Commission for
Communications Regulation

Bitstream price control

Responses to ComReg Document No 10/56

Submissions to Consultation 10/56

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Content

Section

1: ALTO

alto

alternative operators in the communications market

Response to Consultation on Wholesale Broadband Access: Consultation and draft decison on the appropriate price control Ref: 10/56

Submission By ALTO

ALTO is pleased to respond to the Consultation on ComReg's Wholesale Broadband Access – WBA, and draft decision on the appropriate price control.

ALTO welcomes the Consultation as a way of ensuring alignment of strategic priorities, price control, cost control, and transparency. It should also provide a degree of regulatory certainty, which can have the effect of encouraging investment in the communications market.

We welcome this consultation on the price control for the WBA Market here and ComReg's initiative to address margin pressures and wholesale pricing uncertainty in the Irish Market for WBA.

eircom continue to enjoy enduring dominance, 68.0% of the DSL Retail Market and 97% of the WBA market when eircom self supply is included [ComReg Q2 2010 figures]. Through vertical integration eircom also control the supply of services to the Wholesale Physical Network Infrastructure Access – WPNIA, market (formally the market for wholesale unbundled access (including shared access) to metallic loops and sub loops – commonly known as the Local Loop Unbundling Market).

The WPNIA market equals circa 3% of the DSL Retail Market.

The supply problems to the LLU (now WPNIA) market are well documented on the ComReg Web site going back many years, and yet we continue to experience what we consider are supply restrictions in the WPNIA market limiting our ability to compete in the WBA market. The lack of transparency of Equivalence of Input – EoI, between that which eircom supplies itself compared to that supplied to other operators remains a deep rooted problem in Ireland and we are seeking the ComReg establish a price control regime that provides the incentive for eircom to resolve the current issues. Moreover, eircom have indicated to industry that they are intending to maintain closed self supply of order handling and services for their own downstream businesses going forward for future WPNIA fibre products. This is unacceptable.

We welcome and support the ComReg minimum and maximum price control proposals; observing the need to limit eircom's ability to disrupt and potentially distort the market with price changes within those boundaries to suit eircom's commercial benefit. We consider the price change process should be regulated by ComReg so that eircom cannot alter their pricing without passing margin tests developed by ComReg and giving not less than three months prior notice to industry.

ALTO welcomes the clear and logical recognition that 'economic space' is required to be maintained between WBA and WPNIA.

ALTO feels however, that the proposed pricing and pricing methodologies are incorrect. ALTO feels that a Reasonably Efficient Operator – REO, costing methodology should have been used rather than the Equally Equivalent Operator – EEO, costing methodology.

Utilising REO would have changed the proposed pricing that ALTO feels does not leave an economic space with WPNIA line share, the unbundled bitstream equivalent. ComReg should consider this matter further.

ALTO notes that the fixed market has been subject to what can be characterised as aggressive *block and hold* behaviours by the incumbent over the past two to three years (some may suggest longer).

ALTO members have exhaustively invested in network in Ireland, which for the most part has resulted in derisory or limited returns. We call on ComReg to strive to replace the current scenario with a set of relevant, measured and achievable outputs to the benefit of the consumer, competition and innovation in the Irish market.

It is ALTO's view that competition in Ireland has been severely hampered by the elements mentioned above, in addition to an incumbent operator whose owners have engaged in little or not tangible investment to the benefit of their (wholesale) customers.

Response to Consultation Questions:

Q. 1. Do you agree with the detail of the proposed price control including the different specification of the *ex-ante* obligation not to margin (price) squeeze? Please state the reasons for your response.

A. 1. We agree with the detail of the proposed price control including the different specification of the *ex ante* obligation not to margin (price) squeeze. We are supportive given our concerns in previous submissions to ComReg concerning the closeness of the bitstream prices with the Line Share price. The additional network costs borne by the alternative operators to use WPNIA products to offer an equivalent service to eircom WBA products have to be considered within any margin between WPNIA and WBA products. Past experience has indicated to us that we could not match some of the eircom WBA prices prior to the ComReg LLU price changes; hence it's essential that the margin test is on individual products and the baskets as well to prevent the manipulation of prices in the basket to enable certain products to margin squeeze.

We have observed that the recent ComReg reductions in the prices of line share and full unbundling has been followed by eircom's offering of bitstream BMB services and this again brings pressure on the margins between eircom's WBA products and WPNIA products such as LLU Line Share. In our view the constant erosion of this margin has been one of the key factors stalling the growth of the WPNIA LLU market

Q. 2. Do you agree with the preliminary views in relation to the duration and future review of the price control? Please state the reasons for your response.

A. 2. We agree that there is a need for ComReg to set the prices for a period of time to bring some certainty for investment. However, one year is too short given the nascent and fragile nature of the WPNIA market. We believe it would be more appropriate to set a period of time for the WPNIA market to reach critical mass, and hence a commercial footing to compete with eircom in the WBA market. We consider there are enduring restrictions (discussed below) limiting the potential of the WPNIA market hence the threshold approach would provide a more appropriate model to incentivise eircom.

A number of issues are causing concern for the growth of the WPNIA market including but not limited to:

1. We consider eircom are restricting the rate of bulk migrations from bitstream to LLU as we were informed by eircom for health and safety reason the bulk migration rate per exchanges was severely restricted and levels were set by eircom. This appears at odds with the rapid rate at which eircom are migrating their own WBA customers to BMB solutions and the apparent moving of their customers from older ADSL equipment to modern ADSL2+ equipment.

2. eircom are now aggressively pricing and promoting their BMB proposal to directly undermine the WPNIA market;

3. There have been problems in purchasing off-the-shelf NGN solutions for backhauling further LLU roll-out, although these backhaul issues may or may not be resolved following ComReg intervention. This has caused uncertainty.

4. Discrimination in migration pricing; 30 Euro to migrate from LLU to bitstream and 45 Euro in the bitstream to LLU direction,

5. Discrimination that eircom downstream services are left connected to the eircom service when the service is ceased, enabling simple same day remote enablement for new customers. However for LLU the services are physically disconnected meaning that it will take up to ten working days (Two calendar weeks) to connect new LLU customers with the increased risk of service problems and network intervention has occurred,.

Together these issues are creating an environment of uncertainty that is acting to stall the investment and growth of the WPNIA market. We have seen such problems for many years, as evidenced on the ComReg website, and it's continuing.

As above we are of the view that urgent action is required to incentivise eircom to remove these unreasonable competitive barriers to the WPNIA market and as above a different scheme should be put in place where the nascent WPNIA market is allowed to reach a critical mass volume of circa 150 thousand active WPNIA customer connections using LLU.

Q. 3. Do you agree with the proposed notification and approval procedures? Please state the reasons for your response.

A. 3. We agree with the proposed notification and approval procedures offered by ComReg but seek greater transparency of the approval procedure and sufficient notification periods.

Approval Process and Transparency

The issue of eircom introducing a new Leased Lines Reference Offer – LLRO, without discussion caused serious concern in the industry as this is a multi-million euro supply contract to many providers, and eircom claimed it was agreed by ComReg, Given that eircom used the ComReg approval to defend their actions this has brought into focus questions as to what is actually being approved by ComReg. We are thus seeking far more transparency as to how this process works and what is the scope of the approval and operators ability to challenge it. The eircom was not helpful for meaningful negotiations and regulatory certainty and only after lengthy debates was the document opened for discussion. Reference Offers form the basis for major supply agreements to the industry and their stability and certainty is very important to the functioning of the markets, hence changes must be managed carefully and in a transparent way.

Notification Period/s

It is essential that operators have sufficient notice of pricing changes given their need to review and or change commercial packages and regulatory notification of consumers as maybe necessary. Additionally, the notice provides operators the opportunity to take a view of whether there are compliance issues not visible to ComReg before the eircom products or product changes enter the market.

Q. 4. Do you agree with the costing methodology proposed to determine the maximum prices for bitstream rentals? Please set the reasons for your response and set out in detail any specific amendments, supported by detailed analysis where appropriate, to the costing methodology you believe are required.

A. 4. Given the nascent state of competition in the WBA market, we agree with the tilted annuity approach to modelling the eircom costs.

We agree with ComReg that the WBA market in Ireland is no longer in the start up phase and the costs are known hence it is now possible to regulate eircom using a cost orientation model. Whilst we support ComReg's view we believe that any variation of the price by eircom within the range has the potential to distort and disrupt the market for upstream and downstream providers and would thus seek that ComReg regulate the change process as we believe changes by eircom will only be for the benefit of eircom. As a minimum ComReg should carry our per product instance and basket margin squeeze tests and require three months notice of any change so that the industry can input to the ComReg approval process.

Q. 5. Do you agree that in setting a price control in the WBA market that an appropriate economic space to the relative prices of LLU should be maintained? Please state the reasons for your response.

A. 5. We agree that an appropriate economic space between the WBA market and the relative prices of LLU should be maintained for the following reasons:

1. Past pricing pressure. - Experience shows that eircom are prepared to apply margin pressure to the WPNIA market as seen with their pricing of wholesale bitstream products in the past. eircom's WBA prices includes the

copper line from the customer to the exchange; the DSLAM; power; air conditioning; land rental; repair; backhaul; and core network and was priced to with a Euro of the Line Share price. The Line Share service only includes the copper line from the customer premises to the exchange and the access seekers have then to separately purchase and add all of the other components in the list above leading to prices above the eircom wholesale bitstream price.

2. Current pricing pressure. - We note following the intervention of ComReg and associated court activity to reduce the LLU prices, that eircom has now aggressively entered the WBA market with their BMB product. The BMB product is again bringing pressure on the LLU margins and hence the viability of the LLU based solutions.

3. Testing each product for Margin Squeeze – We welcome and support ComReg's proposal to test both the individual eircom wholesale product and the basket of products to prevent eircom from engineering their products within a basket to bring pricing pressure on popular products. The single and basket tests are very welcome as we believe this is how eircom manages to price pressure LLU without being sanctioned. We believe that ComReg should include the eircom wholesale solutions business (or whatever eircom are calling it) within the price control and margin testing as it is also operating in the WBA market

4. Wholesale downstream solutions. – We are aware that eircom have now moved into the wholesale downstream solutions market as evidenced by the emergence of their white-labelled wholesale solutions. These bundled wholesale solutions offer higher value than the standalone-regulated services and act to further price pressure the underlying regulated products as more of the retailer activity is provided within the wholesale cost. We are

seeking that ComReg consider the eircom wholesale solutions business (or whatever eircom are calling it) within any margin test given the additional functionality on offer.

5. No Evidence of Change. - There is no evidence that eircom will allow an appropriate economic space between the WPNIA market and the WBA market (including WBA Wholesale solutions), in fact the contrary exists through white label and the aggressive drive for BMB. It is thus essential ComReg establish regulatory certainty for the WPNIA market to support competing WBA solutions to eircom.

Q. 6. Do you agree with the proposed hypothetical entrant model to set the minimum prices for bitstream rentals in order to maintain an appropriate economic space? Please state the reasons for your response, providing worked examples and/or robust data to support your views.

A. 6. We agree with the proposed hypothetical entrant model to set the cost orientated price and agree that this minimum price should be set at such a level to achieve and appropriate economic space between the WBA Market (including Wholesale solutions WBA products) and the WPNIA LLU market.

Q. 7. Are there any issues in relation to the appropriate price control for the WBA market that ComReg has not considered in this consultation? If so, please document and explain those issues fully and provide examples where appropriate.

A. 7. We consider the following issues in relation to the appropriate price control for the WBA market that ComReg has not considered in this consultation are:

1. The price control and margin squeeze testing should apply to both eircom's WBA regulatory products and to its wholesale solutions business of regulatory products to prevent such circumventing the regulatory aims.

2. Individual Migration Charges – The prices for migrations from LLU to bitstream and bitstream to bitstream should be aligned with the bitstream to LLU charge of 45 Euro. WPNIA providers are at a significant disadvantage to eircom and either the prices should be aligned or the difference built into the price control between the WBA and WPNIA markets.

3. Bulk Migration Charges – We believe eircom are waiving or discounting bulk bitstream to bitstream wholesale migration prices through commercial deals when they sign a retail provider to their network. eircom are currently charging a bulk migration fee of BT 34 Euro per line and a significant bulk management fee to migrate bitstream customers to LLU and this should be factored into bitstream to bitstream wholesale transfers.

   We consider that the difficulties of getting eircom to bulk migrate bitstream to LLU means that operators have no option but to seek project management and ComReg should factor this into the economic space between the WPNIA and WBA markets. This was certainly our experience and we can price pricing information in confidence.

4. Bulk Migration Volumes – The rate at which eircom migrate customers from bitstream to LLU is very low and it can take many months to migrate what internationally would be defined as very modest volumes. The delays in migrating significant volumes quickly have a value and ComReg should factor this into its model. We can provide real experience and timings to ComReg for this activity.

5. Factoring in the cost of repair for full unbundling and line share where required.

6. Factoring in the cost of MDF blocks including those with Over Voltage Protection (very significant cost), footprint/land rental, ironwork, power unit charges etc with all the other standard costs that ComReg have recognised.

7. eircom have now launched their Fibre to the Home Pilot (which is not a trial) and we would expect this service to target LLU and urban areas as it will use the same criteria of customer density and volumes as part of its business case. Therefore, ComReg should consider this when reviewing the depreciation of equipment in these areas as such may replaced in a shorter time frame than other areas raising its economic cost.

Q. 8. Do you agree with the preliminary views expressed by ComReg? Please state the reasons for your response and please explain which preliminary view(s) you do not agree with and detail what specific amendments you believe are required.

A. 8. We agree with the preliminary views expressed by ComReg and agree that a cost orientated max and minimum prices should be established. However it should not be possible for eircom to vary their prices within the range without going through a regulatory approval process and a minimum three month notification period to give operators an opportunity to object. We also agree fully with ComReg that each product should be margin tested individually and as a basket to prevent commercial skewing of the basket to pass the test.

We consider that ComReg should factor supply issues and the costs of discrimination experienced by other operators into the economic space between the WBA market and the WPNIA LLU market.

Promotions

We welcome the inclusion of promotions in the Decision Notice and note a number of eircom promotions lasting six months that are then continued for further six-month periods. This has the effect that the promotion is a permanent change/feature, rather than a short-term offer. It would be helpful for ComReg to define what is deemed a promotion in the Decision Notice as in the normal usage of the word eircom is abusing the aim promotions. A suggestion is that promotions should be a short-term offer not lasting more than three months and if continued it’s considered as a product change.

Q. 9. Do you believe that the draft text of the proposed decision is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

A. 9. We consider that the text as proposed is sufficiently detailed, however given the notorious difficulty in proving discrimination there should be a specific Non-discrimination clause to prevent eircom offering this regulated product and downstream Wholesale Solutions using the WBA component at different prices to different wholesale customers. To address this ComReg should impose both a specific Non-discrimination clause combined with a transparency obligation that eircom has to publish all prices offered for WBA products. If eircom is offering services to the published price list then there should be no argument, however if discounts or different prices are being applied the transparency obligation will drive compliant behaviour. Basically the non-discrimination regulatory remedies do not work properly without associated transparency obligations.

Q. 10. Do you have any views on this Regulatory Impact Assessment and is there other factors (if any) ComReg should consider in completing its Regulatory Impact Assessment? Please explain your response and provide details of any factors that should be considered by ComReg.

A. 10. We agree with the ComReg regulatory impact assessment that the preferred approach should be cost orientation with an *ex-ante* obligation on eircom not to Margin Squeeze.

ALTO

22nd September 2010

2: BT Communications Ireland Ltd.

BT Communications Ireland Ltd ("BT")
Response to ComReg Consultation and draft decision on the appropriate price control for Wholesale Broadband Access.

ComReg Reference Document No. 10/56

Issue 1 – 22nd September 2010

1. Introduction

We welcome this consultation on the price control for the Wholesale Broadband Access (WBA) Market here in Ireland and ComReg's initiative to address margin pressures and wholesale pricing uncertainty in the Irish Market for WBA.

Eircom continues to enjoy enduring dominance: 68.0% of the DSL Retail Market and 97% of the WBA market when Eircom self supply is included [ComReg Q2 2010 figures]. Through vertical integration Eircom also controls the supply of services to the Wholesale Physical Network Infrastructure Access (WPNIA) market (formally the market for wholesale unbundled access (including shared access) to metallic loops and sub loops – commonly known as the Local Loop Unbundling Market). The WPNIA market equals circa 3% of the DSL Market.

The supply problems to the LLU (now WPNIA) market are well documented on the ComReg Web Site going back many years, and yet we continue to experience what we consider supply restrictions in the WPNIA market limiting our ability to compete in the WBA market. The lack of transparency of Equivalence of Input (EoI) between that which Eircom supplies itself compared to that supplied to other operators remains a deep rooted problem in Ireland and we are seeking ComReg to establish a price control regime that provides the incentive for Eircom to resolve the current issues. Moreover Eircom have indicated to industry that they are intending to maintain closed self supply of order handling and services for their own downstream businesses going forward for future WPNIA fibre products.

We welcome and support the ComReg minimum and maximum price control proposals and observe the need to limit Eircom's ability to disrupt and potentially distort the market with price changes within the regulatory min and max levels to suit Eircom's commercial benefit. We consider the price change process should be regulated by ComReg so that Eircom cannot alter its pricing without passing margin tests developed by ComReg and giving not less than three months prior notice to industry.

New Entrants to the WPNIA Market

We are of the view that in carrying out the review, ComReg should ensure that there is sufficient economic space between the WBA and WPNIA markets for new parties to enter the WPNIA market. This will encourage infrastructure investment in Ireland and stimulate downstream competition and consumer benefit.

Changing Wholesale Markets

The Wholesale Market in Ireland has changed over recent years with Eircom now supplying both regulated Wholesale Components that we are familiar with and also

Wholesale Solutions offering a package of supporting facilities and service surround, for example the White Label Product. These supporting facilities and service surround have value and we consider these should form part of both the cost orientation process and the margin test, otherwise value will be shifted from one aspect of the service such as the price to another aspect such as supporting facilities and the aim of the price control will have been circumvented.

Critical Mass
We believe the ComReg price control should be established to incentivise Eircom to fully open the WPNIA market to allow it to reach critical mass, which in our view would be more than 150K active WPNIA LLU lines.

Products within Scope
European legislation mandates the supply of both Line Share and Full Unbundling solutions, and any price control(s) must enable the sustainability of both products in the market.

Migration Costs discrimination
The current Eircom pricing for migrations is leading to a discrimination that needs to be addressed urgently. For example it costs 45 Euro to migrate from Bitstream to LLU, however it only costs 30 Euro in the reverse direction and the work involved is the same. Similarly, Eircom is migrating customers from its legacy bitstream platform to its “Bitstream MB” (BMB) product free of charge, yet it costs 45 Euro per line at the wholesale layer to migrate customers from the legacy Eircom platform to WPNIA LLU platforms. This is proving to be a major barrier for migrating customers to the WPNIA LLU products and should either be resolved in terms of price (preferred) or factored into the costs experienced by WPNIA LLU operators and hence the price control. We do not accept that there are no costs involved in migrating customers to BMB as Eircom would have numerous tasks to manage and there would be a considerable base of bitstream customers on older ADSL1 equipment that would have to be physically re-jumpered to the ADSL2+ technology used for BMB, in exactly the same fashion that jumpering is undertaken from bitstream to WPNIA LLU.

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Additional issues to be considered
Other practices such as Eircom leaving their downstream broadband equipment connected to the line when a customer ceases services is at odds with their practice of forcing the disconnection of WPNIA LLU equipment when a customer ceases an LLU line. This provides Eircom with the unfair situation where it can just electronically enable a port, whereas WPNIA LLU providers have to experience up to 10 days delay to move the customer and pay 45 Euros for this activity. This discrimination should either be stopped (preferred option) or the additional cost to WPNIA LLU providers is factored into the Eircom WBA price control.

Detailed Response
For clarity we have reproduced ComReg's questions and have maintained the same sequence as ComReg.

2. Response to the detailed questions.

Q. 1. Do you agree with the detail of the proposed price control including the different specification of the ex-ante obligation not to margin (price) squeeze? Please state the reasons for your response.

Answer 1
We agree with the detail of the proposed price control including the different specification of the ex-ante obligation not to margin (price) squeeze. We are supportive given our concerns in previous submissions to ComReg concerning the closeness of the bitstream prices (especially BMB) with the Line Share price, particularly when factoring in the difference in connection/migration charges and/or free migrations/upgrades. The additional network costs borne by the alternative operators to use WPNIA products to offer an equivalent service to Eircom WBA products have to be considered within any margin between WPNIA and WBA products. Past experience has indicated to us that we could not match some of the Eircom WBA prices prior to the ComReg LLU price changes; hence it's essential that the margin test is on individual products and the baskets as well.

We have observed that the recent ComReg reductions in the prices of line share and full unbundling has been followed by Eircom's offering of bitstream BMB services and this again brings pressure on the margins between Eircom's WBA products and WPNIA products such as LLU Line Share. In our view the constant erosion of this margin has been one of the key factors stalling the growth of the WPNIA LLU market

Q. 2. Do you agree with the preliminary views in relation to the duration and future review of the price control? Please state the reasons for your response.

Answer 2
We agree that there is a need for ComReg to set the prices for a period of time to bring some certainty for investment. However, one year is too short given the nascent and fragile nature of the WPNIA market. We believe it would be more appropriate to set a period of time for the WPNIA market to reach critical mass, and hence a commercial footing to compete with Eircom in the WBA market. We consider there are enduring restrictions (discussed below) limiting the potential of the WPNIA market hence the threshold approach would provide a more appropriate model to incentivise Eircom.

A number of issues are causing concern for the growth of the WPNIA market including but not limited to:

1. We consider Eircom are restricting the rate of bulk migrations from bitstream to LLU as we were informed by Eircom for health and safety reason the bulk migration rate per exchanges was severely restricted and levels were set by Eircom at a maximum of 25 per exchange per day. This appears at odds with the rapid rate at which Eircom are moving their own legacy bitsteam customers to BMB which involves the re-jumpering the majority of customers from older ADSL1 equipment to modern ADSL2+ equipment.

2. Eircom is now aggressively pricing and promoting their BMB proposal to directly undermine the WPNIA market using low-usage models (average €1.90 per month per customer) and free upgrades;
3. There have been problems in purchasing off-the-shelf NGN solutions for backhauling further LLU roll-out, although these backhaul issues may or may not be resolved following ComReg intervention. This has caused uncertainty.
4. Discrimination in migration pricing; 30 Euro to migrate from LLU to bitstream and 45 Euro in the bitstream to LLU direction,
5. Discrimination in connection charges; 45 Euro to connect LLU versus 30 Euro to connect bitstream or BMB
6. Discrimination that Eircom downstream services are left connected to the Eircom service when the service is ceased, enabling simple same day remote enablement for new customers. However for LLU the services are physically disconnected meaning that it will take up to ten working days (Two calendar weeks) to connect new LLU customers with the increased risk of service problems and network intervention has occurred, plus a 45 Euro charge.

Together these issues are creating an environment of uncertainty which is acting to stall the investment and growth of the WPNIA market. We have seen such problems for many years, as evidenced on the ComReg website, and it is continuing.

As per above, we are of the view that urgent action is required to incentivise Eircom to remove these unreasonable competitive barriers to the WPNIA market and a different scheme put in place where the nascent WPNIA market is allowed to reach a critical mass volume of circa 150 thousand active WPNIA customer connections using LLU.

Q. 3. Do you agree with the proposed notification and approval procedures? Please state the reasons for your response.

Answer 3
We agree with the proposed notification and approval procedures offered by ComReg but seek greater transparency of the approval procedure and sufficient notification periods.

Approval Process and Transparency
The issue of Eircom introducing a new Leased Lines Reference Offer (LLRO) without discussion caused serious concern in the industry as this is a multi-million euro supply contract to many providers, and Eircom claimed it was agreed by ComReg, Given that Eircom used the ComReg approval to defend their actions this has brought into focus questions as to what is actually being approved by ComReg. We are thus seeking far more transparency as to how this process works and what is the scope of the approval and operators ability to challenge it. Only after lengthy debates was the document opened for discussion. Reference Offers form the basis for major supply agreements to the industry and their stability and certainty is very important to the functioning of the markets, hence changes must be managed carefully and in a transparent way.

Notification Period
It is essential that operators have sufficient notice of pricing changes given their need to review and or change commercial packages (and/or systems/processes) and regulatory notification of consumers as may be necessary. Additionally, the notice provides

operators the opportunity to take a view of whether there are compliance issues not visible to ComReg before the Eircom products or product changes enter the market.

Q. 4. Do you agree with the costing methodology proposed to determine the maximum prices for bitstream rentals? Please set the reasons for your response and set out in detail any specific amendments, supported by detailed analysis where appropriate, to the costing methodology you believe are required.

Answer 4.
Given the nascent state of competition in the WBA market, we agree with the tilted annuity approach to modelling the Eircom costs.

We agree with ComReg that Eircom should now be regulated using a cost orientation model given their enduring dominance and supply problems in the WPNIA market. Whilst we support ComReg's view we believe that any variation of the price by Eircom within the range has the potential to distort and disrupt the market for upstream and downstream providers and would thus seek that ComReg regulate the change process as we believe changes introduced by Eircom will only be for the benefit of Eircom. As a minimum ComReg should carry our per product instance and basket margin squeeze tests and require three months notice of any change so that the industry can input to the ComReg approval process.

Q. 5. Do you agree that in setting a price control in the WBA market that an appropriate economic space to the relative prices of LLU should be maintained? Please state the reasons for your response.

Answer 5.
We agree that an appropriate economic space between the WBA market and the relative prices of LLU should be maintained for the following reasons:

1. **Past pricing pressure**. - Experience shows that Eircom are prepared to apply margin pressure on the WPNIA market as seen with their pricing of wholesale bitstream products, which includes the copper line from the customer to the exchange; the DSLAM; power; air conditioning; land rental; repair; backhaul; and core network to within a Euro of the Line Share price. The Line Share service only includes the copper line from the customer premises to the exchange and the access seekers have then to separately purchase and add all of the other components in the list above leading to prices above the Eircom wholesale bitstream price.

2. **Current pricing pressure.** - We note following the intervention of ComReg and associated court activity to reduce the LLU prices, that Eircom has now aggressively entered the WBA market with their BMB product. The BMB product is again bringing pressure on the LLU margins and hence the viability of the LLU based solutions.

3. **Testing each product for Margin Squeeze** – We welcome and support ComReg's proposal to test both the individual Eircom wholesale product and the basket of products. The single and basket tests are very welcome as we believe

this is how Eircom manage to price pressure LLU without being sanctioned. We are also seeking that ComReg consider the Eircom wholesale solutions business (or whatever Eircom are calling it) which is also operating in the WBA market within any margin test given the additional functionality on offer e.g. white label broadband solutions which include ISP services.

4. **Wholesale downstream solutions.** – We are aware that Eircom has now moved into the wholesale downstream solutions market as evidenced by the emergence of their white labelled wholesale solutions. These bundled wholesale solutions offer higher value than the standalone regulated services and act to further price pressure the underlying regulated products as more of the retailer activity is provided within the wholesale cost. We are seeking that ComReg consider the Eircom wholesale solutions business (or whatever Eircom are calling it) with any margin test given the additional functionality on offer.

5. **No Evidence of Change.** - There is no evidence that Eircom will allow an appropriate economic space between the WPNIA market and the WBA market (WBA Wholesale solutions), in fact the contrary exists through white label and BMB that Eircom is going to continue to bring high levels of price and functionality and service pressure on LLU within the WPNIA market and thus ComReg must act to maintain the economic space between the WBA market and the LLU (WPNIA) market.

Q. 6. Do you agree with the proposed hypothetical entrant model to set the minimum prices for bitstream rentals in order to maintain an appropriate economic space? Please state the reasons for your response, providing worked examples and / or robust data to support your views.

Answer 6.

We agree with the proposed hypothetical entrant model to set the cost orientated price and agree that this price should be set at such a level to achieve and appropriate economic space between the WBA Market and the WPNIA LLU market. This will encourage additional investment in LLU by existing LLU operators and new LLU operator entrants.

Q. 7. Are there any issues in relation to the appropriate price control for the WBA market that ComReg has not considered in this consultation? If so, please document and explain those issues fully and provide examples where appropriate.

Answer 7.

We consider the issues in relation to the appropriate price control for the WBA market that ComReg has not considered in this consultation are:

1. Individual Migration Charges – The prices for migrations from LLU to bitstream and bitstream to bitstream should be aligned with the bitstream to LLU of 45 Euro and this charge is a significant disadvantage to the WIPNIA products and should be considered in developing the economic space between the WBA and WPNIA markets.

2. Connection charges – the pricing for bitstream connection (at 30 Euro) versus the price for LLU connection (at 45 Euro) should be aligned, given that the activity performed (jumpering) is identical and that the price differential puts LLU based services at a disincentive/disadvantage to WBA services.

3. Bulk Migration Charges – We believe Eircom is waiving or significantly discounting bulk bitstream to bitstream wholesale migration prices through commercial deals when they win a retail provider to their network away from another wholesale operator. Eircom is currently charging a bulk migration fee to BT of 34 Euro per line and a significant bulk project management fee to migrate bitstream customers to LLU and this should be factored into bitstream to bitstream wholesale transfers. We consider that the difficulties of getting Eircom to bulk migrate bitstream to LLU means that operators have no option but to seek project management and ComReg should factor this into the economic space between the WPNIA and WBA markets,

4. Bulk Migration Volumes – The rate at which Eircom migrate customers from bitstream to LLU is very low (max 25 per day per exchange) and it can take many months to migrate what internationally would be defined as very modest volumes. The delays in migrating significant volumes quickly have a value and ComReg should factor this into its model. We can provide real experience and timings to ComReg for this activity.

5. Factoring in the cost of repair for full unbundling (>100 Euro per event) and line share where required.

6. Factoring in the cost of MDF blocks including those with Over Voltage Protection (very significant cost), footprint/land rental, ironwork, power unit charges etc with all the other standard costs that ComReg have recognised.

7. Eircom have now launched their Fibre to the Home Pilot (which is not a trial) and we would expect this service to target LLU and urban areas as it will use the same criteria of customer density and volumes as part of its business case. Therefore, ComReg should consider this when reviewing the depreciation of equipment in these areas as such may replaced in a shorter time frame than other areas raising its economic cost.

Q. 8. Do you agree with the preliminary views expressed by ComReg? Please state the reasons for your response and please explain which preliminary view(s) you do not agree with and detail what specific amendments you believe are required.

Answer 8.

We agree with the preliminary views expressed by ComReg and agree that a cost orientated maximum and minimum prices should be established. However it should not be possible for Eircom to vary its prices within the range without going through a regulatory approval process and a minimum three month notification period to give operators an opportunity to object. We also agree fully with Eircom that each product should be margin tested individually and as a basket to prevent commercial skewing of the basket to pass the test.

We also consider that ComReg should factor supply and the costs of discrimination experienced by other operators into the economic space between the WBA market and the WPNIA LLU market.

We welcome the inclusion of promotions in the Decision Notice and note a number of Eircom promotions lasting six months that are then continued for further six month periods. This has the effect that the promotion is a permanent change rather than a short term offer. It would be helpful for ComReg to define what is deemed a promotion in the Decision Notice as in the normal usage of the word Eircom is abusing the aim promotions. A suggestion is that promotions should be a short term offer not lasting more than three months and if continued it's considered as a product change.

Q. 9. Do you believe that the draft text of the proposed decision is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

Answer 9.

We consider that the text as proposed is sufficiently detailed, however given the notorious difficulty in proving discrimination there should be a specific Non-discrimination clause to prevent Eircom offering this regulated product and downstream Wholesale Solutions using the WBA component at different prices to different wholesale customers and/or in different geographic areas (e.g. LLU vs. non-LLU). To address this ComReg should impose both a specific Non-discrimination clause combined with a transparency obligation that Eircom has to publish all prices offered. If Eircom is offering services to the published price list then there should be no argument, however if discounts or different prices are being applied the transparency obligation will drive compliant behaviour. Basically the non-discrimination regulatory remedies do not work properly without associated transparency obligations.

Q. 10. Do you have any views on this Regulatory Impact Assessment and is there other factors (if any) ComReg should consider in completing its Regulatory Impact Assessment? Please explain your response and provide details of any factors that should be considered by ComReg.

Answer 10.

We agree with the ComReg regulatory impact assessment that the preferred approach should be cost orientation with an ex-ante obligation on Eircom not to Margin Squeeze.

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3: Eircom Ltd.

eircom Ltd.

Response to ComReg Consultation and Draft Decision 10/56

of

15th July 2010

Wholesale Broadband Access

Appropriate Price Control

DOCUMENT CONTROL

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I. INTRODUCTION

Since 2005, eircom has been regulated in relation to its provision of Bitstream products on the wholesale broadband access market and subject in particular to a retail minus price control. The market for wholesale broadband access, however, has witnessed very significant changes and in the context of a very dynamic and increasingly competitive (albeit to varying degrees depending on geography) retail broadband market, it has become clear that the current retail-minus price control for WBA has become too rigid and burdensome and is no longer suited to market conditions. ComReg's willingness to reconsider the price control for WBA is accordingly welcome.

eircom, however, does not believe that the process being followed by ComReg is sound. It is incomprehensible that more than five years after the initial market review and almost three years after the publication of the Second Edition of the European Commission's Recommendation on the markets susceptible of ex ante regulation, ComReg has not completed its second analysis of the market for wholesale broadband access. It is eircom's view that it is not possible at this stage to amend the price control for WBA without having first completed the relevant market review so as to ensure, in accordance with regulatory requirements, that the price control remedy which ComReg proposes to impose adequately addresses any current competition problems. The changes in broadband access in Ireland have been such since 2005 that it is indispensable to conduct a comprehensive review of the state of competition across the different geographic areas throughout Ireland, taking into account the strategies of different operators and past and future investments in broadband access, including in NGA.

The absence of consideration for the market realities which eircom confronts is apparent in the price control proposed by ComReg which far from introducing some flexibility in Bitstream pricing actually aggravates existing rigidities in seeking to impose, within a narrow range, a price floor, a price ceiling and a margin squeeze. This is clearly disproportionate and unjustified, including when compared with the price control imposed five years ago at a time where competition was not as developed as it is today.

eircom wholeheartedly believes that more flexibility has become absolutely indispensable in Bitstream pricing. This flexibility is needed so that eircom, to the benefit of the competitive process and ultimately consumers, can address in its pricing at the wholesale level, and hence retail level, the different competitive conditions that it experiences in the market, which in turn reflect the very different underlying access network costs in different areas of Ireland. This situation has been a significant element shaping ComReg's LLU Pricing Decision which now needs to be recognised in ComReg's approach to Bitstream pricing.

eircom would agree that one possible avenue to achieve a degree of flexibility in pricing is through the setting of a price floor and ceiling for Bitstream, with the freedom for eircom to price within the range so determined. Beyond the format of it, however, this is not what the price control proposed by ComReg achieves. The band set by the minimum and maximum prices is so narrow as to make the notion of pricing freedom within its limits meaningless. This, it would appear, is because ComReg is not in fact trying to set a Bitstream price which would support the development of competition while fostering further investments in broadband, including in areas where LLU has been deemed by ComReg unlikely to happen. Rather, the various elements of the price floor, in particular the floor and the ceiling, are designed to address entirely separate issues:

- The price floor, to set the "economic space" between WBA and LS/LLU, which ComReg believes is required to ensure the viability of LLU;
- The price ceiling, to prevent excessive prices being charged by eircom on WBA, that is, to prevent eircom making "super-profits"; and
- The margin squeeze test, to prevent price squeezes on the retail market.

The different objectives pursued by the price floor and ceiling are reflected in the different cost basis proposed by ComReg: the costs of an OAO using Line Share for the floor and eircom's for the ceiling. Conceptually, however, this approach is clearly flawed. Having regard to the economies of scale and scope acknowledged by ComReg elsewhere, it is unlikely that an OAO would have lower costs than eircom. Indeed, while the cost model developed by ComReg with Frontier Economics at some point produced OAO costs at a level below eircom's costs, now that some errors have been corrected, it almost systematically, and absurdly, produces a floor price <u>above</u> the ceiling price. (This problem would be compounded when the price for Line Share is reviewed to include a share of the joint and common costs of the loop.) As exemplified by the model outcomes, it is simply not possible for ComReg logically to expect to cap eircom's returns at eircom's geographically averaged costs while at the same time looking to entertain an "economic space" between LLU and WBA.

If ComReg maintains its view that it is necessary to guard against excessive Bitstream prices, then it is essential that the price ceiling be determined so as to accommodate the reality that eircom faces higher network costs in rural areas and/or less utilised routes (which tend to include all those areas which are unlikely to be unbundled). Any such ceiling on Bitstream revenues must also be set so as to preserve existing and future investments in broadband including through NGA and as such any ceiling should also recognise existing investment programmes and more generally the possibility for Bitstream prices to include an allocation of the joint and common costs of the local loop. It is not clear to eircom in these circumstances that any reduction of Bitstream prices is warranted. If it were nonetheless the case that the ceiling price proposed by ComReg, which could take the form of a multi-year, multi-product, price cap, is lower than current Bitstream prices, then it would be essential to provide for a glide path in order not to destabilise the market. The step reduction in Bitstream prices proposed by ComReg is in this regard another significant flaw of the proposed control.

Finally, in a situation where eircom would be subject to both a price ceiling and a price floor, it is difficult to understand the role that would be played by a margin squeeze test. Clearly, in a situation where the retail market is <u>not</u> regulated, the purpose of a margin squeeze could only be to set the level of the Bitstream price. This however would already be catered for by both the floor and the ceiling prices. The margin squeeze test proposed by ComReg has accordingly no function other than regulating retail broadband prices, by seeking to verify that the retail price is sufficient to recover the set Bitstream price and retail costs, which is impermissible.

eircom accordingly suggests that this consultation be withdrawn and the market review for wholesale broadband access concluded as soon as possible so that an adequate price control can be devised, if so justified, which recognises the different intensity of competition to which eircom is subject, for the ultimate benefit of the consumers.

II. RESPONSES TO COMREG'S SPECIFIC QUESTIONS

Q1. Do you agree with the detail of the proposed price control including the different specification of the ex-ante obligation not to margin (price) squeeze? Please state the reasons for your response.

(i) ComReg cannot lawfully amend the existing price control in the manner proposed without having first completed a review of the market for WBA and found eircom with SMP

eircom does not agree with the price control proposed by ComReg, or with the detail of it. While eircom is not opposed to introducing a form of cost-orientation for WBA and replacing the current retail-minus price control, eircom does not believe that ComReg can lawfully do so prior to completing a market review and re-designating, if it is justified, eircom with SMP. It is in this regard entirely insufficient for ComReg to disregard the question of market review and SMP designation by suggesting that the proposed new price control would no longer apply, were eircom not found subsequently to have SMP in the relevant market (in section 8.1, p. 47, at fn 9, p. 6 and fn 23, p. 20 of Doc. 10/56). The question is not simply whether eircom has SMP: it is also about the adequacy of the proposed obligations for the purpose of remedying the competition issues identified during the market review. The requirement that the remedies proposed by the Regulator be proportionate and "*based on the nature of the problem identified*"[1] is a cornerstone of the regulatory framework and the reason why market reviews must be carried out on a regular basis. As the European Commission has explained:

> "notifying remedies or amendments to regulatory obligations several years after the relevant market analysis without carrying out a new market review carries a risk that the measures will be based on a market definition or an SMP assessment that does not correspond to the current market situation, or that the remedies will no longer be appropriate to the problem identified, proportionate and justified. Regular review of markets susceptible to ex ante regulation is therefore essential to meet the regulatory objectives enshrined in Article 8 of the Framework Directive and to provide legal certainty for all market players."[2]

In this context, ComReg's justification that "*there is an imminent need to amend the price control*" (p. 5, Doc. 10/56) in view of the changes in the marketplace is entirely inadequate and misconceived. If there is an imminent need, it is to carry out and complete the market review for wholesale broadband access, in accordance with ComReg's statutory obligations, so that the outdated price control can be replaced, if justified, by a price control adapted to the market realities. ComReg is obliged to conduct a review of the markets recommended by the European Commission as soon as possible after publication of the Recommendation.[3] It is almost three years since the publication of the Second Edition of the European Commission's Recommendation and it is incomprehensible that ComReg would seek to amend an obligation without reviewing the market conditions first. eircom notes further that under the Regulatory Framework, the very purpose of market analysis is to assess developments in the marketplace so that obligations may be withdrawn, imposed or amended so as to address any changes in the competitive situation. Regulations 27(1) and (2) of the Framework Regulations and Regulations 9 and 14 of the Access Regulations refer. In this context, the numerous references in Doc. 10/56 to the fact that "*the WBA market is no longer in the early stages of*

[1] Regulation 9 of the Access Regulations.

[2] European Commission's Comments pursuant to Article 7(3) of the Framework Directive, Case UK/2008/0854, 6 March 2009.

[3] Regulation 26 of the Framework Regulations.

development"[4] and the explanations, at para 2.17ff in particular, why *"when introduced in 2006, the current retail minus approach was deemed the most effective way to regulate WBA products"* but this is no longer the case, are incapable of justifying ComReg's proposed decision.

It is relevant in this regard that the price control proposed in Consultation Doc. 10/56 cannot be considered to fall within the scope of the price control remedy set out in Decision No. D03/05. This is because ComReg during the market review that led to the adoption of Decision D03/05 found that cost-orientation was not an appropriate remedy to address the competition issues identified in relation to the wholesale broadband market and that it would be disproportionate to impose such an obligation.[5] In addition, it is notable that the competition issues identified by ComReg concerned the possibility of margin squeezes between the wholesale and retail broadband access markets, not issues of *"economic space"* between LLU and WBA.[6] It is accordingly clear that ComReg is proposing to replace the price control obligation imposed in D03/05 by a price control of a different nature designed to address competition issues of a different sort. As explained above, this ComReg can only do following the completion of a market review, in accordance with Regulation 27(2) of the Framework Regulations and Regulation 14(1) of the Access Regulations. In these circumstances, it is of no assistance for the purpose of replacing the price control set in D03/05 that the economic space between wholesale products is perceived to be a valid regulatory pursuit by the ERG or the European Commission.[7]

The European Commission's explanations above demonstrate that these issues are not of a procedural nature only but in fact goes to the substance of the regulation of electronic communications. In this regard, ComReg's consultation document, and the proposals therein, suffer from the absence of an overall forward-looking analysis of the market for wholesale broadband access, its relation with LLU and the role of Bitstream in the wider market, eircom's position and those of OAOs in that market including UPC and Imagine, taking into account the potential impact on Bitstream of Next Generation Access technologies and of the price control on investment in such new technology.

As a result, the consultation document and the proposals therein also suffer from the lack of a clear purpose for the rules proposed. ComReg appears to be pursuing a number of objectives, all of which cannot be achieved by means of a single restrictive price control. For instance, it is not possible within the form of control proposed to favour LS based providers at the same

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[4] e.g., p. 14, p. 16, p. 18, 21, 23

[5] At section 6.120 (p. 65) of ComReg Doc. 04/83, ComReg stated that "at this time an obligation of cost-oriented prices for wholesale Bitstream prices on the basis of FL-LRIC would not be appropriate. Cost orientation on the basis of FL-LRIC would be difficult to implement in this market and would be disproportionate given the available alternative of a retail minus obligation."

[6] eircom in this respect does not accept ComReg's statement at para. 2.25, p. 10 of Doc. 10/56 that *"the potential for Eircom to pursue foreclosure of WPNIA investment by way of maintaining an insufficient 'economic space' has always been a concern of ComReg"*.

[7] ERG Documents cannot be interpreted as supporting the introduction of remedies to provide for "economic space" outside the procedural constraints of the regulatory framework. Indeed, for instance, the ERG Report on price consistency in upstream broadband markets (ERG (09) 21) thus states at p. 14 (emphasis added): "As such, when setting regulation, it will not be a simple task to establish a general definition of an efficient operator with all its commercial characteristics (such as network size, number of customers). The required efficiency may have to be determined independently of individual company conditions. But this should not be done without referring to the real market conditions (market shares, market penetration etc.), since these best reflect efficient conditions of competitive undertakings..." eircom doubts in this regard that ComReg's proposal would be considered to be "consistent" with the report of the ERG.

time as encouraging Bitstream investments by eircom. Please see in **Annex 1** the Report of Cento Veljanovski.

In the circumstances, eircom does not accept ComReg's contention that the proposed price control strikes the correct balance between its statutory objectives to promote efficiency and sustainable competition, and to maximize consumer benefits.

All of eircom's arguments thereafter are without prejudice to eircom's position that eircom is currently subject to no regulatory obligation in relation to the "economic space" between Line Share and WBA and that a cost orientation obligation for WBA can only be imposed on eircom in the context of a market review following a finding of SMP.

(ii) The price control proposed by ComReg is inadequately justified, unnecessary and unworkable

The price control proposed by ComReg consists in a set range of maximum and minimum prices for Bitstream rentals as well as a margin squeeze test relying on LRAIC plus retail costs.

Insofar as the minimum price is concerned, eircom for the reasons explained above is of the view that the price control provided for by D03/05 does not allow for the control of the economic space between LLU and WLA. Save for this issue, eircom agrees that the efficient costs of a hypothetical new entrant availing of Line Share are an appropriate benchmark against which to set the price floor for WBA. Insofar as the maximum, ceiling, price is concerned, a number of serious issues arise. First, it is not clear to eircom that preventing excessive prices in the WBA market is necessary in view of the constraints placed on eircom by competition at the retail level including from operators relying on Line Share.

Second, ComReg's proposal to set that price on the basis of eircom's geographically averaged costs produce aberrant results in that the ceiling prices produced by the model are now, following correction of the model, systematically lower than the price floors! Were a price ceiling to be found to be appropriate, then an adequate cost basis must be identified. It is clear that this cannot be that proposed by ComReg.

In circumstances where eircom is subject to a price ceiling, ComReg cannot also require eircom to meet a margin squeeze test. It must be either/or of these requirements. In particular, if as suggested the operator concerned complies with a price ceiling, then the only issue arising is in relation to its retail price, not with the price of the wholesale element, and any control imposed in relation this is in effect a control on the retail price. This is clear from ComReg's explanations at para. 4.12 that "*a vertically integrated SMP operator controlling wholesale inputs provided to downstream operators could, through a combination of setting WBA prices at the upper limits of the cost oriented wholesale price control and <u>pricing its retail broadband unprofitably low</u>, engage in anti-competitive margin squeeze ...*" It is also very clear from the test proposed by ComReg at para. 4.16 which seeks to control the levels of retail prices. A control on the retail price is, however, impermissible because the market for retail broadband is neither a regulated market nor a market that is susceptible for ex ante regulation.

In these circumstances, a choice must be made between setting a ceiling price for Bitstream, or in the alternative, setting the "minus" which must be maintained between the wholesale and the retail elements.

Q2. Do you agree with the preliminary views in relation to the duration and future review of the price control? Please state the reasons for your response.

ComReg's preliminary views are not entirely clear. While at para 5.66 of Doc. 10/56, ComReg suggests that the price control will be subject to review after one year, section 4 of Doc. 10/56 (in particular para. 4.25 to 4.27) appears to suggest that only the maximum prices, not minimum prices, would be subject to review (save in case of a change to the Line Share price). To add to the confusion, the terms of the Draft Decision do not provide for any review.

The proposed duration is similarly unclear in that there appears to be no end date to the decision. ComReg proposes that the "*maximum prices would be set for a period of at least two years*" following the review after the first year. In other words, the price control could apply for a period in excess of three years, although the prices set by the control are based on an assessment of costs over three years. This bears significant risks of inadequate pricing obligations. On the other hand, Section 7 of Doc. 10/56 indicates that the price control will apply as long as eircom has SMP in the WBA market or until otherwise amended by ComReg and the Draft Decision itself includes no reference to the duration of the price control.

eircom believes that it is necessary to build within the price control a compulsory mechanism which would ensure that the price levels are reviewed before the price control can extend to more than three years. In other words, the Decision should provide for a maximum period of three years (one + two) which could be extended if so required following a review. (However, as three years represent the time horizon over which the market should be reviewed, any review of the price control after three years should be done in conjunction with a market analysis.)

As explained above, eircom does not believe that the need for a change of price control is such that it cannot await the completion of the required market analysis and a finding of SMP which demonstrates the requirement for a price control. This would allow ComReg to complete first its modelling exercise for Leased Lines and avoid any unnecessary disruption to the market that a price review would entail. Completion of the leased lines modelling exercise should be for ComReg a pre-requisite to the introduction of a new cost-oriented price control for WBA.

Q3. Do you agree with the proposed notification and approval procedures? Please state the reasons for your response.

eircom does not agree with the proposed notification and approval procedures because they are unnecessary, unduly burdensome and inconsistent with the features of the price control proposed by ComReg.

eircom in particular does not understand why the prior approval of ComReg is required in the context of an obligation to price between a floor and a ceiling. If the proposed price is within the permissible range, approval must be automatic and a requirement of prior approval is accordingly unnecessary and disproportionate.

eircom is also of the view that the distinction which ComReg seeks to draw for the purpose of prior approval between existing and new products is misplaced and unjustified in the context of its proposal for a new price control. In particular, eircom does not accept that it is incumbent on ComReg to ensure, prior to launch, that wholesale broadband access products are "*compliant with Eircom's regulatory obligations*". The market analysis on which ComReg seeks to rely did not identify any need for a prior review of new products and the review by ComReg of new products under D01/06 only arises on foot of the inputs that need to be added to the DCF Model for the purpose of the retail minus control and which require that the characteristics of the products be considered in detail. This is not the case of the proposed price control.

eircom agrees that sufficient prior notification should be given to OAOs. However, a two months' notice appears to be excessive in view of the current timelines applicable under D01/06. eircom believes that 3 weeks (or 15 working days) is sufficient in relation to the notification of the price of new products and the notification of price changes. In circumstances where Bitstream prices are not determined in accordance with a retail-minus mechanism, eircom does not believe that Regulation 17 of the Universal Service Regulations is relevant in setting the appropriate notification period. In addition, Regulation 17 bears little relevance in a context where ComReg is proposing a reduction in prices.

Finally, eircom agrees that any promotions on Bitstream must be priced above the applicable price floor but disagrees to the extent that ComReg suggests that its prior approval is required. It is more difficult to understand the rationale behind ComReg's proposals regarding the application of the price control to bundles (para. 4.33 of Doc. 10/56, p. 26). It would appear that ComReg's considerations are based on the current price control mechanism. However, were a cost-based price control of maximum Bitstream prices to be introduced, the issues associated with determining compliance with a wholesale retail-minus price control in the context of retail bundles simply would not arise.

Q4. Do you agree with the costing methodology proposed to determine the maximum prices for bitstream rentals? Please set the reasons for your response and set out in detail any specific amendments, supported by a detailed analysis where appropriate, to the costing methodology you believe are required.

eircom does not agree with the costing methodology proposed to determine the maximum prices for Bitstream rentals. Very significant issues arise in relation to ComReg's approach:

- The requirement for a cost-based ceiling for Bitstream prices is not justified. eircom believes that excessive wholesale prices are highly unlikely in view of competition on the retail market, including from operators who do not rely on Bitstream, including LLU/Line Share, cable and Wi-Max/FWA operators. Retail prices are close to costs and act as a ceiling on eircom's Bitstream prices.
- In the event that a cost-based ceiling for Bitstream could be justified, and that it is to be applied in conjunction with a cost-based floor, then it is essential that the price control is built to ensure that the ceilings are always higher than the floors. In addition, ComReg's stated objective at sections 1.6 and 3.8 to afford more flexibility to eircom can only be achieved if the spread between floors and ceilings is meaningful. ComReg's proposals do not ensure that the ceiling is always higher than the floor and when, by chance or coincidence, it is, the difference is such as to be worthless.

To ensure that the ceiling is always higher than the floor, the ceiling should always include more elements than the floor, with a clear rationale for including or excluding cost elements. For instance, the floor price could be based on LRIC, or LRIC+, and the ceiling on stand-alone costs. Other possibilities include the calculation of floor and ceiling by reference to the same measure of costs but using best case and worst case scenarios, and a combination of both approaches: e.g., best-case incremental costs for the floor, and worst-case stand-alone costs for the ceiling.

In ComReg's proposals, floors are not calculated by excluding some costs from the ceiling. Instead, ComReg relies effectively on two different models, with the ceiling price based on an assessment of eircom's own costs, and the floor price based on an assessment of the costs of a hypothetical new entrant relying on Line Share for the purpose of offering Bitstream services. This approach is odd: on the face of it, as the entrant operates on a smaller scale than eircom, its costs are likely to be higher than eircom's, on a like for like comparison, and accordingly, the floor is likely to be higher than the ceiling. Indeed, this is the case for almost every cost item in the draft model prepared by ComReg, other than the two key items: DSLAM ports and backhaul costs per megabit. Because the entrant is assumed to offer Bitstream in a restricted, urban area, by coincidence, its costs happened, in an earlier version of the model used for the purpose of the consultation, to be lower than the costs of eircom, assessed and averaged on a national basis. In other words, the only reason why the costs for the ceiling were higher than the costs for the floor lies in the higher unit costs per DSLAM port, and the higher per megabit backhaul costs in rural areas. However, it would appear that now, having made further corrections to the model, the ceilings are systematically lower than the floors.

The results of the model are highly sensitive to two assumptions: firstly, that the entrant will build only in certain locations and will have increasing utilisation, while eircom will build nationally for 100% market share initially, and secondly, that due to migration of OAO demand to Line Share, eircom will suffer declining volume and utilisation. However, a failure of line share take-up would improve eircom's utilisation while reducing the OAO share. This would increase the OAOs costs and reduce eircom's costs further reducing any difference between floor and ceiling.

It would appear that this absurd situation, where ceiling prices could be set below the floors, is the result of ComReg pursuing entirely different, and irreconcilable, objectives in setting price floors and price ceilings for Bitstream. ComReg appears to be of the view that a price floor is required in order to ensure a sufficient margin between LLU/LS and Bitstream. For the reasons explained above, it is logical to assume that all things equal, this price floor would be set above the incumbent's efficient costs. This means that eircom may then achieve a higher return than those which would be achieved on a strict cost basis. This, however, is a trade-off. ComReg cannot assist LLU/LS entry through the regulation of Bitstream pricing while employing also rate of return regulation for the same price.

It would assist for the purpose of setting a price ceiling for Bitstream to understand why ComReg believes that eircom will price (significantly) above the price floors and the competitive concerns that would arise as a result of this, having regard to the fact that a Bitstream price significantly above the floor would seemingly sustain Line Share uptake. If ComReg's concerns regarding the possibility of excessive prices for Bitstream are related to the fact that ComReg does not expect LLU/LS to be rolled out on a national basis, then determining the price ceiling for Bitstream should recognise this and the consequences in terms of the actual costs faced by eircom and issues of cost recovery for eircom, including in terms of the allocation of the joint and common costs of the local loop to broadband and hence Bitstream.

If ComReg does identify a need to protect Bitstream access seekers from excessive prices in certain parts of the market, then the price ceiling should recognise the cost differences arising in those parts in the market. The lack of a capability in the model allowing to distinguish between the different costs arising in serving different parts of the market is another shortcoming of the cost model in the role that ComReg seems to envisage for it.

Q. 5 Do you agree that in setting a price control in the WBA market that an appropriate economic space to the relative prices of LLU should be maintained? Please state the reasons for your response.

eircom recognises that ensuring that there is an appropriate space between Bitstream and LLU may be a valid regulatory objective. However, such an objective may only be pursued by ComReg in accordance with the requirements set out under the regulatory framework, in particular the Framework Regulations and the Access Regulations. As explained in response to Question 1, the market analysis upon which the Draft Decision is purportedly based did not identify any issue regarding the economic space between Bitstream and LLU. Accordingly, ComReg may not lawfully set a price control for WBA that seeks to set an appropriate economic space between WBA and LLU. In particular, ComReg must first complete a market analysis and assess whether or not any operator has SMP. It is not possible for ComReg to design a price control which provides for an appropriate economic space between wholesale products before assessing the extent if any of eircom's SMP on the market for WBA. eircom fails to understand in this regard, and regrets, that ComReg did not follow the recommendation of the European Commission to review Market 4 and Market 5 together.

The need for a review of the market prior to setting a minimum price for Bitstream (if required) is absolutely essential. eircom in particular does not believe that the conditions of competition are homogeneous throughout Ireland and this needs to be reflected in any remedy imposed on eircom in relation to wholesale broadband access. The sensitivity of the model to LLU take-up only adds to the importance of this issue.

Q. 6 Do you agree with the proposed hypothetical entrant model to set the minimum prices for Bitstream rentals in order to maintain an appropriate economic space? Please state the reasons for your response, providing worked examples and/or robust data to support your views.

In addition to the concerns set out in response to Question 5, including the requirement for a distinct treatment of costs and volume projections for price floors and price ceilings, a number of issues arise in relation to the hypothetical entrant model proposed by ComReg.

- It appears that ComReg has not conducted a sensitivity testing of the draft model used for proposing the prices. Sensitivity testing is necessary to assess the degree of flexibility which must be introduced in a control so as to accommodate the movements in volume and market share that deviate significantly from the base modelling assumptions. However, there appears to have been no analysis of the impact of cost movements or volumes, that is, there is no real "what if" analysis. The draft model seems to rely on just one set of forecasts and does not consider what the market might look like if WiMax, Mobile Broadband, Optical fibre/NGA or Cable platforms were to take a significant share of the DSL base. Also, the model does not properly consider the possibility that OAOs fail to utilise Line share to its full extent.

The model should in particular be tested for sensitivity to its own outputs. The cost floor proposed by ComReg is no more than an estimate of the average costs faced in a range of sites by an OAO relying on Line Share for the purpose of producing Bitstream. However, a reasonable operator will not build in those sites where the cost is above the average, where it is cheaper to purchase Bitstream from eircom. It is accordingly possible that operators build in a smaller number of sites than that accounted for in the model, thus reducing the floor. At some point, some fixed cost elements might dominate so that unit costs would not decline further.

In this regard, it appears to eircom that ComReg's confidence in terms of its assumptions regarding DSL-enabled sites, unbundled sites, volumes, market shares, unit costs etc. for the purpose of setting prices up to 2012 is misplaced. It produces very narrow ranges for minimum and maximum prices, allowing for just a few percent in variation, with the result that the model and its outcome are not future-proofed. (Indeed, the model already is out by 15% on 2009/10 volumes, and maybe 40% on Transmission costs.) Instead, ComReg should seek to produce a range of realistic scenarios which give low unit costs, and high unit costs, and allow eircom work within this range.

- ComReg's model does not properly consider how an alternative operator makes investment decisions. ComReg's model assumes that whichever exchange is unbundled today would be unbundled by a new entrant. This is questionable and ignores the fact that an entrant facing an average cost of, say €5 per customer per month, face a range of different costs at different sites. Let us suppose these costs range only from €3 to €7. If eircom is allowed (or indeed required) to offer service at €5 per month, why would an OAO build a site with an expected cost of €7 per user? He will not and instead will avail of eircom's Bitstream service. Therefore, he will only build sites with costs ranging from €3 to €5, on average €4. Under the proposed price control, eircom would then be allowed/required to sell at €4, and the OAO would then not build where the cost is in the range €4 to €5 ... and so on. By regarding volumes and prices independently, ComReg fails to address this feedback loop.

  A rather different outcome would arise if the price control were to recognise that much of the OAOs' costs are already "sunk" as Line share collocation is already in place, and DSLAMs installed. In this case, the OAO will consider only incremental or avoidable costs when considering the bitstream/LS alternatives. This would give a much lower minimum price.

Q. 7 Are there any issues in relation to the price control for the WBA market that ComReg has not considered in this consultation? If so, please document and explain those issues fully and provide examples where appropriate.

There are numerous, important, issues which are not considered by ComReg in its consultation document. In addition to the concerns identified above, in particular in response to Question 1, such issues include in particular a lack of any discussion of the pricing principles which could be applied in order to arrive, on the basis of the draft costing model, to prices appropriate in view of the objectives being pursued and a lack of discussion of these objectives. This in turn results in a lack of analysis of the potential impact of the proposals on investments.

(a) **Pricing principles**

Pricing principles allow us to move from the costs of network elements to the price of services. As exemplified below, contrary to what ComReg appears to believe, it is not necessarily appropriate to set the price of a service at the level of the average costs of the elements used to provide the service.

Gradients

Pricing at the average cost does not necessarily achieve the most efficient outcome. Consider first the basic notion of price discrimination, in the well know examples of peak and off peak pricing for calls. Suppose there are two market segments, business and consumer. Business is almost price inelastic, and makes calls during the day. Consumer is highly price elastic, and makes calls mostly in the evening. Consider that the network costs €100, and the inelastic business demand is for 100 minutes. Consider scenario 1, where there are no consumer calls, and so the cost per minute is €0.10. If the price is set at this level, there will be no consumer calls. However, if the operator is free to set prices and sets the off-peak price at €0.01, there will be many consumer calls: say 400 minutes. Now, the total cost is still €10, but there are 500 minutes in total, so the unit cost per minute is €0.02. So, at first glance, consumers paying €0.01 are paying below cost. However, these consumers pay €50 in total, so business users only have to pay the remaining €50 (or €0.05 per minute). The peak and off peak pricing approach, which is not derived from the cost model in either scenario, gives attractive prices to consumers while halving the price for business users.

It should be clear from this example that pricing requires an understanding of demand, and demand is not independent of price. Demand can be different for different segments, even if cost are the same. For instance, the costs of a 1Mb Broadband service and a 7Mb Broadband service might not differ much. However, if there are two different segments of users, with different willingness to pay, then it may be possible to set prices in such a way that demand is increased and unit costs reduced. Customers would then pay less than would be the case if the unit cost translated rigidly into a price and would include a segment which may not otherwise have availed of the service because the average unit cost exceeded the price that 1Mb users were willing to pay. The same can be said in relation to price structures. Some customers may be willing be pay high initial fees, but only low ongoing charges. Other customers may prefer low entry fees to encourage risk-free trials. Operators translate these preferences into promotions, discounts, bundles and other pricing ideas in the retail markets.

ComReg however has taken no account of the relationship between costs, price and demand and instead appears to have assumed that the current price structure is the only possible price structure, and set maximum and minimum levels for each existing price. This will stifle innovation and deter new price structures at the retail level. For example, ComReg has calculated a cost per Mb for backhaul in the range €72.59-€79.15 per month (eircom's current charge is €50.) ComReg has not allowed for the possibility that future increments may cost less: expanding from 100Mb to 1Gb may be more costly per Mb than a later expansion from 1Gb to 10Gb. eircom may wish to reflect this in wholesale prices by having a tiered charge: e.g. first 100Mb is €80/Mb; next 500Mb is €70/Mb and above 600Mb price is €50/Mb. This might better reflect the cost/volume relationships but ComReg has simply not considered whether this option should be allowed.

WBA is an intermediate market, situated upstream from the retail broadband access market, and downstream from the markets for access to network elements (for LLU/LS or RIO services). As such the imposition of a mechanical cost-oriented price control which directly translates average costs into price may have a negative impact on demand on the market by flattening the price gradient, which in turn would render the relevant retail markets less efficient. The setting of cost-oriented prices is not just about requiring prices equal to average costs. Other factors must be considered, as ComReg has recognized in its **Cost Recovery Principles** including:

- The principle of ***cost causation***: costs should be recovered from those whose actions cause the costs to be incurred at the margin;
- The principle of ***distribution of benefits:*** costs should be recovered from the beneficiaries especially where there are externalities;
- The principle of ***effective competition***: the mechanism for cost recovery should not undermine or weaken the pressures for effective competition;
- The principle of ***cost minimisation***: the mechanism for cost recovery should ensure that there are strong incentives to minimise costs;
- The principle of ***practicability***: the mechanism for cost recovery needs to be practicable and relatively easy to implement.

By failing to consider the various options available in terms of the pricing methodology, ComReg has ignored all of these issues. As a result, the proposed price control is irremediably flawed.

Glide path

Significant reductions in regulated markets may have unwelcome distorting effects which are generally avoided through the adoption of a smooth glide path providing for the reduction of prices over time, between the current price and the target price to be reached at the end of the price cap period.

For example, if a cost is expected to decline from 18 to 17 to 15 over 3 years, but the price now is 20, then the price control would typically require the price decline in even steps from 20 to 15 by the end of year 3: i.e. cpi-8% with the first reduction due in twelve months time. An immediate step reduction is unusual, disruptive and as such, must be justified by reference to special circumstances which require such an approach. Any reduction in the Bitstream price should accordingly be achieved using a glide path.

In addition, it is not acceptable, as ComReg proposes, in the context of uncertainty over falling unit costs over the period considered, to require a step reduction in prices at Year 1 to immediately reflect the Year 2/Year 3 modelled levels of cost.

Geographical averaging

Finally, ComReg has also failed to consider that costs differ significantly with geography and that as a result of this, the competitive conditions faced by eircom are likely to vary accordingly (depending on the presence of LLU operators, cable and/or Wi-Max). While eircom currently applies a single national pricing policy for broadband, it could be envisaged that eircom vary retail prices depending on location (rural – v – urban for instance). Different retail prices (and hence the wholesale prices derived from the retail prices using retail minus) could be accommodated in a number of ways under the current retail minus regime. This however would be made very difficult by the proposed price control, in view of the price ranges, which have floor and ceiling prices so close as not to make a meaningful difference capable of supporting different retail prices.

It is worth noting that unlike the gradient argument above, geographic differentiation may have a sound basis in cost. DSLAM costs may be similar in all locations, but transmission costs may differ by a huge amount. ComReg's approach to modeling tends to hide this effect, by calculating only DSLAM costs by site, and adding nationally average transmission costs.

(There is data available on incremental costs per DSL site enabled which shows a wide variation in unit cost per customer connected.)

Cost allocation

There is no discussion of the possibility that Bitstream prices recover in part the joint and common costs of the local loop not recovered from narrowband access revenues. Instead, ComReg assumes that the only costs that Bistream is entitled to recover in that respect is the current price for Line Share. eircom believes that this assumption should be put to consultation and refers the Report prepared by David Gabel included in Annex 2 which outlines the difficulties arising from the approach followed by ComReg. In particular the question of the allocation of part of the joint and common costs of the local loop should be discussed in the context of setting a ceiling on Bitstream price.

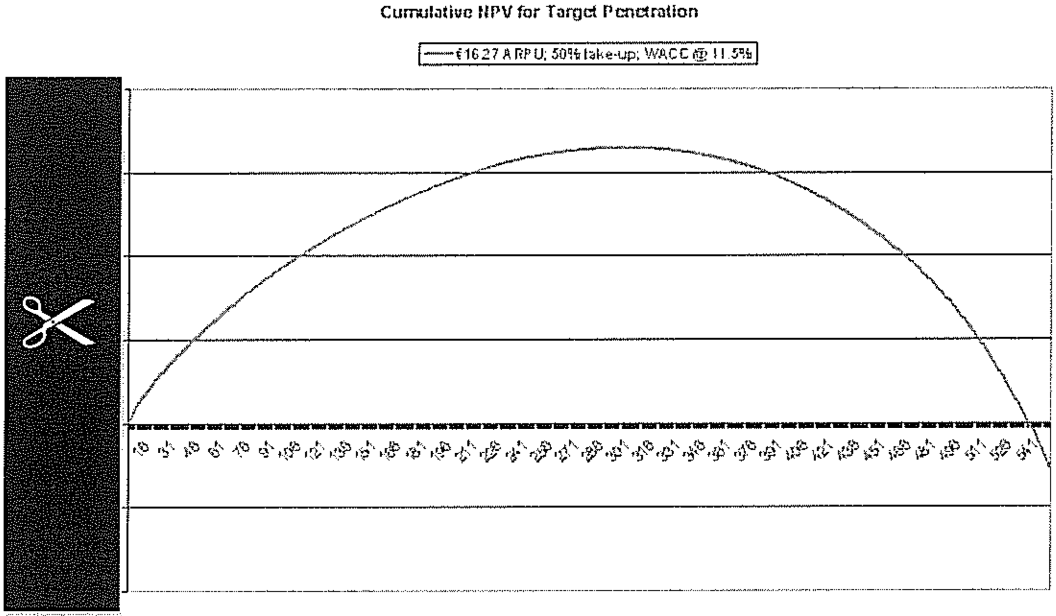
(b) Impact on investment

ComReg fails to consider a longer term dynamic context. There is no discussion of Next Generation Access technologies such as Fibre to the cabinet/VDSL, or Fibre to the Home (FTTH). These technologies may make current generation Bitstream obsolete, changing the depreciation timetable. In addition, it is most likely that ComReg's proposed approach of rigid rate of return regulation (capping prices at the FL-LRIC+ level, to allow a maximum return equal to the cost of capital) will deter any investment in risky new technology.

In this regard, there is also no consideration by ComReg of the impact of the new control on the incentive for eircom, and of alternative operators, to invest and innovate. It appears that ComReg is under the apprehension that eircom, and operators generally, make investment decision by considering the average cost per customer calculated by reference to certain sites. This is not the case: rather, operators consider the incremental cost and revenues for each extra site they consider investing in, on a site by site basis. Any investments proposed in the context of significant risk must inevitably be assessed in the context of the expected return on this investment. In the context of such risky investments there are a range of broad potential outcomes, ranging from loss of the entire investment in the context of minimal take-up, to high rates of return in the context of maximum take-up. This range combined with a probability rating is used to generate an expected rate of return. Investments will not be approved where the expected rate of return is less than the company's required return.

Projects with significant risks have to demonstrate a potential return greater than a hurdle rate well in excess of the WACC: in other words, such projects must have a positive NPV when cash flows are discounted at the WACC.

Consider the approach adopted by eircom in determining whether to extend broadband coverage beyond the initial 465 sites enabled by the end of 2006. Having built a national service with wide coverage, the core and common costs were regarded as essentially fixed. eircom therefore conducted a detailed analysis of the ***incremental*** cost and revenues of each site – based on assumptions about future take-up levels including wholesale revenues. In this analysis, eircom assumed retail costs are essentially incremental, so that only wholesale income contributes to the network cost. eircom then ranked all sites so that the sites with the largest NPV (using a required return of 11.5%, consistent with the allowed cost of capital at the time) would be considered first. The resulting analysis is shown in figure 1 below.



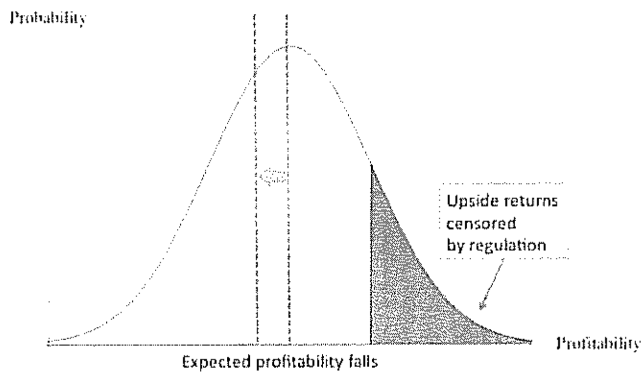
Taking the price controls into account, investment was approved only in 319 sites of the potential 541 where the NPV was positive. ComReg's proposed control call into question previous investment decision as an investment with a target NPV of over €15m should have a zero NPV. It is a significant error of ComReg's approach that ComReg takes the investment made using past rules as a given, ignoring that they are a result of past regulation. Of the original 319 sites, 31 remain to be completed in financial year 2010/11. In most cases, at this point in time, the business case remains positive were current regulation to continue. However, in almost all cases, the proposed price control would result in a significantly negative NPV and continued investment at those sites is under threat.

In the light of the above, changing the rules in the form of an immediate move to rigid cost of capital regulation now would effectively negate any return for risk taking. Failed projects are entirely at eircom's cost. Successful projects are limited to a return of WACC. In these circumstances, overall, the returns must average less than the WACC, endangering future investments.

ComReg is statutorily require to encouraging efficient investment in infrastructure and promoting innovation. eircom is of the view that ComReg's proposed price control does not take appropriate account of this imperative, with potentially serious implications:

- a sudden reduction in wholesale broadband prices, and thereby broadband returns, will inevitably lead to a reduction of the broadband footprint that eircom is in the position to justify on economic grounds.

- Any investments proposed in the context of significant risks must inevitably be assessed in the context of the expected return on this investment. In the context of such risky investments there are a range of broad potential outcomes, ranging from loss of the entire investment in the context of minimal take-up, to high rates of return in the context of maximum take-up. This range combined with a probability rating is used to generate an expected rate of return. Investments will not be approved where the expected rate of return is less than the company's required return. A policy of "censoring" returns in the case of investment success leading to a superior rate of return, as ComReg appears to pursue in the form of its proposals for a price ceiling for Bitstream based on LRIC+, would have the effect of reducing the expected rate of return for proposed investments.



This in turn could have a major negative impact on the assessment of all future major investments, most notably NGA.

Q. 8 Do you agree with the preliminary views expressed by ComReg? Please state the reasons for your response and please explain which preliminary views you do not agree with and detail the specific amendments you believe are required.

For the reasons explained in response to Questions 1 – 7, eircom does not agree with the views expressed and the assumptions made by ComReg. In summary, eircom does not agree that it is appropriate to use the draft costing model to set both ceilings and floor prices or that the average costs produced by the model can be readily used to set Bitstream prices. eircom further believes that it is not appropriate to require eircom to comply with both a margin squeeze test and a price ceiling. eircom is also of the view that in the light of the proposal for a cost-oriented price floor, a margin squeeze test (in another form than that proposed by ComReg) would be more appropriate than the ceiling proposed by ComReg. This is because by proposing a ceiling determined on the basis of LRIC+, ComReg is capping return on risky investments at an inappropriately low level, thereby endangering future investments. In addition, the scope of the differential between the proposed floors and ceilings is so narrow as to become meaningless and certainly insufficient to achieve the pricing flexibility admittedly being pursued by ComReg. (It is in fact so narrow that floors are susceptible to be above ceilings.) Furthermore, in proposing a new price control for WBA, ComReg seemed to have had no regard whatsoever to the underlying regulatory objective and policies.

Q. 9 Do you believe that the draft text of the proposed decision is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

Significant issues arise with the draft text of the proposed decision. The comments below are without prejudice to eircom's view that ComReg does not have the legal powers to impose a cost-oriented price for Bitstream without first conducting a market review in accordance with

Regulations 27 of the Framework Regulations and the proposed control including a price floor, a price ceiling based on LRIC and a margin squeeze test is unjustified, disproportionate and inadequate.

- In relation to Section 1(Statutory and legal powers) and Section 3 (Scope and Application), for the reasons explained in response to Question 1, the legal basis proposed for the draft decision is inadequate. In particular, ComReg excluded the possibility of a cost-orientation obligation in the consultation that led to Decision D03/05 published in Doc. 05/11r. Doc. 05/11r cannot accordingly provide the legal basis for ComReg's decision. In this regard ComReg cannot rely on Regulation 17 of the Access Regulations as the price control proposed clearly is not a specification of an existing obligation but indeed an amendment.

  It is not possible to argue, as ComReg appears to suggest, that ComReg may rely upon Regulation 14 and the market analysis conducted in the first round of market reviews for the purpose of amending the obligation of price control set out in D03/05. A new market analysis is clearly required for that purpose.

- For the reasons set out in response to Question 3, the regulation of bundles and discounts of Bitstream services is not required and accordingly unjustified. The definitions of bundles, discounts and promotions are accordingly also superfluous and section 7 and section 8should be deleted.

- It is not helpful to define "economic space" by reference to "space".

- The process for amending prices, set out at section 5.2, is not clear. In particular it is not clear what a "review by ComReg" entails. eircom believes that changes to the regulated range at the instigation of ComReg should be subject to public consultation. This comment also applies in relation to section 5.7. The reference at section 5.3 to "the maximum prices and minimum prices which are based on the pricing of the regulated wholesale input, LLU Line Share" suggests that there are maximum prices and minimum prices imposed by the Decision which are not "based on Line Share". It does not appear that this is the case. The wording should therefore be clarified in this respect. "Based on" may also be interpreted in a number of ways and would benefit from clearer explanation to the relevance of Line Share pricing in setting WBA prices. The timelines for review mentioned in the Consultation Document should form part of the Decision.

- The test for the margin squeeze referred to in section 5.5 should be set out in the Decision. It is unnecessarily confusing to refer to a paragraph in the consultation document.

- eircom finds the process and requirements for the publication and approval of prices and products inappropriate. Some of these issues have been set out in response to Question 3. In summary:

  - There should be no need for prior approval of prices which are comprised within the band set by the minimum and maximum prices.

  - There can be no prior approval by ComReg in the context of this Decision of changes to products or of new products.

  - In circumstances where no prior approval is required, notification to ComReg at the time the price change is introduced is sufficient.

  - Even if prior notification was justified (which eircom does not believe is the case), a two month period is excessive. The proposed process for shortening this period is inadequate as it requires even further advanced notification to ComReg, which would seem to defeat the purpose of such a request in the first place. Rather, eircom could require that ComReg makes its decision of approval in a shorter timeframe at the time of notification and ComReg could access to that request where appropriate.

- If prior approval is required and justified (which eircom does not believe is the case), for the sake of clarity, legal certainty and accountability, ComReg should be required to make a decision within a defined period of time, failing which the proposed change will be considered to be approved.

- ComReg may not lawfully amend Decision D03/05 set out in Document 05/11r by way of the proposed decision. The Decision should accordingly not provide that "unless expressly stated otherwise in this Decision Instrument, all obligations... are continued in force." Rather it should indicate that "for the avoidance of doubt", all obligations etc continue in force. eircom would also suggest that the appropriate reference is to Decision D03/05, not Document 05/11r.

- eircom does not believe that it is acceptable that the decision be effective "until further notice". Instead the decision should apply for a finite period of time, reflective of the projections over time supporting the price control. The decision could be renewed following an update of the model, if so required and justified.

Q. 10 Do you have any views on this Regulatory Impact Assessment and is there other factors (if any) ComReg should consider in completing its Regulatory Impact Assessment? Please explain your response and provide details of any factors that should be considered by ComReg.

eircom is surprised by ComReg's assertion at A4 that no Regulatory Impact Assessment (RIA) is needed because there is no new obligation. This is clearly not the case. The format of the proposed control and the revised notification and publication time lines are so different from those currently existing that a regulatory impact assessment is essential and indeed required. Any change to the regulation of wholesale broadband access at this stage requires a RIA having regard to the very different environment the control operates as compared to 2005.

Despite its view that no RIA is required, ComReg has however attempted to demonstrate some impacts on various stakeholders of certain options. While this is welcome, several important options are omitted and the impacts are not well quantified.

eircom is not satisfied that the proposed control will encourage efficient investment and innovation by eircom. In fact by limiting the rate of return on future investments to the eircom WACC it overtly seeks to prevent both of these.

The control appears to prevent any form of geographically differentiated pricing. One possible result is that Bitstream products or naked DSL based products would be unable to compete with Cable or LLU based product, or other infrastructures such as WiMax, or LTE. In rural areas, eircom will be forced to sell Bitstream service at a national average price. Once again the RIA makes no attempt to quantify the effect on competition or consumer welfare of this outcome

Reference: Submission re ComReg 10/56

Wholesale Broadband Access

Consultation and draft decision on the appropriate price control

Annex 1

Implications of the

Proposed Pricing Rules

Report prepared by Gabel Communications for

24 September 2010

Table of Contents

I. Qualifications and Experience

1. My full name is Dr. David Joshua Gabel. I live in the city of Newton, in the state of Massachusetts, United States. I am the head of an international consulting firm that has advised regulatory authorities in multiple jurisdictions within the United States and in several countries outside the United States. I am also Professor of Economics at Queens College, in New York City. I have been practicing as an economist in the field of telecommunications regulation for more than 25 years.

2. I received my Ph.D. in economics from the University of Wisconsin Madison, in 1987. The topic of my dissertation was: The Evolution of a Market: The Emergence of Regulation in the Telephone Industry of Wisconsin, 1893-1917. Much of my research has focused on the cost structure of the telecommunications industry, as well as its pricing practices.

3. I have a longstanding relationship with state regulatory commissions in the U.S., which have jurisdiction to regulate wholesale prices, as well as retail intrastate prices. Since 1991 I have written monographs for the "think tank" of the state regulatory commissions, the National Regulatory Research Institute ("NRRI"). In recognition of my expertise, particularly with respect to telecommunications costing, I was named the NRRI's first institute fellow in 2003.[1] I have also been a regular speaker at the National Association of Regulatory Utility Commissioners ("NARUC") summer training camp.

4. I co-developed a cost model for the state regulatory commissions to estimate the cost of the local exchange network. This model, known as the Local Exchange Cost Optimization Model ("LECOM"), is widely used by academics and regulatory commissions. Indeed, LECOM was the foundation for the forward-looking cost models adopted by the Federal Communications Commission ("FCC") and the German Regulatory Authority for Telecommunications and Posts.[2]

5. In 1997 and 1998, at a time when the US telecommunications industry was subject to significant *ex ante* regulation at the federal level, I worked as a consultant to the FCC in its review of cost models sponsored by various industry participants. My research was widely cited by the FCC in its Universal Service costing proceeding. Specifically, the FCC relied on my recommendations for the material and placement costs of copper and fibre optic cables, support structures, and digital switching machines.[3] I have also advised the FCC on such issues as depreciation, customer location algorithms, and expense factors.

6. Since the passage of the 1996 Telecommunications Act in the United States, I have advised the regulatory commissions of the states of Washington, New Mexico, and Maine in various proceedings, and, in particular, numerous proceedings regarding interconnection pricing and universal service costs. I have been retained by these state regulatory commissions because of my ability to impartially conduct critical reviews of cost models submitted by both incumbents and entrants. The cost models I have

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[1] See http://www.nrri.ohio-state.edu/About/nrri-institute-fellows/?searchterm=gabel

[2] See http://www.bundesnetzagentur.de

[3] See 10th Report and Order, Docket CC 96-45, November 2, 1999, FCC 99-304; available at http://www.universalservice.org/_res/documents/about/pdf/fcc-orders/1999-fcc-orders/FCC-99-304-with-appendices.pdf#search=%22fcc%2099-304%22

reviewed have been used for establishing the cost of interconnection, unbundled network elements, retail services, and the avoidable retail costs associated with the resale of retail services. In each of the aforementioned states I have regularly reviewed the economic cost models submitted by the parties, assisted in the development of the record, and assisted in the drafting of the commission's decisions.

7. In 2008 I testified for the Government of New Zealand in a price squeeze claim against Telecom New Zealand. My primary writ was to estimate the extent to which there was a price squeeze in the market for packet switching.

8. I am familiar with the EU regulatory framework and have worked in countries outside the United States which have adopted a regulatory framework based on the EU model

9. I have authored and co-authored articles and chapters on competition and regulation in the telecommunications industry in numerous journals and texts. A selection of those works are:

    "Promoting Innovation and the Deployment of Advanced Telecommunications Services to Business," Contemporary Economic Policy (with Guang-Lih Huang), Vol. 26, No. 2, April 2008, pp. 229-247;

    "Broadband and Universal Service," Telecommunications Policy, July-August 2007, pp. 327-346;

    "Estimating the Cost of Switching and Cables Based on Publicly Available Data," with Scott Kennedy. Monograph published by the National Regulatory Research Institute 1998;

    "Fully Distributed Cost Pricing, Ramsey Pricing, and Shapley Value Pricing: A Simulated Welfare Analysis for the Telephone Exchange," (with Mark Kennet). Review of Industrial Organization, vol. 12 (August 1997), pp. 485-499.

    "Economies of Scope in the Local Telephone Market." (with Mark Kennet) Journal of Regulatory Economics. Nov. 1994, vol. 6, no. 4, pp. 381-398.

    "Competition in a Network Industry: The Telephone Industry, 1894-1910," Journal of Economic History, vol. 54, September 1994, pp. 543-572.

10. With David Weiman, I edited and provided the introduction to Opening Networks to Competition: The Regulation and Pricing of Access, published by Kluwer Academic Press in 1998.

11. In February, 2010 I filed a report on behalf of eircom in response to ComReg's Consultation Document 10/01.[4]

12. A copy of my *curriculum vitae* may be found in Appendix A.

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[4] ComReg 10/01, "Consultation and draft direction: further specification of the obligation not to unreasonably bundle pursuant to D07/61"; dated 6 January 2010, (Hereinafter: "Doc. 10/01").

II. Purpose Of This Report

13. I have been retained by eircom Ltd. ("eircom") to review ComReg's Consultation Document 10/56[5] (Doc. 10/56) and to comment on the likely effect of the proposed pricing rules contained therein. I have carefully reviewed Doc. 10/56.

14. In this report I will explain why Comreg's pricing proposal: :

- Discourages infrastructure investment in eircom's NGA;
- Discourages ONAs from moving up the investment ladder; and
- Hinders the efficient recovery of capital investments.

III. Discussion

A. Proposed Pricing Rules

15. In Doc. 10/56, ComReg announced its intention to change from the current retail-minus-price control[6] to a cost-plus model for wholesale broadband access ("WBA"), or "bitstream", as it is commonly called.[7] The proposed price control would be applied to both rental products[8] and ancillary services/products.[9] In the case of the bitstream rental products, the price control would require prices to be set within a maximum-price and minimum-price range, based on a forward looking 'cost plus' model. The maximum price would be set by reference to the efficiently incurred costs and required regulated rate-of-return of eircom, whereas the minimum prices would be set by reference to a hypothetical operator availing of LLU line share.[10] For the ancillary services/products, the price control will require eircom to demonstrate that individual prices that they propose are cost oriented and maximum prices will be set.

16. When introduced in 2006, ComReg deemed retail-minus approach to be the most effective way to regulate WBA products. ComReg reached this conclusion partly because these products were still relatively new, and also because ComReg believed it would be difficult to accurately estimate the forward-looking costs for a market that was nascent but expected to grow rapidly.[11] ComReg is now of the preliminary view that the retail-minus-price control is less appropriate, since the market for WBA is no longer in the early stages of development.[12]

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[5] ComReg 10/56, "Consultation and Draft Decision: Wholesale Broadband Access Consultation and draft decision on the appropriate price control"; dated 15 July 2010, (Hereinafter: "Doc. 10/56").

[6] As established in ComReg Decision No. 01/06.

[7] Doc. 10/56, par. 1.1.

[8] Doc. 10/56, par. 2.13.

[9] Doc. 10/56, par. 2.16.

[10] Doc. 10/56, par. 4.5.

[11] ComReg asserted that "any other form of price control (in particular cost orientation)risked being either ineffective if the costs estimated were too high (or low) and/or acting as a disincentive to infrastructure investment if the costs estimated were below cost plus a reasonable return." Doc. 10/56, par 2.17.

[12] Doc. 10/56, par. 3.21.

17. In summation, ComReg has proposed setting maximum prices in the WBA market to guard against excessive pricing, while setting minimum prices in the WBA market to ensure the maintenance of an appropriate economic space between the relative pricing in the regulated markets for WBA and eircom's wholesale physical network infrastructure access ('WPNIA').[13]

18. ComReg is particularly concerned that changes to WBA prices, and eircom's WPNIA prices, could reduce the economic space available to other authorized operators ("OAOs"). ComReg believes that this would increase uncertainty and could dissuade OAOs from engaging in efficient infrastructural investments even where current bitstream prices offered sufficient economic space. ComReg believes that its proposed cost based price control "would serve to promote efficiency and sustainable competition and maximise consumer benefits."[14]

B. Next Generation Networks

19. In Doc. 10/56, ComReg notes that "DSL broadband has been subject to a rapid rate of technological evolution at all levels of the network:…[and that a] Next Generation Network (NGN) based on Internet Protocol is being rolled out which will replace a wide range of existing network infrastructure, including elements of the network used for the WBA service."[15] Although ComReg recognizes the rapid rate of technical development with respect to broadband service, and the prominent role of NGNs, Doc. 10/56 fails to address the implications of the proposed pricing rules on NGN investment by both eircom and the OAOs. Before addressing this issue, I will provide some brief background comments on NGNs.

i. Purpose and Design

20. Broadband products have traditionally been delivered by incumbent operators, such as eircom, using circuit-switched infrastructure that was initially designed to deliver narrowband products such as voice.[16] These networks relied predominantly on dedicated copper facilities between the end-user and the switch in the central office. As demand for higher speed data products increased these networks were partially redesigned and then adapted to provide broadband products. However, because of their narrowband roots, the broadband services these networks deliver are severely limited in terms of throughput and geographic reach. An NGN, on the other hand, is a packet-based network that is specifically designed to provide multiple broadband services over great distances. This is accomplished by installing 'large pipes' and aggregating traffic close to the end-user where it can be transported on shared high capacity facilities. Clearly, the days of dedicated copper facilities and voice services dominating network architecture have come to an end.

21. The purpose and design of the older generation networks is often mirrored by the manner in which the cost of a regulated network element is estimated and recovered. For example, ComReg recently determined that "only costs which are incremental to the provision of [Line Share] LS should be recovered in the price of LS since the common

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[13] Doc. 10/56, par. 1.7

[14] Doc. 10/56, par. 2.26.

[15] Doc. 10/56, par. 2.5.3.

[16] Doc. 10/56, par. 2.6.

costs of the local loop are already reflected in narrowband prices. As a result of this, ComReg has decided that a maximum monthly rental charge of €0.77 is the appropriate cost oriented charge going forward."[17] This decision reflects the position that the purpose and design of the network was primarily for the provision of voice services and that the data component (e.g. Line Share) is, at best, secondary. However, with NGNs this situation is reversed; the purpose and design of NGNs is to provide high speed data services and voice services are an afterthought.

ii. Expected Benefits

22. The expected qualitative benefits of NGNs are significant. For example, according to a recent report by the Department of Communications, Energy and Natural Resources (DCENR) the availability of Next Generation Networks will underpin a transformation in Ireland in the areas of economic development, sustainability, social inclusion, education, public services, research and development, and products and service.[18] This paper recognized NGNs "as a key enabler for the Smart Economy, on which our future prosperity will increasingly depend and which will also drive national and regional competitiveness."[19]

23. While the quantitative benefits of NGNs are difficult to estimate, they are nonetheless expected to be significant as well.[20]

iii. Expected Cost of Delayed Investment

24. The aforementioned report by the DCENR also suggested a number of threats to Ireland's future prosperity should the transition to NGN not be made. The DCENR argued that these factors further strengthen the case for policy approaches which facilitate the roll-out of NGN.

    • Delays in investing in telecoms infrastructure slowed the rollout of broadband in Ireland. We cannot afford a similar situation in relation to Next Generation broadband.

    • If there is not investment in Next Generation broadband now, Ireland will lag significantly behind other advanced economies in terms of attracting inward investment and remaining economically competitive.

    • Without ubiquitous access to high speed bandwidth applications, Ireland will face a digital divide, with citizens and business in the rural areas not able to avail of the

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[17] See ComReg Doc. 09/66 "Response to Consultation and Decision: Rental Price for Shared Access to the Unbundled Local loop Response to Consultation Document No. 08/106 and Decision"; dated 18 August 2009, (Hereinafter: "Doc.09/66"); par.1.4.

[18] Department of Communications, Energy and Natural Resources 2009 Report entitled: "Next Generation Broadband: Gateway to a Knowledge Ireland" (Hereinafter: DCENR Report); page 6.

[19] DCENR Report, page 5.

[20] Estimated benefits are usually quoted in the tens-of-billions of dollars per year. For example, see generally, "The need for speed: the importance of next generation broadband networks" The Information Technology and Innovation Foundation, March 2009, Ezell S, Atkinson R, Castro D, and Ou G; available at http://www.itif.org/index.php?id=231; and "A Framework for Evaluating the Value of Next Generation Broadband: A report for the Broadband Stakeholder Group" dated June 2008; Section 5; available at: http://www.broadbanduk.org/component/option,com_docman/task,doc_view/gid,1009/Itemid,63/

many economic, social and educational benefits and opportunities that Next Generation broadband affords their urban counterparts.[21]

25. As above, while difficult to estimate, "The cost of delay, beyond the point at which it is rational to invest [in NGNs] is likely to be considerable." [22]

iv. Implementation Status

26. In Doc. 10/56, ComReg notes that an NGN based on Internet Protocol is currently being rolled out, and that certain equipment based on older technologies, like ATM, are no longer being installed.[23]

27. The current[24] (and planned future) use of NGN architecture indicates that it is the appropriate forward-looking technology for ComReg to consider when making decisions, such as those proposed in Doc. 10/56, as it is the architecture eircom and OAOs will build out.

v. Factors Affecting Implementation

28. The decision to invest in NGN facilities, and the timing of this decision, depends on a number of economic and regulatory factors. The economic factors include the willingness of consumers to pay a premium for NGN services.[25] ComReg has substantial control over a significant factor, the manner in which NGNs will be regulated.[26]

C. Implications of the Proposed Pricing Rules

i. Lower Bitstream Prices Reduce Investment Incentives

29. ComReg has proposed that the minimum bitstream charge be set equal to the costs incurred by a hypothetical operator availing of LLU Line Share, plus the incremental cost of providing equivalent functionality to the WBA products provided by eircom.[27] This methodology proposed by ComReg is consistent with the wholesale pricing recommendations of the European Regulators Group ("ERG").[28] The ERG favored this

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[21] DCENR Report, page 13.

[22] "Regulating next-generation fixed access to tele-communications services" David Lewin, Brian Williamson, and Martin Cave, Revised November 2008; page 10.

[23] Doc. 10/56, par. 5.48.

[24] See, for example, http://www.siliconrepublic.com/comms/item/17488-eircom-new-ngn-ethernet-boo

[25] "Regulating next-generation fixed access to tele-communications services" David Lewin, Brian Williamson, and Martin Cave, Revised November 2008; page 3.

[26] "Regulating next-generation fixed access to tele-communications services" David Lewin, Brian Williamson, and Martin Cave, Revised November 2008; page 13. See also par. 36 below.

[27] Doc. 10/56, pars. 5.76 and 5.79.

[28] The ERG has been replaced by the Body of European Regulators for Electronic Communications (BEREC). See: http://www.erg.eu.int/

methodology because, like ComReg, it sought to establish economic space between the pricing of line share and bitstream.[29]

30. ComReg has proposed new maximum bitstream rates that are lower than the existing wholesale rates. The ERG did not propose a maximum price for bitstream. Nevertheless, it did caution that if there was not an appropriate space between the price of LLU and bitstream, new entrants would be discouraged from making LLU investments. If the proper space was established, new entrants would have an incentive to "climb the ladder of investment."[30]

31. ComReg's proposal to lower the wholesale bitstream price does reduce the incentive for entrants to climb the ladder of investment via line share. This follows from ComReg's proposal to lower the wholesale fee for using the bitstream product and this, in turn, makes the alternative mode of operation, line share, relatively less appealing. That is, if a firm can produce retail broadband service using either bitstream or line share, and the wholesale price of bitstream declines, while the price of line share remains unchanged, then the ONA supplier of broadband retail services will find bitstream access comparatively more appealing relative to the situation that existed prior to the wholesale price reductions.[31]

32. I have already explained why the proposed pricing rules will likely reduce the likelihood that other network operators will move up the investment ladder. My research on the deployment of advanced telecommunications services suggests to me that eircom too will likely reduce its investments in response to the proposed bitstream price reductions.

33. As noted above, Doc. 10/56 gives little attention to the likely impact this pricing decision will have on eircom's investment decisions.[32] Along with Guang-Lih Huang, I have studied the impact that wholesale pricing had on the deployment of Advanced Telecommunications Services (ATS) over such technologies as ATM, SONET, packet switching, and Ethernet technologies. We analyzed the deployment of these advanced telecommunications technologies by assembling a rich data set which showed the technology deployment decisions made by hundreds of carriers in approximately 14,000 wire centers in the United States. For each wire center, we had information about such factors as the local company, the proximity of rivals, and various regulatory policies, which included the pricing of wholesale services.

34. In a paper published in <u>Contemporary Economic Policy</u>,[33] Huang and I concluded that "The results indicate that regulators cannot have the best of both worlds. That is, the econometric results support the proposition that to the degree to which regulators choose to promote price competition today through low [wholesale prices]…there will be a reduction in the deployment of ATS by incumbents." As I mentioned in the prior

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[29] Report on ERG Best Practices on Regulatory Regimes in Wholesale Unbundled Access and Bitstream Access, ERG (07) 53 WLA WBA BP final 080604, Best Practice 12.

[30] Id., Best Practice 10.

[31] The current space would be maintained if the line share price were reduced. However, a reduction in the line share price would be inappropriate, since it was set to cover the incremental cost of providing line share. Furthermore, if both the price of bitstream and line share were reduced by an equal amount, there would be no new incentive for entrants to move up the economic ladder.

[32] ComReg does express its concern that the current pricing regime may have on OAO's investments. Doc. 10/56, par. 2.25.

[33] http://www.mysmu.edu/faculty/kennethhuang/default_files/Gabel_Huang_PromotingInnovation.pdf

paragraph, we also considered a number of other factors that influenced the roll-out of advanced telecommunications services. All of our findings were consistent with basic economic logic. For example, densely populated areas, as well as localities with a large number of people employed in data-intensive industries, were more likely to have advanced telecommunications services available from their network operators than people living in rural areas.

35. Huang and I found that the incumbents' willingness to deploy advanced telecommunications services was more sensitive, as measured by the elasticity of offering advanced telecommunications services, to the wholesale pricing regime then it was to either direct competition or the threat of competition.[34] These elasticity estimates imply that all else being equal, the threat of entry[35] has a smaller impact on an incumbent's investment decisions than the wholesale pricing regime. This empirical result should be heeded by those who claim that an incumbent's investments are mostly driven by the threat of entry, rather than the wholesale pricing rules.

36. Huang and I concluded the paper with the following advice to policy makers:

> [T]his research indicates that [incumbent local exchange carriers] react in a consistent fashion to the myriad economic incentives and policies that have been considered in this model. For example, the authors' findings suggest that firms increase their rollout of [advanced telecommunications services] where they are offered subsidies…, high wholesale prices…, high rates-of-return…, or where there are a large number of potential users of the new services (i.e. number of employees). Firms are also more willing to provide a new service when they face more potential competitors. On the other hand, if the market is in a rural area, there is a reduced likelihood that the product will be offered. None of these findings are entirely counter-intuitive – common judgment often provides excellent guidance for deciding which policies should be adopted. Firms tend to react in a predictable manner to incentives.[36]

37. ComReg's proposed policies would likely discourage investments by eircom because ComReg is sending a signal that it wants to reduce copper based bitstream rates despite the rollout-out of NGN architecture. The proposed reduction in the wholesale rates discourages the movement of traffic from the old network to the new network as it puts the NGN bitstream products at a comparative disadvantage to where they would stand absent the price reduction of the older bitstream products. The proposed reduction in the bitstream prices will make the NGN products relatively more expensive. Production theory, as well as one's basic intuition, tells us that this will reduce the demand for NGN products. This, in turn, will reduce the flow of investment dollars to NGNs.

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[34] David Gabel and Guang-Lih Huang, "Promoting Innovation and the Deployment of Advanced Telecommunications Services to Business," Contemporary Economic Policy, Vol. 26, No. 2, April 2008, pp. 229-247.

[35] The threat of entry was measured by the date the Federal Communications Commission deemed a market irrevocably open to competition.

[36] David Gabel and Guang-Lih Huang, "Promoting Innovation and the Deployment of Advanced Telecommunications Services to Business," Contemporary Economic Policy, Vol. 26, No. 2, April 2008, p.245.

38. Furthermore, the proposed wholesale pricing reductions would discourage future investments by OAOs that have moved up the investment ladder to line share. The proposed price reduction will reduce the potential margin that OAOs can earn because ComReg has proposed a price ceiling that is strictly cost based, and, unlike the current retail (price) minus regime, eliminates the margin that is built into the bitstream rates.

39. In summary, the proposed wholesale price reduction is not likely to lead to an increase in infrastructure investment by either eircom, or the OAOs who will have a decreased incentive to move up the investment ladder. Potential investors in NGNs are mindful of how a regulatory authority sets wholesale rates. Lowering the bitstream rates in a manner which harms investors with eircom and firms that are using line share would likely have a negative impact on potential NGN investors.

ii. The Proposed Rate Structure Is Inefficient

40. The existing wholesale pricing methodology, retail-minus for bitstream and cost plus for line share, provides an economic incentive for OAOs to move up the investment ladder. The retail-minus methodology preserves the contribution to the overheads and profits that are built into the existing retail rates. The line share rate, on the other hand, was designed to cover the incremental cost of using DSL technology on an existing copper line.[37] No margin is built into the line share rate. The fact that the proposed bitstream rates would be lower than the existing wholesale rates would indicate that the current bitstream rates include a margin above and beyond the measured economic cost of production and allocated overhead costs.

41. Currently, if the OAO feels that it wants to differentiate itself in terms of transmission speed and contention ratio, or reduce its wholesale payments, it invests in DSLAMs. The proposed new price control lowers the price of Bitstream access and the Next Generation Bitstream service offered by eircom allows the OAO to control the contention ratio. These changes aid the OAO that is relying on bitstream access, but it also reduces these OAOs incentive to use line share rather than bitstream access.

42. I concur with ComReg that its proposed pricing structure and levels would provide the OAOs with an economic incentive to deploy faster services. This logically follows from the pricing distortion proposed by ComReg. ComReg has proposed that the port charge be calculated by dividing the DSLAM costs "by the average number of subscribers."[38] The quotient sets a rate that, unlike today's bitstream rate, is independent of the speed of transmission or functions offered through the DSLAM.

43. ComReg is proposing that the wholesale rate be based on the average cost of production, despite the range in economic costs associated with network equipment. When I use the term economic costs I have in mind, for example, the type of economic costing analysis described by ComReg in this proceeding: "[e]conomic depreciation is usually understood to be any form of depreciation that attempts to set capital charges to reflect the cash flows generated by the asset."[39]

44. The hardware that is used to provide high-speed data services, such as the DSLAM, is subject to rapid technological change and price declines over time. One of the pricing

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[37] Doc. 09/66 par. 3.196, 3.208, and 3.280.

[38] Doc. 10/56, par. 5.72.

[39] Doc. 10/56, par. 5.37.

challenges in this industry is determining how to recover capital costs when the cost of replacement equipment with equal or superior functions and capabilities is likely to decline over time.

45. The pricing structure proposed by ComReg is inefficient given the rate of technical change observed in this industry. To illuminate my assertion, assume that DSL service is currently provided using either an 8 Mb/s or 24 Mb/s line card. Further assume that three years ago 24 Mb/s cards were prohibitively expensive, and therefore, eircom purchased the slower 8 Mb/s cards. Finally, assume that the economic life of a card, that is the period of time when it becomes more profitable to replace an asset than to continue to use it, is five years.

46. Now, consider bitstream pricing under the following situations. With scenario A the manufacturer's price of the 8 Mb/s cards three years ago was less than the price of 24 Mb/s cards today. In scenario B, three years ago the manufacturer's price of the 8 Mb/s card was equal to the price of the 24 Mb/s card today. In scenario C, the manufacturer's price of the 24 Mb/s card is less than the price of the cards purchased three years ago.

47. ComReg has proposed that the wholesale price be set equal to the average cost of production. In scenario A, the average price of a card will be greater than the book cost of the 8 Mb/s card and less than the 24 Mb/s card. OAOs will have an incentive to order the 24 Mb/s bitstream service because they do not have to pay the full cost of buying the state-of the-art equipment. Furthermore, the cost of the 8 Mb/s card may not be recovered by eircom because of the OAOs' decision to use the newer 24 Mb/s card. The shift to the new card may strand the investment in the old card.

48. In scenario B, the wholesale price would be set equal to the average cost, which by assumption, shows no variation over time. In this situation, OAOs have an incentive to order the faster port termination because for the same price they obtain a faster connection. This bitstream pricing will accelerate the retirement of 8 Mb/s cards. The economic life of the 8 Mb/s cards is greater than three years but under this wholesale pricing methodology, eircom has a shorter period of time to recover the cost of the equipment. Knowing this, eircom either has to establish a short capital recovery period given the history of the reduction in the cost of installing, equipping, and furnishing electronic telecommunications equipment, or eircom will not recover its initial investment.[40]

49. In scenario C, where the current cost of a 24 Mb/s line card is less than the cost of an 8 Mb/s card, the bitstream price will be based on the average cost of the line cards. Under ComReg's proposal, there will be only one wholesale price and again the OAOs will have an incentive to order the 24 Mb/s service since more functionality and capabilities are available at the same wholesale price. The movement from the 8 Mb/s to 24 Mb/s cards will accelerate the retirement of the 8 Mb/s cards. Because the stream of revenues that can be earned with the 8 Mb/s cards is limited, there will be a need to set an initially high price in order to recover all of the capital costs associated with the cards in a period shorter than five years.

50. I assert that many of the 8 Mb/s cards are likely to be stranded under the pricing regime proposed by ComReg because this equipment can be used to meet the demands of most data users but will be retired prematurely. While the 24 Mb/s cards are crucial for the

[40] See, for example, the Turner Price Index for digital circuit equipment.

provision of video entertainment services, the 8 Mb/s more than adequately provides the bandwidth needed by most households today and for the foreseeable future.[41]

51. ComReg rightly states that rates should encourage economic efficiency. One type of economic efficiency is productive efficiency, defined as the minimization of production costs.[42] It is economically wasteful to prematurely replace existing equipment with new facilities that provide unneeded capacity. ComReg's pricing proposal will interfere with eircom's effort to minimize its production costs.

52. ComReg's proposal can lead to a second type of inefficiency. Electronic communications is undergoing rapid change and it is efficient to have a pricing structure that reflects the various needs of consumers. The average cost of service price proposal is inconsistent with the notion that prices should reflect the varying needs of consumers.

53. Summarizing this final point, ComReg contends that its pricing proposal would promote economic efficiency and would lead to the roll-out of faster data services.[43] The proposal to set the port charge based on the average cost-of-service fails to satisfy the efficiency goals identified by ComReg.

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[41] For example, the Federal Communications Commission was recently charged by the legislature to establish what constitutes adequate broadband access. In a technical paper released by the Commission, the agency established target upload and download speeds of 4 and 1 Mbs, respectively: "Thus the 4 Mbps download, 1 Mbps upload Target is forward-looking, taking into account forecasts of future usage, along with current usage and historical increases in broadband speeds. It represents a speed significantly higher than what the typical residential customer consumes today (approximately 1 Mbps downstream and 250 kbps upstream), and a speed sufficient to stream high quality video from commonly used websites and services." The agency noted the 4/1 Mbs standard "represents a higher universal target than many countries around the world." Federal Communications Commission, OBI Technical Paper, "Broadband Performance," 2010, pp. 16-17, http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db0813/DOC-300902A1.pdf .

[42] Doc. 10/56, par. 2.28.2.

[43] Doc. 10/56, pars. 1.6 and 2.33.

Appendix A

Curriculum Vitae

DAVID J. GABEL

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DEGREES:

B.A. Boston University, magna cum laude, 1976; awarded distinction in history.

M.S. University of Wisconsin-Madison, 1982, economics.

Ph.D. University of Wisconsin-Madison, 1987, economics.

DISSERTATION TITLE: The Evolution of a Market: The Emergence Of Regulation in the Telephone Industry of Wisconsin, 1893-1917.

WORK EXPERIENCE:

Queens College. 1987 -

Professor of Economics since 1997. Teach industrial organization, statistics, econometrics, economics of the Internet, operations research, microeconomics, business economics, and economic history.

Massachusetts Institute of Technology. 2001 - 2006.

Internet and Telecommunications Convergence Consortium, Visiting Scholar.

Graduate School, City University of New York. 1988 -

Teach Industrial Organization.

Columbia University. 1988 -

Affiliated Research Fellow, Columbia Institute for Tele-Information, Graduate School of Business.

Ohio State University. 2003 -

Senior Fellow, National Regulatory Research Institute.

Ohio State University. 1991 - 1998.

Institute Associate, National Regulatory Research Institute.

Northeastern University. 1993 - 1995.

Visiting Research Associate.

Michigan Divestiture Research Fund. 1986 - 1987.

Wrote report that identified the cost of telephone services in the information age. Quantified the stand-alone and incremental cost-of-service of different telephone services.

Office of Chief Economist, Wisconsin Public Service Commission, 1979 - 1980, 1983 - 1985.

Directed cost study that quantified the stand-alone and incremental cost-of-service of different telephone services. Supervised cost study of local measured service. Written and oral testimony presented on costing and pricing issues.

New York State Consumer Protection Board, 1985 - 1986.

Presented expert testimony to the New York Public Service Commission. Quantified the incremental and embedded cost of message and access services, and the elasticity of demand for various telephone services.

American Telephone and Telegraph Company, 1982 - 1983.

Responsible for developing interfaces between engineering simulation models and a financial forecasting system. Analyzed the impact of changes in demand on capital expenditures.

Dean Witter Reynolds, 1982.

Advised management on the procurement of telephone networks and hardware. Developed economic model for analyzing different capital expenditure alternatives.

Richard Gabel, Communication Consultant, Summer 1976 and 1980, 1981 - 1982.

Researched the technical impact long distance service had on the design of the local telephone network. Analyzed Bell Operating Company's forecasting procedures. Assisted in the analysis of private line costing and pricing issues raised in antitrust litigation.

Massachusetts Department of Public Utilities, 1977 - 1979.

Developed costing and pricing procedures for gas, electric, and telephone services. Hearing examiner.

Yadkin Valley Telephone Corporation, 1976 - 1977.

Outside plant and PBX installations.

TEACHING EXPERIENCE:

Queens College, 1987 -

Teach industrial organization, regulation, economics of the Internet, microeconomics, business economics, statistics, operations research, econometrics and economic history.

Michigan State University, 1994 - 2005.

Taught course on the costing and pricing principles underlying the provision of telecommunications services at a National Association of Regulatory Utility Commissions (NARUC) training seminar.

Ohio State University, 1988.

Taught course on how to calculate the cost of telephone services.

University of Wisconsin, 1980 - 1981, 1984.

Teaching Assistant for introductory economics and economic history.

PUBLICATIONS POST-QUEENS COLLEGE EMPLOYMENT:

"Promoting Innovation and the Deployment of Advanced Telecommunications Services to Business," Contemporary Economic Policy (with Guang-Lih Huang), Vol. 26, No. 2, April 2008, pp. 229-247.

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"Historical Perspectives on Competition and Interconnection between Local Exchange Companies," (with David Weiman) Opening Networks to Competition: The Regulation and Pricing of Access. Coeditor David Gabel and David Weiman. Kluwer Academic Press. 1998.

"Introduction," (co-author David Weiman) to Opening Networks to Competition: The Regulation and Pricing of Access. Coeditor David Gabel and David Weiman. Kluwer Academic Press. 1998.

"Is Residential Service Subsidized? Moving Past the Rhetoric Through an Empirical Analysis of the Cost and Revenue Associated with the Kiwi Share," Universal Service with Network Competition, University of Auckland Press, Centre for Research in Network Economics and Communications, 1996.

"The Effect of Cellular Service on the Cost Structure of a Land-Based Telephone Network," (with Mark Kennet), appearing in Telecommunications Policy (1997).

"Fully Distributed Cost Pricing, Ramsey Pricing, and Shapley Value Pricing: A Simulated Welfare Analysis for the Telephone Exchange," (with Mark Kennet). Review of Industrial Organization, vol. 12 (August 1997), pp. 485-499.

"The Effect of Cellular Service on the Cost Structure of a Land-Based Telephone Network," National Regulatory Research Institute Quarterly Bulletin (with Mark Kennet), vol. 17 (Winter 1996-97), pp. 561-577.

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Regulatory Research Institute, Ohio State University, 1995. 114 pages.

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4: Magnet Networks

Magnet Networks welcomes the consultation. We also welcome the recognition that an ‘economic space’ is required to be maintained between WBA and WPNIA. However, we feel that the proposed pricing and pricing methodologies are incorrect. Magnet Networks feel that a reasonably efficient operator (REO) costing method should have been used rather than the equally equivalent operator (EEO) costing method. Utilising REO would have changed the proposed pricing which Magnet Networks feels does not leave an economic space with WPNIA lineshare, the unbundled bitstream equivalent.

Q. 1. Do you agree with the detail of the proposed price control including the different specification of the ex-ante obligation not to margin (price) squeeze? Please state the reasons for your response.

Magnet Networks agrees that price control should consist of both rental and ancillary services. In relation to ancillary products Magnet Networks agrees a cost orientated model is the best one to adopt. These services are generally one off services such as connection charges, upgrades, cancellations etc. Thus, imposing a cost orientated prices means the incumbent recovers its cost whilst not unduly burdening the OAO.

In relation to the proposed price control outlined for rental prices Magnet Networks still has its reservations about same. Magnet Networks understand why ComReg feels necessary to set a maximum and minimum price point for rentals. Magnet Networks also applauds ComReg’s recognition of the necessity to maintain an ‘economic space’ between WBA and the WPNIA markets. Magnet Networks does not feel that the market and the telecoms sector has progressed enough to move away from the reasonable efficient operator (REO) test. The reasonably efficient operator test ensures that margins covered are that of a reasonably efficient operator rather then just the dominant operators’ costs. The dominant operator is more likely to have lower costs than a OAO due to economies of scale and scope and general historic benefits, thus by utilising the dominant operators input cost there is a risk of eliminating operators from the market by ComReg proposed pricing practices without actually allowing a breach of competition to happen.

Magnet Networks recognises that ComReg has identified areas where margin squeeze may take place such as bundling products and giving discounts in unregulated aspects of the bundles thus pricing a competitor out of the market. Thus, Magnet Networks congratulates ComReg in bringing bundles into the regulatory remit and considering the implications of margin squeeze when analysing pricing.

Overall Magnet Networks agree that the ex ante obligation not to margin squeeze is a pre-requisite to any price control, however, it must be remember that regulatory compliance is not a defence to any abuse of dominant position as outlined in Deutsche Telekom AG ‘v’ Commission (2008).

Q. 2. Do you agree with the preliminary views in relation to the duration and future review of the price control? Please state the reasons for your response.

Overall Magnet Networks agrees with the preliminary views except the view that ComReg outlined at 4.26 that if there was a “significant migration from bitstream to WPNIA … ComReg … would review the price control … so that eircom continues to have the ability to recover its efficiently incurred costs." Magnet Networks feels that the WPNIA input price of .77 cent outlined in Decision 04/09 is a cost orientation price and thus reflects the cost of providing this service therefore any migration across by consumers from WBA to WPNIA means that eircom still recover their input costs. Thus, a market review should not take place if there was such a significant migration. This would ultimately be penalising an OAO and readjusting the market into eircom's favour.

Q. 3. Do you agree with the proposed notification and approval procedures? Please state the reasons for your response.

Magnet Networks agrees with the proposed notification and approval procedures. Two months notice to OAO post ComReg approval is sufficient time to raise queries and concerns in the relevant forum.

Q. 4. Do you agree with the costing methodology proposed to determine the maximum prices for bitstream rentals? Please set the reasons for your response and set out in detail any specific amendments, supported by detailed analysis where appropriate, to the costing methodology you believe are required.

Magnet Networks agree overall to the preliminary assumptions. Magnet Networks would also like noted that they feel the WACC rate is too high, however, that is for another consultation. However, as previously stated Magnet Networks disagree with the utilisation of the efficiently incurred costs and would prefer that the reasonably efficient operator costs were used to calculate the maximum pricing.

Also Magnet Networks disagree with the number of exchanges proposed at Clause 5.21.2, Magnet Networks assumes that the exchanges are those outlined in the Further Input to Consultation 09/62 and Decision 10/10 which outlines 157 exchanges that ComReg believe would be economical to unbundle. Magnet have unbundled 40 exchanges and in the current regulatory and pricing environment have made a decision to stop unbundling exchanges. Due to ComReg's current and proposed pricing strategy Magnet Networks does not see a future for LLU in Ireland[*Confidential Spreadsheets attached*] This shows there is no benefit to unbundling an exchange.

Q. 5. Do you agree that in setting a price control in the WBA market that an appropriate economic space to the relative prices of LLU should be maintained? Please state the reasons for your response.

Magnet Networks agrees that it is necessary that when setting a price control in the WBA market an appropriate positive economic space must be kept between the WBA and LLU. This economic space should increase investment in LLU not as per Magnet Networks figures duly attached act as a disincentive to investment.[*Confidential Spreadsheet*].There are a number of reasons for maintain such a space. The first reason is to ensure that there is no foreclosure by the incumbent of the LLU space. The second reason is to promote investment in alternative access infrastructure and thereby ensuring that the customer has genuine alterative choice. The third reason is to ensure competition generally and that there is real choice in the marketplace for the customer.

Q. 6. Do you agree with the proposed hypothetical entrant model to set the minimum prices for bitstream rentals in order to maintain an appropriate economic space? Please state the reasons for your response, providing worked examples and/or robust data to support your views.

[Confidential Spreadsheet].

Magnet feels it is necessary to highlight to ComReg that assuming a new market entrant would acquire a 25% market share is overzealous considering any individual current provider holds no more than 15% of the broadband[1] market (inclusive of LLU) thus ascribing a 25% margin to a new entrant is unrealistic. It would be more realistic to apportion a 10% market share to the new entrant and even this is being optimistic. It must be noted the provider that has acquired 15% of the market has done this by firstly, being a strong worldwide brand and secondly, by purchasing the residential customers of another broadband provider. A new entrant can not product differentiate and thus price is the only way to differ. There is also the intransigence of Irish customers who are very brand loyal even when there is a big price difference.

Magnet Networks have attached 2 confidential spreadsheets, one outlines a WPNIA provider obtaining a 10% market share for Linshare within the exchanges they have a presence. The other spreadsheet outlines a WBA provider obtaining a 10% marketshare and the input costs relating to that. It shows that the prices proposed foreclose the lineshare market. It highlights that the economic space is in WBA's favour rather than in LLU's favour.

Q. 7. Are there any issues in relation to the appropriate price control for the WBA market that ComReg has not considered in this consultation? If so, please document and explain those issues fully and provide examples where appropriate.

Magnet Networks feel that the use of EEO is incorrect and the correct methodology should be REO as per Recital 26.[2]

Q. 8. Do you agree with the preliminary views expressed by ComReg? Please state the reasons for your response and please explain which preliminary view(s) you do not agree with and detail what specific amendments you believe are required.

Magnet Networks understands ComReg's perspective however, overall Magnet Networks does not agree with ComReg's preliminary views. Magnet Networks believes that a positive economic space between WBA and WPNIA is advisable and imperative; however, the inputs and how ComReg seem to be costing these inputs to feed into the proposed maximum and minimum prices are unrealistic. Magnet Networks have provided confidential input information to ComReg with this consultation as outlined in question 6.

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[1] http://www.btireland.ie/mediacentre/pr_2009_07_22_vodafone.shtml

[2] http://ec.europa.eu/information_society/policy/ecomm/doc/library/public_consult/nga_2/090611_nga_recommendation_spc.pdf

Q. 9. Do you believe that the draft text of the proposed decision is from a legal, technical and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

Though Magnet Networks does not agree with the majority of the proposals and text within the decision however, the decision itself is clear and precise with regards to what it proposes.

Q. 10. Do you have any views on this Regulatory Impact Assessment and is there other factors (if any) ComReg should consider in completing its Regulatory Impact Assessment? Please explain your response and provide details of any factors that should be considered by ComReg.

Magnet Networks believes there is an error in the Regulatory Impact Assessment. At A.13(ii) it was recognised that utilising a SEO/REO test in relation to margin squeeze was more appropriate then EEO. However, in the summary of impacts on stakeholders and on competition the third option utilises the EEO test to assess margin squeeze. Magnet Networks believes that this is an error and the correct test is REO. Though broadband has been with us a while the market itself has not diversified enough that OAO's can compete effectively with the incumbents downstream retail arm. The current take up of LLU[3] over the total DSL[4] lines is 2.3%. The remaining 707,768 is wholly eircom retail or eircom wholesale lines. Thus Magnet Networks believe utilising the EEO test for margin squeeze is incorrect and REO should have been used as per the European NGA Recommendations.[5]

[3] http://www.siliconrepublic.com/comms/item/13588-llu-rethink-needed-as-uk/

[4] ComReg quarterly Quarter 1 2010

[5] http://ec.europa.eu/information_society/policy/ecomm/doc/library/public_consult/nga_2/090611_nga_recommendation_spc.pdf

5: Sky

Response to ComReg 10/56
Wholesale Broadband Access consultation on appropriate price control

Sky has offered TV services in Ireland for over 20 years and is interested in assessing the potential to offer telephony and broadband services to its customers, as it does throughout the UK. A key consideration for Sky is the robustness and certainty of the regulatory regime under which the incumbent, Eircom, has obligations due to its holding of significant market power in various markets. Sky welcomes ComReg's consideration of the approach to pricing of Wholesale Broadband Access (WBA).

1. We agree with the approach that ComReg is proposing in moving the price control of WBA away from a retail minus basis to being cost oriented. This properly reflects the maturing of the market, both in overall market growth and Eircom's offerings.

2. WBA has been offered by Eircom for over 7 years and in other jurisdictions for over 10 years. During this time the elemental costs associated with the provision of the service, the take up, and hence the per-unit costs, have become well known and verifiable. Additionally, a key upstream input to the cost of WBA, the local loop, has been price regulated providing the basis for an important cost floor. Ensuring a proper and robust price relationship between WBA and its upstream LLU input will be now be achievable and transparent.

3. Sky agrees with ComReg that the reconfiguration of the wholesale product offering into its simplest components, and pricing them on a cost oriented basis, will provide a stronger basis for the development of innovative competitive market offerings (recognising that cost oriented LLU provides an even better input component to support innovation and differentiation)[1].

4. Transparency in the calculation of any wholesale price proposed by Eircom will be key to ensuring the incumbent is neither exercising a price squeeze nor price gouge. The publishing of regulated accounts – not just to the regulator but to the industry – in sufficient detail will be critical in ensuring Eircom meets its regulatory obligations on cost orientation. Eircom's record on the

[1] ComReg, Consultation 10/56: Consultation and Draft Decision – Wholesale Broadband Access, 15 July 2010, paragraph 2.23

production of timely, accurate and meaningful regulated accounts has not been good[2]. ComReg should impose suitable incentives on Eircom to ensure that Eircom fulfils the requirement of full accounting transparency.

5. ComReg has proposed a range of prices for both the minimum and maximum price points of the new price structure[3]. Sky has not reviewed these price proposals against either EU best practice benchmarks nor against current Eircom LLU pricing. We would urge ComReg to take the opportunity through this consultation to pursue best practice pricing in order to help ensure the provision of broadband services in Ireland becomes more competitive.

6. We note that ComReg is of the view that by setting a minimum and maximum WBA price, rather than a cost oriented specific point price; this will provide Eircom with some flexibility to *"offer differentiated wholesale products at differentiated prices"*[4]. ComReg will be mindful that such flexibility afforded Eircom, in offering and pricing of WBA access products could raise concerns. For example, care should be taken in permitting Eircom to offer volume or other product bundling based discounts of a regulated product, as that may enable Eircom uniquely to favour its own downstream retail operations, the detriment to its competitors.

7. The flexibility of setting a price within a determined maximum and minimum should not extend to the SMP operator being permitted to offer different prices to different downstream customers, including itself, without objective justification.

8. ComReg have proposed that the initial period for setting of the regulated prices be one year. Sky considers this is an appropriate period for the initial period in moving from retail minus to cost orientation. Depending on the market experience and Eircom's compliance, a longer period that offers greater certainty can be considered following the first year.

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[2] ComReg, 'Consultation - Accounting Separation and Cost Accounting Review - Draft accounting direction to Eircom Limited' 5th October 2009
[3] ComReg consultation 10/56 paragraph 6.2
[4] ComReg consultation 10/56 paragraph 3.7

6: Vodafone

Vodafone Response to the ComReg Consultation and Draft Decision on the Appropriate Price Control for Wholesale Broadband Access

Ref. ComReg Document 10/56 Response Date: 24 Sept 2010

Introduction

Vodafone welcomes the opportunity to respond to this ComReg consultation and draft decision on the appropriate price control for Wholesale Broadband Access. Our views are set out fully in response to the consultation questions below.

Response to Consultation Questions

Q1. Do you agree with the detail of the proposed price control including the different specification of the ex-ante obligation not to margin (price) squeeze? Please state the reasons for your response.

<u>Introduction</u>

In the context of the current stage of development of the WBA market it is both appropriate and feasible to replace the current retail minus price control for Bitstream rental products with a price control derived from a forward looking cost model.

Retail minus price controls result in the situation where an SMP operator in an upstream market is able to set the price of regulated products in this market by varying its retail pricing in a downstream market which is not subject to regulatory controls. In this situation the retail arm of the operator will have advance notice and control of pricing and product changes as these are driven by changes to the retail product which it initiates. The retail minus approach therefore has the effect of undermining the effectiveness of a remedy imposed in the wholesale market by linking it to a price which the SMP operator has freedom to set in a manner optimised to its own business needs in a competitive downstream market.

A move to a price control in the wholesale market which is derived from a forward looking cost model removes the ability of the downstream retail arm of the SMP operator to effectively control the cost inputs and cost structure of its competitors.

It is essential that the prices for Bitstream products provided by the SMP operator are consistent with the efficient cost oriented level so that the potential for retail prices of DSL broadband being set at an excessively high level to the detriment of end users is avoided. In addition, the price of Bitstream rental products must be set such that the overall price structure for wholesale inputs (both WBA products and WPNIA inputs) provided by Eircom is efficient. In particular there should not be scope for the price of Bitstream rental products to be set at levels that would deter efficient infrastructure investment by OAOs on the basis of use of WPNIA inputs, or as described by ComReg in paragraph 2.35 of the consultation:

> *"… the differential in pricing between the regulated service and an upstream wholesale service (e.g. between WBA products and WPNIA products) should provide sufficient and appropriate 'economic space' so that infrastructure-based competition is not discouraged."*

Vodafone does not however agree that the particular form of price control proposed by ComReg in the present consultation is the most effective means of achieving ComReg's statutory objectives in respect of the wholesale broadband access market. Indeed, for the reasons set out in this submission, Vodafone considers that the proposed revised WBA price control would allow Eircom wide flexibility to set the price of Bitstream rental products that is entirely unjustified and provides considerable scope for WBA pricing strategies by the SMP operator that would be to the detriment of consumer welfare, sustainable competition, and efficient infrastructure based investment by OAOs in the provision of retail DSL broadband services.

<u>Proposed Cost Orientation Obligation For Bitstream Rental Prices Within A Range</u>

Vodafone welcomes ComReg's recognition of the need to amend the current WBA price control to reflect changing market conditions and provide visibility to OAOs in particular in relation to the future regulation of WBA products subsequent to the recent regulatory decisions on the pricing of LLU inputs. We also agree that the current one-to-one relationship between specific Eircom retail broadband products and WBA product equivalents required by the existing retail-minus price control is not appropriate in an environment where past uncertainty on underlying wholesale costs has been considerably diminished, and the increasing complexity of retail product offerings in terms of bundles is posing serious challenges for monitoring of compliance by Eircom with its existing regulatory obligations. The proposed move to a cost oriented price control on 'per port' and 'monthly per bandwidth mbps' charges for Bitstream rentals should increase flexibility for both Eircom and OAOs to offer differentiated retail broadband services (either on a stand alone or bundled basis) while also providing greater certainty to operators on the pricing environment for regulated WBA inputs.

While Vodafone agrees that a cost oriented price control for Bitstream rentals on the basis of a forward looking cost model is the most appropriate approach, we strongly disagree with ComReg's proposal that rental charges would be cost oriented by a set range of maximum and minimum prices within which Eircom would have flexibility to set prices. Vodafone believes that the alternative of setting a strict cost orientation price obligation at a specific price point for both 'per port', 'monthly per bandwidth mbps' charges, and the prices of legacy Bitstream rental products is the optimal regulatory price remedy in the WBA market and has been rejected by ComReg without adequate justification.

In paragraph 3.6 of the consultation, ComReg acknowledges that a requirement on the SMP operator to demonstrate to ComReg that prices are cost oriented according to a specific price point could ensure that prices are neither excessive nor set at too low a level. There is therefore no incremental benefit of adopting a broader cost orientation obligation allowing Bitstream rental pricing within a set range over the stricter obligation of cost orientation on the basis of a specific price point in terms of the achievement of the two central objectives of avoiding excessive retail pricing to the detriment of end users while also ensuring a sufficient economic space between the pricing of WBA and WPNIA products. Either approach would achieve the main stated objectives of the price control remedy. However two reasons are offered by ComReg in support of its proposal to apply a cost orientation obligation allowing pricing within a set range rather than the alternative of cost orientation on the basis of a specific price point. These do not in Vodafone's view have any validity as a justification for the proposed approach.

The first reason offered by ComReg for its rejection of a price control remedy at a specific price point is that the implementation of this approach would limit the incentives of Eircom to achieve efficiency savings if it were applied on an annual basis. However the incentives for the SMP operator to achieve efficiency savings are likely to be very limited irrespective of the price control methodology used (whether at a specific price point or by allowing price flexibility within a set range) where only an annual price review period is employed. This is the case as any efficiency savings achieved beyond those envisaged in the price model would accrue to Eircom for a period of no more than 12 months, and their effect would likely be fully taken into account in the cost model used to determine either the specific price point, or maximum price, for the following year. It is the duration of the period for which cost oriented prices are set, not the format of the cost orientation obligation (specific price point or price range), that is the key factor with respect to maximising the incentives for dynamic efficiency on the part of the SMP operator.

Vodafone notes that ComReg is proposing, following an initial one year price review period, to set the price control for a multi-year period (at least 2 years). The move to multi-year regulatory price controls of Bitstream rentals, following an initial one year review period is appropriate and necessary both to enhance regulatory certainty and to promote dynamic efficiency. However the implementation of cost oriented price regulation of Bitstream rental charges at a specific point would be of equivalent effectiveness to cost oriented pricing within a set range in fulfilling these criteria.

The second reason offered by ComReg for its proposed decision is that cost orientation at a specific price point would limit the flexibility of the SMP operator to offer differentiated wholesale products at differentiated prices, whereas this would be facilitated by allowing the SMP operator to price within a cost oriented price range. Vodafone notes however that the proposed separate ‘per port’ and ‘monthly per bandwidth mbps’ elements of Bitstream rentals to be regulated is a structure that already appears to offer very wide scope for flexible provision of differentiated broadband products and ComReg has not provided any evidence of types of differentiated WBA products that would be precluded from introduction by the SMP operator if cost oriented regulation at specific price points were to be implemented, or exactly how this latter approach would act to limit flexibility and product differentiation even in principle.

If a situation arose where Eircom were proposing to introduce a type of differentiated WBA product that it claimed could not be priced to recover its efficiently incurred costs and cost of capital in the context of a cost orientation obligation on the basis of specific price points (although Vodafone cannot envisage a type of WBA product structure that would present this difficulty) then it should have the opportunity to provide objective evidence for this to ComReg at that stage. In the event that this claim were justified then there may be grounds for introducing a cost oriented price range for that particular WBA product variant only. However as this scenario is currently hypothetical and speculative it would be neither appropriate nor proportionate for ComReg to adopt a cost oriented price range for all Bitstream rental products on the basis of the claimed need to foster flexibility for such an eventuality when this does not appear to be an imminent or high probability potential event.

In addition the ComReg proposed approach engenders significant pricing uncertainty in the market. In a pricing model based on a fixed per port charge and a variable usage charge the unit cost per customer can vary over time. In fact Eircom has projected an increase in customer usage over time. In this scenario when setting a retail price today an OAO must project forward the anticipated average usage over the expected lifetime of the product and set its retail price so that this recovers its costs. To increase further the wholesale cost input uncertainty by giving Eircom the freedom to vary its wholesale pricing within a range would render the process of retail proposition development practically impossible.

The foregoing indicates that there is little validity to the points raised by ComReg in support of adoption of a cost oriented price control obligation on the basis of discretion to price within a range, rather than the alternative of regulation at a specific price point. In addition both approaches appear to be effective in terms of achieving the central objectives of avoiding excessive pricing and ensuring a sufficient economic space between WBA and WPNIA products. However Vodafone considers that there are important disadvantages associated with cost oriented price regulation that permits the SMP operator to price freely within a maximum and minimum price range that do not arise under the alternative approach of implementing specific cost oriented prices.

Firstly Vodafone notes that allowing Eircom discretion to price within a range whose upper and lower bounds are defined by the outcome of two separate cost modelling exercises means that significant uncertainty for OAOs in relation to the future pricing of WBA products by Eircom would exist. By contrast, under the approach of price regulation at a specific price point, full predictability of the price of Bitstream rental products is ensured for the duration of the review period. ComReg's proposed approach is therefore significantly inferior to the alternative with respect to the objective of maximising regulatory certainty in relation to WBA product pricing for OAOs.

Secondly, as ComReg has recognised, facilitating the SMP operator to price within a range creates scope for strategic or anti-competitive behaviour that is not available when cost oriented prices are set at specified levels. Although it is ComReg's intention that the lower bound (minimum price) of the proposed cost oriented price range would be set high enough to maintain the viability of efficient OAOs competing on the basis of WPNIA inputs, this is not certain and it is clear that the SMP operator would use the discretion to price Bitstream rentals within the proposed range to optimise its own commercial position, at the expense of its competitors and therefore competition, to the extent possible within the allowed range..

Thirdly there are direct negative implications for consumer welfare. It is a precondition for the imposition of a price control by ComReg that eircom has SMP on the market. i.e. it is unconstrained by the market in its pricing policies. If the minimum price level is based on a bottom up pricing model and has a sufficient margin to encourage OAOs to invest in LLU based solutions, then any wholesale pricing by eircom above this level results in super normal profits for eircom.

If the wholesale pricing was set at the minimum regulated level then competition in the retail market would reduce the overall retail price to the wholesale price plus the minimum sustainable retail mark-up over this wholesale price. From a consumer welfare point of view once wholesale pricing is above the minimum level the difference between the wholesale price and the minimum regulated level amounts to a levy by eircom into the retail market. Competition in the retail market cannot provide any downward pressure on the wholesale price. Therefore consumers would pay more than necessary for retail products and eircom would obtain excess returns not only from its own retail sales but also derived from the retail activities of OAOs using Eircom supplied wholesale inputs.

A properly set minimum price at a specific price point should therefore be the only price permitted to be charged by the SMP operator. Pricing above this level reduces the overall consumer welfare as end-users pay higher prices than necessary.

Vodafone considers that when these shortcomings of the approach to cost orientation within a price range are taken into account, it is clear that the alternative strict approach to cost orientation on the basis of a specified price point is the optimal price control methodology to employ.

Appropriate Level of Cost Oriented Price of Bitstream Rentals

The two distinct general costing approaches to determining the maximum and minimum prices for Bitstream rentals in the proposed cost oriented range as outlined by ComReg are two separate cost modelling exercises that can validly be used to seek to determine the appropriate cost oriented price for WBA products where these would be set at a specified price point. For the reasons set out previously Vodafone believes that the setting of cost oriented prices at a specific price point for Bitstream rental products is the optimal approach to implementing the price control remedy in the WBA market, and the question therefore arises as to which of the two approaches would be the most appropriate to adopt in the context of setting specific cost oriented price points.

The different outcomes, in terms of estimated cost oriented prices, arising from the two different cost modelling exercises (one determined by reference to the SMP operator's efficiently incurred costs, and the other determined using the modelled efficient costs of an efficient entrant competing in the market on the basis of use of the LLU Line Share product) indicate the significant degree of uncertainty that exists in relation to the precise cost oriented price level. While it is appropriate that both cost modelling exercises are undertaken, only one estimate can be used as the basis for a specific cost oriented price point.

Vodafone considers that, after execution of the two cost modelling approaches, the outcome of the model that produces the lowest estimate of the cost oriented price should be adopted by ComReg. On the assumption that the cost modelling carried out by ComReg to date is correctly specified, the appropriate cost oriented price point for Bitstream rental products would be the indicative minimum price currently forming the lower bound of the cost oriented range proposed in the consultation document. This approach to using the lower of the two estimated cost oriented prices from the two separate cost modelling exercises is in Vodafone's view the most appropriate approach to the determination of a specific cost oriented price point for Bitstream rental prices as it is likely that the higher estimate from the two approaches would include costs for the WBA product that would be in excess of the true underlying efficient level. Adoption of the higher estimate of the cost oriented price from the two cost modelling approached would therefore risk facilitating Eircom in exploiting its position of SMP in the WBA market to earn profits significantly greater than its calculated cost of capital, and for this reason should not be implemented.

<u>Relevant Benchmark For Determination Of Costs Of An Efficient OAO Using WPNIA Inputs</u>

Vodafone believes that the bottom-up cost modelling approach employed by ComReg to estimate the proposed minimum price (set by reference to a hypothetical efficient OAO competing with Eircom on the basis of use of regulated WPNIA inputs) uses the incorrect benchmark. The appropriate costs of an efficient OAO competing on the basis of WPNIA inputs should not be those of an operator using the LLU Line Share product, but those of an efficient operator using the full local loop unbundling (ULMP) product. Vodafone considers that the use of the costs of an efficient operator deploying ULMP in determining an estimate of the cost oriented price that preserves the necessary economic space for OAOs using WPNIA inputs is the optimal approach as it would take fully into account the economics of the most infrastructure intensive form of investment available on the SMP operator's fixed network and therefore properly align OAO incentives with respect to efficient investment in full unbundling of the local loop. This approach would therefore more effectively advance ComReg's objectives of promoting efficient investment and sustainable competition in the market.

By way of detailed explanation it is the case that in order for an OAO to produce a WBA input based on LLU it must, in addition to paying the variable per line cost for access to the "high frequency" or broadband portion of the access path, pay the upfront and ongoing costs associated with unbundling the exchange. It is the case that these costs associated with unbundling the exchange are the same whether the OAO decides only to avail of Line Share or alternatively to use ULMP.

For bundled narrowband and broadband services it is a commercial decision for the OAO whether it uses ULMP and provides the retail narrowband services itself or decides to use Line Share and purchase the narrowband services from eircom by way of SB-WLR.

In terms of assessing the economic space for provision of WBA using an LLU input the lower of these two cost stacks should be the reference cost for an OAO. To use the higher of the two encourages inefficient investment and embeds unnecessary cost in the overall cost inputs underpinning the retail price of services. As the SB-WLR price is based on a retail minus model it is likely to be higher than the equivalent ULMP based inputs and should not be used. In addition the use of SB-WLR by an OAO encourages infrastructure duplication as the Line Share unbundling activities are in large measure duplications of eircom's activities required to provide narrowband access without the benefit of using them for this purpose. Therefore the appropriate test to apply in assessing economic space is to compare Eircom's combined narrowband and broadband provision against an OAO's provision of the same services using ULMP.

In the case where the OAO only wishes to provide Broadband services it must be recognised that the current Line Share pricing model assumes that all costs associated with the narrowband access are fully recovered from other sources, in particular narrowband line rental. For an assessment of economic space limited only to the WBA market to be valid it would need either to omit OAO costs whose equivalents are recovered by eircom in other markets (effectively the exchange unbundling costs) OR to include in the eircom cost stack an apportionment of the equivalent costs of exchange unbundling.

As the second approach is likely to lead to an outcome which requires the WBA price to be higher than the price control derived from a forward looking cost model and which would increase retail pricing decreasing consumer welfare this is not an appropriate approach.

In any event whichever of these tests yields the lowest WBA price limit it is the appropriate one to use as the economic space would otherwise be wider than that necessary to facilitate efficient investment.

[Redacted]

If ComReg's policy objective is to achieve the deepest levels of efficient infrastructure based competition then in the context of the Irish market a regulated WBA price at the lower end of the cost oriented range provides the correct incentives.

<u>Proposed Obligation Not To Create Margin Squeeze</u>

Vodafone considers that it is both appropriate and necessary that an ex-ante obligation on the SMP operator Eircom not to cause a margin squeeze between the price of WBA products and the associated retail offerings is included in the price control remedy in the WBA market. In the absence of this obligation there would clearly be the scope for Eircom to set the price of its retail DSL broadband products at a level relative to the price of the associated WBA products such that it would not be viable for efficient OAOs to compete in the market on the basis of use of these wholesale inputs. The inclusion of an obligation not to margin squeeze as part of the WBA price control remedy to avert the risk of foreclosure of OAOs is vital particularly in the context where the direct link between the retail price and the price of Bitstream rental products is proposed to be removed with the change from a retail minus to a cost oriented price control. Vodafone therefore agrees in principle with the proposed margin squeeze test as set out in paragraph 4.16 of the consultation document.

Although an ex-ante obligation on Eircom not to margin squeeze must be included as a central element of a revised WBA price control, Vodafone disagrees with ComReg's preliminary proposal to change the specification of the existing margin squeeze test from a 'Similarly Efficient Operator' (SEO) basis to an 'Equally Efficient Operator' (EEO) basis. Vodafone does not believe that the fact that OAOs have had access to regulated wholesale inputs for a considerable period is sufficient justification for the proposed change as this fact has no direct relevance to the central issue of whether Eircom continues to have considerable advantages in terms of economies of scale and scope relative to alternative operators competing in the provision of DSL broadband services on the basis of use of Bitstream rental products. The continued possession of scale economy advantages by Eircom is a key factor underpinning both its SMP designation and the specification of the margin squeeze test currently in place on a SEO basis.

As Eircom continues to have significant advantages in terms of being able to exploit economies of scale and scope not available to OAOs arising from its much larger relative share of DSL broadband subscribers, among other factors, it would be contrary to the promotion of efficient competition in the retail market for ComReg to use a EEO specification of the margin squeeze test that wrongly assumed that such scale differences are either absent or not material. Vodafone also does not believe that ComReg's preliminary view that an EEO test encourages efficient investment in infrastructure is valid. Efficient investment in infrastructure is appropriately fostered through an efficient regulated wholesale price structure, not through the adoption of a margin squeeze test that, by disregarding the significant economy of scale related differences in the costs of Eircom relative to OAOs, would provide considerable scope for the SMP operator to set retail prices that would artificially undermine the feasibility of competition by efficient (when adjusted for economies of scale and scope differences) OAOs on the basis of use of Bitstream rental products, while allowing the fixed incumbent to remain compliant with an effectively much lighter price control obligation than in force at present.

Creating the scope for such an artificial and market distorting penalty to be imposed on efficient Bitstream based competitors to Eircom in the provision of retail DSL broadband services may compel additional infrastructure investment in some cases on the basis of wholesale inputs that are further upstream but would also pose the significant risk of market exit or reduced scope of competition (geographical or product based) on the part of at least some of these competitors. Moreover any additional investment that would occur as a result of the proposed change to the margin squeeze test would not be based solely on an efficient wholesale price structure, and therefore may amount to inefficient overinvestment in infrastructure. The risk of adverse outcomes from the proposed change would be particularly significant in the case of exchange areas with relatively small numbers of subscriber lines where investment by OAOs in the provision of retail broadband services on the basis of wholesale inputs further upstream from Bitstream rental (LLU Line Share or ULMP) will not be feasible for the foreseeable future. In the case of these exchanges the move to an EEO margin squeeze test would only have the potential to lead to a retail pricing approach by Eircom that would seriously undermine the economics of Bitstream based competition by efficient alternative operators that have not yet achieved scale comparable to the fixed incumbent.

In relation to ComReg's preliminary view on the separate question of whether it is appropriate to apply the margin squeeze test to individual products or to the aggregation of Bitstream products, Vodafone agrees that it is necessary that the test be applied to individual products and not merely to the suite of Bitstream products as a whole. It is evident that if the margin squeeze test was applied only to Bitstream products in the aggregate then there would be wide scope for Eircom, as outlined by ComReg in paragraph 4.15.2 of the consultation document, to discount the prices of individual Bitstream products in segments where competitive intensity is highest to the detriment of OAOs with more limited product ranges as the feasibility of these competitor's operations would be undermined by artificially low margins in the broadband product segments where they compete. It is also correct that an aggregate approach to the margin squeeze test would reduce the transparency of the retail pricing by Eircom of its retail DSL broadband offerings with respect to the ability to detect exclusionary behaviour in respect of individual broadband products. Consequently it is Vodafone's view that the obligation not to margin squeeze must be applied on an individual product basis in order to effectively address the risk of anti-competitive pricing behaviour by the SMP operator.

Vodafone notes the proposal in paragraph 4.14 of the consultation that ComReg will consider the overall potential foreclosure effects of the margin squeeze in the marketplace so that compliance action may not be taken where ComReg considers that anti-competitive effects are not material. Vodafone does not agree that this proposal is appropriate and considers that compliance action must be taken by ComReg in any case where it is identified that the relative pricing of wholesale and retail broadband products by Eircom constitutes a margin squeeze.

With regard to the proportionality of this approach, Vodafone considers that compliance action in the context of a margin squeeze could be reasonably regarded as disproportionate only if it were found, on the basis of objective quantitative evidence, that the costs of ensuring compliance with the obligation not to margin squeeze considerably exceeded the benefits of addressing it. However Vodafone does not believe that compliance action by ComReg to prevent margin squeeze is ever likely to be disproportionate as the costs of securing compliance are not large, particularly if the margin squeeze is identified and addressed in advance of the introduction of the retail product that creates it, and because these costs are unlikely to be material relative to the anti-competitive harm caused by the creation of a margin squeeze that would accrue over time. The costs of compliance for Eircom with its obligation not to create a margin squeeze, where instances of non-compliance are identified, would relate primarily to the minor costs of adjustments to the pricing of retail broadband products (whether stand-alone, as part of a bundle, or promotional) relative to the associated wholesale broadband inputs and would therefore justifiably be required to be incurred by Eircom even in circumstances where it could be claimed that the anti-competitive effects of a margin squeeze would be very limited.

Notwithstanding the fact that ensuring compliance with the obligation not to margin squeeze would be very unlikely to be disproportionate in practice, Vodafone also strongly objects to the proposal for ComReg to forbear from taking action in certain cases on proportionality grounds as ComReg has failed to define a clear and objective threshold below which the anti-competitive effects of a price squeeze would not be material and has omitted to set out a robust framework that would objectively quantify the anti-competitive effects of potential instances where a margin squeeze were created. ComReg's failure to clearly specify the circumstances when compliance action in the context of an identified margin squeeze would not be taken means that the implementation of this proposal would create enormous regulatory uncertainty, particularly for OAOs, to the detriment of efficient investment and sustainable competition in the market. Vodafone would also have serious concerns that the absence of a clearly defined and transparent materiality threshold for compliance action could lead to an arbitrary or inconsistent approach to ensuring compliance with the obligation not to create margin squeeze.

Action by ComReg to ensure compliance by Eircom with its obligation not to create margin squeeze in cases where non-compliance would be identified would be both appropriate and proportionate under essentially all conceivable circumstances. Therefore ComReg's proposal in paragraph 4.14 of the consultation is both unjustified and unnecessary, even were such an approach warranted its implementation in the absence of a clearly specified materiality threshold and rigorous published framework for assessing the extent of anti-competitive effects of a price squeeze would generate enormous uncertainty that would be completely counterproductive to the achievement of the objectives of the overall proposed price control regulation. Accordingly Vodafone urges ComReg to withdraw the preliminary proposal to selectively forbear from compliance action and, in the interests of maximising regulatory certainty, to explicitly commit to take compliance action in any case where non-compliance by Eircom with the latter's regulatory obligation not to create a margin squeeze is identified.

Vodafone also strongly disagrees with ComReg's proposal in paragraph 4.19 of the consultation document that Eircom not be required to notify ComReg of its proposed retail broadband offers in advance, for assessment of the SMP operator meeting its obligations. If an ex-ante obligation not to create a margin squeeze is to be fully effective then it is essential that proposed retail offers are notified to ComReg sufficiently in advance of their proposed introduction to the market that any margin squeeze can be detected on the basis of the margin squeeze test and the relevant retail offer can be amended or prohibited before it can have any anti-competitive effect. Vodafone has serious concerns that ComReg's proposal not to impose an obligation on Eircom to notify its retail broadband offers in advance would effectively mean that retail offers constituting a margin squeeze would only become evident once they were in the market and that there would be a significant delay between launch of the product, the identification of a failure of the SMP operator to comply with its obligation not to create a margin squeeze, and the initiation of effective compliance action by ComReg. In the interim period non-compliant retail offers could be availed of by end users and this could have a serious adverse effect on competition in the market.

Vodafone notes ComReg's statement that the removal of the proposed requirement on Eircom to notify its proposed retail broadband offers in advance respects Eircom's commercial freedom in an unregulated market. However the retail market is unregulated only because the WBA market is strictly regulated and prevents Eircom from leveraging its position of SMP into the downstream market. As a central feature of the effective regulation of the WBA market is the obligation on Eircom not to create a margin squeeze, and as the determination of whether a margin squeeze being caused must necessarily be determined by reference to the price of retail broadband offers, it is essential that an obligation on Eircom to inform ComReg of its proposed retail broadband offers significantly in advance of commercial launch should be maintained.

Vodafone notes that over the past number of years Eircom has carried out automatic speed upgrades to the various Bitstream products. This has the effect of providing a higher bandwidth product to end-users even if they don't have the usage to justify its purchase in the normal course. In practice this means that the overall average usage profile of Eircom customers on, for example, an 8Mbit/s package has been artificially diluted as a significant proportion of the users on these packages have usage requirements well below the package capability.

This issue is relevant in performing a margin squeeze test on a product which has variable pricing based on usage. If the average usage of eircom's embedded base is used then this will be artificially low because of the effects of these automatic upgrades. Therefore in performing a margin squeeze test of a WBA product with a variable usage charge the correct approach to use is to reference the eircom cost stack against the average usage of new additions from organic growth to that particular product rather than the average usage of all users of that product.

Proposed Cost Orientation Obligation For WBA Ancillary Products

Vodafone agrees that the prices for the ancillary services/products in the WBA market should be regulated and their maximum prices set at the cost oriented level. It is important that OAOs have the necessary high degree of regulatory certainty in relation to the prices of these ancillary products for business planning purposes. It is also essential that charges for ancillary services and products are not set at levels that act as an artificial disincentive to the migration of existing OAO customer bases from service provision on the basis of WBA products to service provision on the basis of WPNIA inputs.

However Vodafone does not have visibility of the detail of the cost inputs and modelling analysis undertaken by ComReg to establish that the proposed maximum prices of the ancillary products as set out in the table below paragraph 6.3 of the consultation document actually equate to the true underlying cost oriented level. This limits our ability to determine the appropriateness of the proposed maximum levels of the charges for many of the products.

Vodafone notes that the proposed maximum charges for service establishment per access seeker and the Bitstream (Ethernet) Connection Service do not differ from the current level and it is not clear whether the proposed decision in relation to these charges is the result of a modelling exercise or whether it was concluded that the existing charges should be maintained as the maximum prices due to the absence of readily available information to verify the actual cost oriented price of these ancillary services. If the latter then Vodafone considers that every effort should be made by ComReg in terms of collection of relevant data and cost modelling, to confirm the appropriate cost oriented maximum price for these services (which may or may not approximate the current prices) before reaching a final decision.

Promotions and Bundles

Vodafone concurs with ComReg's preliminary view that price control obligations should apply in full both to promotional WBA offers of limited duration, and to WBA products irrespective of whether they are within a bundle or offered on a stand alone basis. The offering of promotional Bitstream products priced such that they constituted a margin squeeze would have a major adverse effect on sustainable competition that would not be significantly mitigated by the ostensible limited duration of the promotions.

If the pricing for WBA is derived from a forward looking cost model then it raises questions as to how it would be possible for eircom to offer wholesale promotions and bundles. Such promotions and bundles would represent discounts on the standard pricing. In order to avoid below cost selling these discounted prices would also have to be based on a forward looking cost model that fully recovered costs. If the discounted price is based on such a model then the element of costs that can be removed from the standard pricing to achieve the discounted pricing, and the reason why these costs were not removed from the standard pricing in the first instance would have to be objectively established.

Conclusion

Vodafone agrees with many aspects of ComReg's proposed amended price control obligation on Eircom in the wholesale broadband access market. However fundamental changes to ComReg's current proposals, particularly in respect of the detail of the cost oriented regulation of Bitstream rental prices, are imperative if the price control obligation is to achieve ComReg's regulatory objectives. For the reasons already set out, Vodafone believes that ComReg should revise its current proposals to ensure that regulation of the SMP operator's Bitstream rental prices at the cost oriented level is implemented at a specific price point. In addition Vodafone believes that the lower of the two prices estimated from ComReg's modelling of 'maximum' and 'minimum prices' should be used for this purpose. ComReg's bottom up cost model of the costs of an efficient OAO competing on the basis of WPNIA inputs should be optimised by taking account of use of the full unbundling (ULMP) product in place of the LLU Line Share product currently used.

Vodafone is in agreement with ComReg's proposed general approach to the price regulation of WBA ancillary products, however it is important that greater transparency is provided by ComReg in relation to the objective basis for the proposed maximum prices if consultation respondents are to be able to provide fully informed comment.

While Vodafone also agrees that the proposed obligation on Eircom not to create a margin squeeze is fully justified, the continued importance of differential scale effects between Eircom and OAOs means that the margin squeeze test must continue to be specified on a 'similarly efficient operator' basis to avoid distortions to competition and investment in the provision of DSL broadband services.

Q2. Do you agree with the preliminary views in relation to the duration and future review of the price control? Please state the reasons for your response.

Vodafone agrees that it would not be appropriate to immediately introduce a cost oriented price on a multi-year basis given the likely significant uncertainty in the initial stages around how the new price control methodology may impact pricing and investment incentives. In addition the likely completion of a leased lines cost modelling exercise in the short term, which may have implications for the how the SMP operator's costs are recovered, may require an early review of the maximum price which reduces the utility of setting a multi-year price control at the present time.

While Vodafone considers that it is appropriate that the regulated price be set for a period of one year initially (when the outputs of the leased line cost modelling exercise should have been finalised and implemented, as appropriate, in the pricing of the regulated products provided by the SMP operator) and then reviewed, it is particularly important that regulated WBA prices then be set on the basis of a control for a period of not less than 3 years so that the necessary degree of regulatory certainty can be provided to operators to enable effective business planning. In addition to the greater regulatory certainty provided relative to a price control regime of shorter duration, a minimum 3 year WBA price control review period would also have superior dynamic incentive properties.

In the interests of dynamic efficiency, and to maximise regulatory certainty, Vodafone agrees with ComReg's preliminary view that there should be no mechanism for setting prices to compensate for over or under-recovery in the maximum price on a retrospective basis.

Vodafone agrees that ComReg must have the flexibility to intervene in the setting prices of WBA products provided by the SMP operator within a multi-year control period in exceptional circumstances or where the regulated price of LLU line share were to be modified. However Vodafone believes that the 'exceptional circumstances' that would warrant intervention must be clearly specified from the outset. The criteria set out previously by Vodafone in our submission to ComReg consultation document 09/39 on LLU and SLU monthly rental charges remain valid in clarifying the nature of the exceptional circumstances in which intervention to amend the proposed WBA price control would be warranted. These criteria are:

1. The factors that have changed make a material difference to Eircom's cash outflow
2. The changes to relevant cost factors are outside the control of Eircom

Q3. Do you agree with the proposed notification and approval procedures? Please state the reasons for your response.

Vodafone agrees with the proposal that Eircom should not introduce any new products or price changes without ComReg's prior approval. The proposed obligations of advance notification to the market of intended prices or price changes for new or existing WBA products of 2 months via publication on the eircom website, and of 3 month advance notification to ComReg, are both reasonable and necessary to ensure that Eircom complies with its other regulatory obligations in respect of WBA product pricing, and to allow OAOs sufficient time to assess and respond to proposed changes. However Vodafone considers that the proposed advance notification period to the market is sufficient solely on the basis that Eircom's own retail arm is only notified of the new products or price changes at the same time as OAOs so that no anti-competitive advantage is provided to Eircom retail, for example in terms of development and timing of launch of retail propositions using new wholesale products. If simultaneous notification to Eircom retail and OAOs cannot be ensured then the notification period must be further extended as appropriate to ensure that a level playing field for all operators is secured.

Vodafone also considers that these notification requirements should apply equally to promotional WBA product price changes that would be in effect for a limited period, as well as to WBA offers as part of bundles, as they do to permanent price changes or product introductions offered on a stand alone basis. It is clear that that promotional and bundled WBA products, and associated price changes, may have significant competitive impacts and cannot therefore be excluded from the proposed advance notification and approval obligations.

It is clear that where new WBA products (whether permanent or promotional in nature), or changes to the pricing of existing products, were to be introduced by Eircom in the absence of notification and approval procedures then they would have an immediate market impact. There would be wide scope for such changes to affect the nature of competition in the retail market and the incentives for OAOs to compete in the retail market on the basis of WBA products relative to competition on the basis of WPNIA products. In the event that WBA products introduced without prior notification to ComReg created a margin squeeze there would inevitably be a delay before this margin squeeze could be verified using the relevant margin squeeze test and effective compliance action taken by ComReg. There would also be the risk that a legal appeal against ComReg's decision could be initiated by Eircom, further extending the period during which non-compliant WBA products would be offered. The need to preclude the adverse effects on sustainable competition of such potential outcomes clearly warrants the proposed notification and pre-approval procedures being put in place.

Vodafone notes that in the context of a retail minus price control it is impossible to set a wholesale price without the retail price being known. This means that Eircom Retail would always have knowledge of product or pricing developments in advance of OAOs as the definition of the upstream wholesale inputs was in effect reverse engineered from the retail offering.

A wholesale price control derived from a forward looking cost model means that the regulated price of the wholesale input is not derived from the price of the downstream retail product but rather the retail product is derived from the wholesale input parameters. Breaking the link between the retail price and the upstream regulated market through this latter approach means that eircom's obligations of non-discrimination are more readily enforced as there is no reason why eircom retail should receive any wholesale product development information in advance of OAOs. The cost oriented wholesale input price would be determined independently and retail product development based on the input can be commenced at the same time by all retail service providers (OAOs and Eircom Retail) following notification to the market of the wholesale product.

Q4. Do you agree with the costing methodology proposed to determine the maximum price for bitstream rentals? Please set the reasons for your response and set out in detail any specific amendments, supported by detailed analysis where appropriate, to the costing methodology you believe are required.

Vodafone considers that is important to emphasise at the outset that while ComReg's proposed cost methodology to determine the proposed maximum price for Bitstream rentals, including the assumptions used, are described at a high level, the consultation provides little visibility of the quantitative detail on the cost inputs, and some of the costing rules, used by ComReg to establish that the proposed maximum prices of the Bitstream rental products as set out in the table below paragraph 6.2 of the consultation document actually equate to the underlying efficient cost oriented level. This significantly limits our ability to determine the appropriateness of the proposed maximum levels of the charges for the products and Vodafone believes that, while there may be some constraints around the publication of confidential information ComReg must, in the interests of transparency, publish information to a much greater level of detail in relation to the costing methodology and how the specific outputs of the model were obtained (which could be included in a technical annex) particularly in light of the important implications for future provision of DSL broadband services. Notwithstanding the limitations arising from the incomplete information provided by ComReg in relation to its costing methodology, our views in relation to the information provided is set out further below.

Vodafone considers that the general methodology and the main preliminary common assumptions used by ComReg to determine the maximum price for Bitstream rentals are reasonable and do not omit any major cost categories. The proposed use of Eircom's current network dimension as the basis for costing elements is also superior to the use of a bottom up model based on a hypothetical greenfield network in estimating the cost oriented price. However Vodafone believes that it is imperative that ComReg obtain independent verification to ensure that all of the cost data obtained from Eircom's regulatory accounts accurately reflects those of an efficient operator, within the constraints of the current network dimension, to avoid the significant risk that the estimated maximum price would otherwise considerably exceed the true efficient cost oriented level.

ComReg has indicated in paragraph 5.11 of the consultation that it has critically assessed the data on costs of network elements primarily or exclusively used for provision of broadband products that it has obtained from Eircom's regulatory cost accounting system, however it is unclear whether independent verification that such costs approximate the efficient level has been consistently applied across all cost categories. For example it is not clear whether the opex costs obtained from Eircom's regulatory accounts have been assessed in this regard, and there appears to be no reference to whether, and to what extent, efficiency adjustments have been applied to the cost categories. Independent verification of model data against the efficient operator benchmark is also essential with respect to cost modelling rules such as the configuration rules for ISAM configuration for each DSLAM site which are referred to, but not detailed, in paragraph 5.49 of the consultation. As no sensitivity analysis of use of alternative cost estimates or rules has been published, it is not possible for respondents to assess their effect on the estimated maximum price which limits the ability to provide informed comment. Vodafone considers that it is essential that ComReg provide far greater transparency in relation to these issues if all stakeholders are to have confidence that the estimated cost oriented price is not set at too high a level to the detriment of competition and consumer welfare.

With regard to the category of access network costs it is essential that the costs incorporated in the model do not include any access costs already recovered from narrowband access, but rather are those solely attributable to the provision of the broadband service.

In relation to the appropriate method for the annualisation of capital costs, Vodafone agrees that the use of the tilted annuity approach with a timing adjustment would be optimal as it properly accounts for future prices, provides efficient investment incentives, and is not overly sensitive to input assumptions.

[Redacted]

Q5. Do you agree that in setting a price control in the WBA market that an appropriate economic space to the relative prices of LLU should be maintained? Please state the reasons for your response.

Yes, it is essential that the cost oriented price in the WBA market is set such that an appropriate economic space is maintained relative to the price of WPNIA inputs so that the incentives for efficient WPNIA based infrastructure investment are maintained, and the risk of foreclosure of WPNIA based competition (due to strategic Bitstream pricing by the SMP operator) is precluded.

As set out in the response to question 1, the necessary economic space can be most effectively secured by undertaking the two general cost modelling exercises set out by ComReg in its proposed setting of maximum and minimum prices for Bitstream rental products. However Vodafone does not believe that the optimal price control would be to use the outcomes of these two cost models to set upper and lower bounds for a range within which Eircom would have discretion to set prices. Rather we consider that whichever of the outcomes of the two models that produces the lowest estimate of the cost oriented price should be adopted by ComReg to set the cost oriented price at a specific price point.

Vodafone also considers that the appropriate costs of the hypothetical entrant in the proposed ‘entrant’ model should be those set by reference to use of full local loop unbundling (ULMP) rather than LLU Line share.

This approach, together with the obligation on Eircom not to create a margin squeeze, should achieve the two central objectives of an optimal price control by avoiding excessive pricing of WBA products to the detriment of end users while also maintaining an appropriate economic space relative to the price of WPNIA inputs. At the same time this option would offer greater predictability to OAOs regarding future WBA product pricing than ComReg’s current proposed approach while eliminating the scope for strategic pricing on the part of the SMP operator.

Q6. Do you agree with the proposed hypothetical entrant model to set the minimum prices for bitstream rentals in order to maintain an appropriate economic space? Please state the reasons for your response, providing worked examples and/or robust data to support your views.

The lack of visibility in relation to the detail of the proposed entrant model and the actual quantitative inputs used to obtain the estimated prices for Bitstream rentals as the output of the model (information which could appropriately have been included in an Annex to the consultation document) limits Vodafone's ability to comment relative to a situation where complete information on the model was available. Notwithstanding the constraints imposed by the incomplete information on the model available in the consultation Vodafone agrees that many aspects of the general approach and assumptions used by ComReg in the proposed hypothetical entrant model, as in relation to the evolution of demand and efficient entrant market share as set out on page 39 of the consultation, are appropriate.

However, as set out in the response to question 1, Vodafone believes that the entrant cost modelling approach employed by ComReg to estimate the proposed minimum price uses the incorrect benchmark. The appropriate costs of an efficient OAO competing on the basis of WPNIA inputs should not be set by reference to those of an operator using the LLU Line Share product, but those of an efficient operator using full local loop unbundling (ULMP). Vodafone considers that the use of the costs of an efficient operator utilising ULMP in determining an estimate of the cost oriented price that preserves the necessary economic space for OAOs using WPNIA inputs is the optimal approach. This approach would take fully into account the economics of the most infrastructure intensive form of investment available on the SMP operator's fixed network and therefore properly align OAO incentives with respect to efficient investment in full unbundling of the local loop. This approach would therefore more effectively advance ComReg's objectives of promoting efficient investment and sustainable competition in the market.

With regard to the category of access network costs in the model, Vodafone notes in particular that it is essential in the context of the use of the appropriate benchmark that the costs incorporated in the model do not include any access costs already recovered from narrowband access, but rather are those solely attributable to the provision of the broadband service.

Q7. Are there any issues in relation to the appropriate price control for the WBA market that ComReg has not considered in this consultation? If so, please document and explain those issues fully and provide examples where appropriate.

Vodafone is not aware of other relevant issues in relation to the appropriate price control for the WBA market that have not been considered by ComReg in its consultation document.

Q8. Do you agree with the preliminary views expressed by ComReg? Please state the reasons for your response and please explain which preliminary view(s) you do not agree with and detail what specific amendments you believe are required.

As set out in the response to question 1, Vodafone agrees with many aspects of ComReg's proposed amended price control obligation on Eircom in the wholesale broadband access market. However fundamental changes to ComReg's current proposals, particularly in respect of the detail of the cost oriented regulation of Bitstream rental prices, are imperative if the price control obligation is to achieve ComReg's regulatory objectives.

For the reasons previously set out in this submission, Vodafone believes that ComReg should revise its current proposals to ensure that regulation of the SMP operator's Bitstream rental prices at the cost oriented level is implemented at a specific price point. In addition Vodafone believes that the lower of the two prices estimated from ComReg's modelling of 'maximum' and 'minimum prices' should be used for this purpose. ComReg's bottom up cost model of the costs of an efficient OAO competing on the basis of WPNIA inputs should be optimised by taking account of use of the full unbundling (ULMP) product in place of the LLU Line Share product currently used.

Vodafone is in agreement with ComReg's proposed general approach to the price regulation of WBA ancillary products, however it is important that greater transparency is provided by ComReg in relation to the objective basis for the proposed maximum prices if consultation respondents are to be able to provide fully informed comment.

While Vodafone also agrees that the proposed obligation on Eircom not to create a margin squeeze is fully justified, the continued importance of differential scale effects between Eircom and OAOs means that the margin squeeze test must continue to be specified on a 'similarly efficient operator' basis to avoid distortions to competition and investment in the provision of DSL broadband services.

Q9. Do you believe that the draft text of the proposed decision is from a legal, technical, and practical perspective, sufficiently detailed, clear and precise with regards to the specifics proposed? Please explain your response and provide details of any specific amendments you believe are required.

Vodafone considers that the draft text of the proposed decision is from a legal, technical, and practical perspective sufficiently detailed and precise in terms of the requirements proposed.

Q10. Do you have any views on this Regulatory Impact Assessment and are there other factors (if any) ComReg should consider in completing its Regulatory Impact Assessment? Please explain your response and provide details of any factors that should be considered by ComReg.

Vodafone disagrees with key aspects of ComReg's Regulatory Impact Assessment (RIA) and many of the conclusions arising from the assessment.

In relation to Step 2, the identification and description of the regulatory options, Vodafone notes that the identification of the options for the price control on Bitstream rentals includes a comparative assessment of the merits of the various options that would more effectively be incorporated in Step 3 (determine the impacts on stakeholders) in the form of an enlarged version of the tabular format used in that latter stage. The inclusion of elements of comparative assessment by ComReg in Step 2 is not systematically structured to assess the options (retail minus, cost orientation at a specified price point, cost orientation with associated maximum prices/minimum prices) against all the relevant criteria and as a result omits key information that, when formally considered, indicates that an alternative price control on Bitstream rental prices to that currently proposed by ComReg would be optimal. In addition Vodafone considers that many of the points made by ComReg in support of the currently proposed price control (cost orientation with associated maximum and minimum prices) are not valid.

Vodafone is in broad agreement with the assessment of the retail minus option for the WBA price control, and in particular with the shortcomings of maintaining this approach in terms of its restriction on flexible provision of diverse broadband services, ensuring sufficient 'economic space' between WBA and WPNIA inputs, and the increasing difficulty of monitoring and enforcing compliance in the context of the complex broadband packages increasingly available. However Vodafone considers that there are errors in ComReg's comparative assessment of the two options in respect of a cost oriented price control that have been identified. It is clear that either of the two options for a cost oriented price control of Bitstream rental products achieve the key objectives of avoiding excessive pricing and ensuring sufficient 'economic space' to preserve the feasibility of efficient investment to compete using WPNIA products. However Vodafone considers that the claimed disadvantages of the option of cost orientation at a specified price point are not valid. Specifically, as cost oriented prices set at a specified price point can be as effective as cost orientation with maximum and minimum prices in incentivising the SMP operator to achieve efficiency savings, where the former is set on a multi-year basis (as explained in the response to question 1) cost orientation at a specific price point cannot be deemed to be inferior relative to the proposed broader cost oriented price control within a range. For the reasons set out in response to question 1, Vodafone also does not accept that the flexibility of the SMP operator to offer future differentiated wholesale products at differentiated prices.

Vodafone considers that ComReg has failed to properly assess the two cost orientation options on a comparative basis with respect to the key objectives of promoting competition and maximising regulatory certainty. As the option of cost orientation precludes discretion for the SMP operator to set Bitstream rental product prices, it removes any scope for strategic pricing behaviour on the part of the incumbent and therefore effectively promotes competition. Cost orientation at a specific price point also maximises regulatory certainty for OAOs regarding future pricing of regulatory inputs and therefore would effectively stimulate efficient investment. The option of cost orientation with maximum and minimum prices is clearly inferior on a comparative basis with respect to these criteria. In this context Vodafone considers that it must be concluded that the option of a cost oriented price control at a specific price point is the optimal approach to the price regulation of Bitstream rental products.

With regard to the proposed obligation on the SMP operator not to create a margin squeeze, Vodafone agrees with ComReg's assessment of the necessity for this obligation and of the need to implement this obligation on a product by product basis. However in the context of the continued existence of structural economies of scale advantages held by the incumbent relative to OAOs it must be concluded that a margin squeeze test on a similarly efficient operator basis is appropriate and necessary to impose on Eircom.