amortisation of capital expenditure related to the USO will in most cases exceed a one-year period and frequently exceed the designation period. From this point of view, the designation period could be seen as a lower-bound for a relevant period of assessment of eir's profitability. For practical reasons, the net cost of USO needs to be calculated on an annual basis, but that should not limit the evaluation of an unfair burden to the same time frame. It should consider how net cost affects the USP over time. While ComReg had only limited data available during the initial years of calculating the net cost of USO, this is no longer the case.

- ComReg's use of HCA for an assessment of profitability in the context of the unfair burden assessment in not appropriate: eir submits that a CCA or Modern Equivalent Asset (MEA) value would be a more appropriate measure of MCE than HCA. Best practice assessments of a company's return on capital are based on the 'fair value' of

[17] As a benchmark for eir's profitability for the years 2010/11 to 2011/13.
[18] ComReg 19/41 paragraph 222

assets to calculate the capital employed. Use of such an approach would imply that the ROCE would be lower, impacting on the conclusions drawn on profitability. In Decision 19/41 ComReg acknowledge that "*CCA may inform what is in principle an 'economically meaningful measure of profitability*'" but go on to argue that there are no adequate CCA accounts available and reference Regulation 11(7) of the Regulation which refer to need for accuracy of the accounts and other information used to inform the net cost calculation. In terms of Regulation 11(7) this is only related to the net cost calculation itself and not the assessment of an unfair burden. Regarding the lack of an alternative to HCA eir agree that such is not available, however, this should not prevent alternatives being used to inform ComReg in its evaluation of an unfair burden. Where there are clear indications as demonstrated by eir in its submission to ComReg 17/73, 17/81, 17/95, 17/109 and 18/36 that the return on capital employed would have been much lower on a 'fair value' basis compared on a historic basis this should factor into the ComReg analysis and require further investigation.

- <u>The profitability of eir alone should not be viewed as an absolute criterion for determination of an unfair burden</u>: ComReg presents eir's profitability and its financial strength as evidence that eir had the ability to internalise the net costs associated with the USO. ComReg's position means that eir must subsidise its competitors. It raises the costs incurred by eir while lowering the costs of eir's competitors. This is not consistent with the principle of fair competition and is in fundamental contradiction with one of the principles of the regulatory framework for electronic communications which is designed to ensure a level playing field for all operators. Put simply it is not sufficient for ComReg only to consider the profitability of eir when evaluating an unfair burden, consideration should be given to the market as a whole. eir's point should not be reduced to a question of how companies can be compared as suggested by ComReg in Decision 19/41.[19] Comparisons must clearly be made using a reasonable approach.

- <u>ComReg has failed to adequately consider the competitive disadvantage for a USP</u>: In the counterfactual scenario it is undisputed that eir's profitability would have been higher than it is when eir is burdened with the USO. From this it is clear that the availability of a mechanism that compensates for the negative impact of USO price regulation is a condition for eir to pursue market-based, efficient pricing strategies. In our response to ComReg 17/73, 17/81, 17/95, 17/109 and 18/36 we provided compelling evidence of the changes in market structure, revenue shares, ARPU etc. It is undeniable that eir's competitive position has seen a significant and continuous deterioration since 2009/10. In urban areas in particular eir has experienced a very significant loss of customers. Coupled with significant and detailed price regulation eir's

[19] Paragraphs 262 and 263

ability to cross-subsidise is greatly undermined by these developments. The absence of funding for the USO is therefore clearly a competitive disadvantage for eir relative to other market participants. (See also eir's comments above re the CJEU reference concerning the nature of ComReg's assessment of unfair burden).

- ComReg's analysis shows no concern for international precedent: There is international precedent for providing USO funding. While the practical approaches employed by national regulators vary from that of ComReg, it our view that if any of these approaches were applied to eir they would lead to a judgment of an unfair burden. It is not appropriate for ComReg in Decision 19/41[20] to simply dismiss international precedents as having limited direct relevance. Even ComReg's consultants Oxera refer to approaches taken in other jurisdictions, e.g., on the time-period for calculation of the life-cycle benefits.

To summarise, eir fundamentally disagrees with the approach ComReg has used to determine the existence of an unfair burden. Accordingly, eir submits that ComReg's preliminary finding that a positive net cost does not constitute an unfair burden is untenable. Oxera's profitability assessment must be amended by taking onboard our comments (including those set out in our previous submissions referenced above). This will make it more robust and in line with international best practice and lead, in our view, to a conclusion that the net cost incurred by eir is an unfair burden. At a minimum ComReg should wait until the question of assessment of unfair burden has been adjudicated upon by the CJEU and the Irish courts.

[20] Paragraph 291

Vodafone Response to Consultation

Assessment of eir's 2015-2016 Universal Service Fund Application

Assessment of the net cost and unfair burden for the period 2015-2016

Reference: ComReg Doc 21/17

Version: Non-Confidential

Date: 18/5/21

Introduction

Vodafone welcomes the opportunity to respond to the ComReg assessment of the net cost of Universal Service and the assessments of unfair burden for the period 2015 to 2016.

The consultation deals with the claim from Eircom for USO cost funding for 2015/2016 which they state amounts to €12.86m. From its initial review ComReg found the actual cost under consideration for its review was €6.7m, taking into account updated data from the 2016 CAM and some adjustments downward of Payphone and consultancy support fees. ComReg's preliminary view is that the positive net cost of €6.7m (or of €12.86m as claimed by Eircom) is not an unfair burden for the period 2015-2016.

It is a long-stated position of Vodafone that Eircom are pricing excessively in wholesale markets and this has been the case since Vodafone entered the fixed market. The profitability of Eircom is clear with consistent ROCE well above the regulated WACC of 8.18%. Eircom continue to be one of the most profitable incumbent telecom operators in Europe. The EBITDA Margin at the end of December 2020 was 49% before adjustments. It is extremely reliant on wholesale to maintain high profits and against this backdrop it defies any logic that industry would be required to provide additional funding to Eircom in the form of any Universal service payment. Vodafone payments have made very significant financial contributions to the overall profitability of Eircom during the period of the review and in subsequent years. To seek to supplement excess profits for wholesale services with a further payment for USO is completely unjustified.

Vodafone are reliant on regulation to deliver certainty and stability on wholesale pricing and we continue to push for fair and balanced regulation, for a fair return on investment (using an up to date WACC), and up to date regulated pricing for WLR, FTTC and other wholesale services. The spectre of USO funding requests, in a market where wholesale costs are so high when compared across Europe, is undeniably an impediment to investment in Ireland.

The responses to specific consultation questions are set out below.

In summary <u>Vodafone agrees with the ComReg preliminary positions.</u> ComReg agree with Oxera's conclusion that the net cost of USO did not significantly affect Eircom profitability and its ability to achieve a fair rate of return on capital employed.

Background

It is useful to summarise the wider context in terms of USO funding requests going back over 10 years at this stage.

Vodafone has always noted this is a complex costing exercise and one which requires ongoing engagement between ComReg and Eircom however there is an unacceptable level of uncertainty with the number of years that remain subject to challenge or evaluation.

USO Decisions 2010-2015

In 2019 ComReg issued Decisions[1] that the positive net cost for each year did not represent an unfair burden on Eircom. The total amount under consideration in aggregate was approximately €43m ComReg determined that the net cost did not materially affect Eircom's profitability and ability to earn a fair rate of return on capital employed, that the net cost was not excessive in view of Eircom's ability to bear it, and that the net cost did not cause a significant competitive disadvantage for Eircom.

These Decisions are subject to appeal and Vodafone does not propose to comment any further other than to highlight the high level of uncertainty arising for industry.

USO Fund Applications 2016-2020

ComReg have published[2] information notices in relation to Universal Service Fund Applications for the years 2016 through to 2020. ComReg note the deadlines have passed for submission of funding requests as required in ComReg's Decision on the Cost of universal service obligations (Principles and Methodologies) D04/11. ComReg information notices indicate that Eircom did not to submit funding requests as per requirements of D04/11. Vodafone note the statement that D04/11 requirements remain in place.

[1] ComReg Decisions D05/19, D06/19, D07/19, D08/19 and D09/19
[2] ComReg documents 21/44, 19/34, 18/76

Consultation Questions

Question 1: Do you have any observations on the results of ComReg's direct net cost calculation?

Vodafone Response: Vodafone do not propose to comment on the specifics of the detailed TERA analysis and note ComReg's preliminary view in paragraphs 194 and 195 that the adjustments made by ComReg (regarding uneconomical customers, the Payphone model and consultancy fees) improved the accuracy of net cost calculations in line with the relevant principles and methodologies in D04/11.

The impact of the 2016 CAM is market and Vodafone welcome the use of more precise data to inform the calculation of Direct net cost

Vodafone agree there should be a downward adjustment as reflected in the revised calculations. Arguably further reductions are appropriate. It is worth recalling that after significant delay WLR prices became cost oriented in July 2016 when they dropped from €18.02 to €15.91. The level of reduction demonstrates the high level of recovery on basic access that existing during these years. It should be further noted at the same as customers migrated on to FTTC based products the prices of these wholesale products were also increasing. In July 2015 wholesale FTTC customers faced a price increase of €2 on basic standalone VUA which further increased in July 2016 by €3.50 negating any benefit of the 2016 WLR price reduction.

Question 2: Do you have any observations on ComReg's preliminary view that consultancy costs incurred in respect of a USO funding application do not form part of the net cost?

Vodafone Response: Vodafone agree that the decision to make a funding request is a commercial decision by Eircom and should be disallowed.

Question 3: Based on ComReg's assessment, detailed in Sections 5 and 7, do you have any observations on ComReg's preliminary view that the positive net cost for 2015/16 is €6,701,390?

Vodafone Response: Vodafone do not propose to comment on the specifics of the detailed Oxera analysis and would agree on the scope of intangible benefits informing ComRegs preliminary review. Notwithstanding the points above regarding direct net cost calculation we agree with the approach to calculation of the positive net cost.

Question 4: Following ComReg's assessment, do you have any observations on ComReg's preliminary view that a positive net cost of €6,701,390 (or €12,861,430 as claimed by eir) is not an unfair burden on eir for the period 2015-2016?

Vodafone Response: Vodafone agree that a positive net cost of €6.7m or €12.8m is not an unfair burden on Eircom.

ENDS